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FSD News

EDITORIAL

In trying to deepen the financial system to increase inclusion, it makes sense to look at the other side of the coin and understand what may be driving financial exclusion. We asked the Centre for Development Studies, Bath to look at the dataset from the recent FinAccess survey on usage of financial services in Kenya and see what could be learnt about the drivers of exclusion.

Susan Johnson, who led the analysis, presented initial findings at the first FSD Kenya seminar on financial inclusion in August. Attended by a number of researchers and others with an interest in the subject, the seminar generated a lively discussion. The study sought to explore the influences on financial exclusion beyond affordability and physical access. While the FinAccess data provides strong evidence that cost and income are major determinants of whether people use banks, SACCOs, informal mechanisms or nothing at all, the analysis shows a number of other factors playing a role. Strong influences include age, level of education and gender.

Although there is little doubt that reducing costs will be a major contributor to reducing financial exclusion, the study suggests that this will not be enough. Financial education is one way in which we can encourage greater usage of financial services across social and cultural barriers. It can also help ensure that services are used in a way which impacts positively on people's lives. Current turmoil in credit markets in the US is a sharp reminder of the dangers of over-indebtedness. FSD Kenya will be looking at how we can support the public and private sectors in promoting financial literacy.

David Ferrand
Director

NEWS AND VIEWS

Launch of East African Credit Bureau Association

Dr. Kamau Thugge, Economic Secretary in the Ministry of Finance represented the Permanent Secretary at a colourful and well attended launch breakfast at the Grand Regency hotel on Wednesday, 26 September 2007. The event attended by CBK deputy Governor, Ms. Jacinta Mwatela, represented the culmination of a six month publicity campaign by the association to make the benefits of credit reference bureaus known to both the financial sector and the public. The sharing of information about credit worthy borrowers will make lending less risky and therefore allow banks and other providers of credit to price discriminate between borrowers. At FSD Kenya we see this development as a major stride forward in the development of more inclusive and deeper financial markets. Under our GrowthFin programme, FSD has been an active partner with the Association in this current effort.

Wachura Ndege, Chairman of EACBA, James Kashangaki, GrowthFin Programme FSD, Jacinta Mwatela, Deputy Governor of Central Bank of Kenya.

The GrowthFin SME Finance Innovations Fund

The financing of small and medium enterprises (SMEs) has for long been largely overlooked by the financial sector in Kenya. However, with the advent of a more stable economic environment, falling interest rates and increasing liquidity, financial institutions have noted the potential of the SME sector. This has yet to translate into real and sustained growth in financial products and services to the "missing middle". Under its re-launched SME Finance Innovations Fund, GrowthFin is looking for innovative ideas that will provide the Kenyan SME with choices already available to many SMEs throughout the world. The Fund will co-invest or share costs to help innovators in the financial sector get their ideas off the ground. We will look at any credible idea, whether from large existing institutions or a new player. Information on how to apply is available from our website or office.

African Microfinance Conference

The third African Microfinance Conference held in Kampala brought together over 500 practitioners, experts and stakeholders in micro-finance to discuss the theme "New options for rural and urban Africa". There was strong participation from Kenya in the conference. FSD Kenya supported the attendance of nine delegates. Among the more provocative presentations was one by Professor Malcolm Harper's who asked "What is wrong with microfinance?", urging delegates to critically re-examine gains in micro-finance in the light of its assumed role in development. The consensus was that micro-finance has to be understood as only one of many interventions which contribute to economic and social development. It is a mistake to regard it as a panacea for poverty alleviation.

Publication of SACCO Bill

The Government has just published a SACCO Bill which sets out a new framework for regulation of the sub-sector. While now it cannot to be presented to Parliament until next year, it is encouraging news that real progress is being made on introducing regulation to this area. Many Kenyans depend on SACCOs for financial services and there is potential for many more to be served by the movement. The strength of credit unions in contexts as diverse as the US, Mexico and Germany show that mutuals in their various forms have a long-term role in financial systems. Ensuring stability is however essential to realising this potential. Under the Bill it is likely that only the largest two hundred or so SACCOs will be subject to direct prudential oversight. However this will help protect the assets of roughly three quarters of the sector. For the smaller institutions without front-office services an appropriate lighter touch is envisaged.

FINANCIAL SERVICES ASSOCIATIONS

Nearly 40% Kenyans are financially excluded (FinAccess 2006), with the majority of these in sparsely populated rural areas. High transaction costs associated with low transaction sizes, poor infrastructure, high poverty incidences and low population densities typical of rural Kenya dissuade other service providers, such as MFIs, from operating in these areas. Financial Services Associations (FSAs) are rural grass-root member based financial institutions that provide a credit, savings and money transaction services to their members. Characterised by lower costs and the ability to operate in more remote rural areas, FSAs offer an important way to increase access to financial services in Kenya.

The Nunguni FSA building was financed entirely by the FSA shareholders.

History of FSAs in Kenya

K-Rep Development Agency (KDA) started promoting the FSA concept in 1997. With support from a number of development partners it has since established 77 FSAs in five of the eight provinces of the country. FSAs were originally conceived as user-owned, financed and managed institutions requiring minimal outside intervention apart from training and an initial period of oversight. It had been assumed that following the initial support the FSAs would become self-reliant. However, in common with many member managed organisations the FSAs suffered from poor management and weak governance. The managers were drawn from the membership and lacked the basic capacity and experience to manage a financial institution. There was often no clear separation of responsibilities between management, governance and ownership. This frequently led to problems, not least in lending practices with loans disbursed to friends, relatives or influential board members. To counter these challenges KDA experimented with a management contract arrangement under which it hired qualified managers for the FSAs. In the FSAs in which the approach was tested there was a marked improvement in performance leading to increased confidence in the FSA and greater usage by communities.

FSD's involvement with FSAs

Following the successful test of the management contract approach, KDA and FSD Kenya developed a project to transform the KDA FSA network into a sustainable system based on the management contract approach. The aim was to establish a commercially viable management services company to provide services and supervision to the FSAs. At the outset the performance of most of the FSAs was weak and a lot needed to be done to turn them into viable operations. K-Rep Fedha Services Ltd (KFS), a limited liability company was registered to provide management services and supervision to the FSAs at a fee. During the transformation period FSD Kenya is providing financial support towards operations, institutionalisation of KFS and capacity building for both KFS and the FSAs. The transformation will help separate management from ownership and governance, eliminating conflicts of interest. Results from the first 18 month phase of this transformation project were positive with the two pilot regions attaining operational self-sufficiency.

A second phase of the FSA transformation project, which will further refine the FSA model before a roll-out to the rest of the regions, is underway. One of the key challenges faced by the FSAs has been the ability to generate accurate and timely reports to facilitate decision-making. Among the services to be provided by KFS is a computerised information system enabling FSAs to provide daily reports, making monitoring and supervision more effective. An appropriate system has been identified and is being piloted in three FSAs. This second phase will entail training for both KFS and FSA staff to enhance their ability to manage and provide quality services to the increasing FSA membership. In addition to training KFS will also support the FSAs in market research and product development, strategic planning, business development, branding and marketing. This current phase of the transformation project is expected to demonstrate the ability to attain operational self-sufficiency at the regional level across the whole network.

Automation is now being piloted in the network, with the aim of improving service levels and strengthening reporting.

What does the future hold for FSAs?

Due to challenges related to remoteness and minimal economic activity in some districts, not all the existing FSAs can join the management contract arrangement – at least for now. The new model has to be commercially viable and as a result only 46 of the 77 FSAs have thus far signed service agreements with KFS. Discussions are underway with 5 others, and 11 new FSAs will be established based on this new model in the next two years. The outreach of the new FSA model is set to more than double expanding from the current 64,000 membership to reach 150,000 rural low-income people over the next two years. Once the model is proven, it will be extended to other areas where it can operate sustainably.

Use of technology is set to play a big role in extending financial service provision in more remote rural areas. SokoTele, a mobile phone based money transfer service operated by Celtel, one of the mobile phone companies, is being piloted in Mathima FSA, a remote and arid part of Kitui district. Some FSAs may act as agents for M-Pesa, the money transfer service offered by Safaricom. The future could see more linkages as other service providers seek to realise cost efficient ways to serve low-income clients. Given their on-the-ground presence in more remote rural areas, improving information systems and relative security the FSAs are attractive prospective partners.

EVENTS CALENDAR

Nov 23 – 24	**2nd Kenya Microfinance Conference**, Strathmore University, Nairobi, Kenya
Dec 3 – 4	**Africa Finance Conference**, Kampala, Uganda *http://www.secondfinancialsectorconference.com*

4th Floor Kenya Re Towers, Off Ragati Road, Upper Hill | P.O.Box 11353, 00100 Nairobi, Kenya
T +254 (20) 2712627, 2718814, 2718809 | +254 (724) 319706, (735) 319706 **E** info@fsdkenya.org **W** www.fsdkenya.org