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FSD News

EDITORIAL

The start of 2011 saw FSD adopt a new strategy for its support for financial inclusion in Kenya. We've seen tremendous progress over the last few years in the development of Kenya's financial markets. FSD's aim is to encourage the growth of financial markets which reach low income people and smaller scale businesses on a sustainable basis. It is clear that there is now a real dynamism in Kenya's financial sector with a growing number of institutions competing to address lower income markets. FSD therefore needed to look critically at where we could now offer the most value.

Branchless banking has shown tremendous growth over the last few years driven by the entry of mobile phone companies into the payments market. This has also given rise to considerable innovation drawing on the new payments infrastructure being created. However we see even greater potential. There are real prospects for a move away from cash as the primary payment mechanism. Although eliminating cash entirely may be overambitious, achieving a 'cash-lite' economy could have tremendous benefits in reducing costs. In a competitive financial system the costs of transacting using electronic money could reduce to a few shillings. This would give rise to a tremendous increase in financial inclusion - finally enabling some of the poorest in Kenya to use the formal financial system. Over the next five years FSD will be working on a series of initiatives to encourage developments to realise this ambition.

We are also acutely aware that simple access to financial services doesn't imply extensive usage or impact. To this extent the headline figures on access in Kenya highlighted by the FinAccess survey can be misleading. There is a need to better understand how low income people and smaller enterprises use portfolios of financial services to meet their livelihood or business needs. Based on a better understanding of the client perspective, more appropriate products can be developed, delivered in ways which make sense from the point of view of solving real world financial problems. FSD's second major strategic thrust will therefore be on finding solutions to the specific financial service needs of poorer groups and maximising our impact on poverty reduction.

David Ferrand
Director

NEWS AND VIEWS

A large format printer in operation at Union Technology (K) Ltd in Nairobi. Access to appropriate and affordable finance for SMEs can lead to increased employment and growth. Over the last year, FSD has successfully partnered with a number of Kenyan banks to develop and grow the use of supply chain finance products tailored for SMEs.

Supply chain finance facility

Businesses in a fast growing economy quickly run out of liquidity to keep up with the demand for their products or services. For entrepreneurs in growing businesses that do not have balance sheet support, these times can be very challenging. Trying to release cash tied up in invoices and stock can quickly become an all consuming activity. The financial sector in Kenya has been slow to respond to this need and develop the appropriate products. In desperation to keep the business afloat, entrepreneurs may resort to costly forms of informal finance.

Over the last year FSD has successfully partnered with a number of Kenyan banks to develop and grow the use of supply chain finance products. Four institutions are at various stages of internalising the procedures, minimising risk, developing appropriate product documentation and developing relationships with suppliers and buyers along various supply chains.

Retail electronic payments draft regulation

This quarter sees the introduction of draft regulations by the Central Bank of Kenya (CBK) setting out a structure of formal regulation for the rapidly developing retail electronic payments market. Recognising the importance of allowing a new industry to develop before seeking to impose too strong a regulatory burden, CBK initially adopted a light and highly adaptive approach to oversight. With retail electronic payments - especially mobile-phone based - now forming an integral part of the national payments system, it is appropriate for Kenya to adopt a more formalised structure for regulation. Two new draft regulations have been promulgated covering electronic retail transfer providers and issuers of electronic money. Although we frequently see these two functions closely integrated (as in Safaricom's M-PESA system), they represent different functions and require different rules. Initially issued under the existing Central Bank of Kenya Act, the regulations will eventually fall within the forthcoming National Payments System legislation.

FinAccess 2011

Preparations are well underway now for the next round of the FinAccess demand-side survey. The first two rounds conducted in 2007 and 2009 have provided a valuable insight into the landscape of access in Kenya. The study is a public-private initiative driven by the Financial Access Partnership, with the secretariat provided by the CBK's research department, supported technically and financially by FSD. Field work is due to start by the middle of the year and headline results available during the 4th quarter.

BUILDING PROJECT MANAGEMENT AND ICT CAPACITY TO DRIVE SACCO AUTOMATION

SACCOs represent a major element of the financial system and provide services to a large number of low income households in Kenya. Analysis of the FinAccess 2009 study combined with other evidence indicates the strategic importance of the SACCOs movement in Kenya to pro-poor financial sector development. An estimated 1.7m people, 9.0% of the adult population, use SACCOs. This compares with an estimated 3.8m (21.5%) and 0.6m (3.4%) who use commercial banks and MFIs, respectively.

The new SACCO law and related regulations look to address weaknesses in the sub-sector and build credibility in the financial credibility of the deposit-taking SACCOs through prudential oversight by the SACCO Society Regulatory Authority (SASRA). Timely and reliable reporting will be a key requirement under this regulation which in turn depends on the strength of information systems in the SACCOs.

In late 2009 FSD in partnership with Accenture Development Partnerships (ADP), carried out an assessment of potential SACCO automation solutions. This offered guidance to SACCOs approaching the market for new solutions. An ongoing next phase builds on this and addresses the deployment challenge.

Multiple factors are forcing ICT uptake in the SACCO sector

Across the SACCO sub-sector information and communication technology (ICT) is seen as a differentiator, key growth driver, and enabler of more sophisticated product offerings. Specifically automation is being driven by a number of factors:

1. To better serve existing clients while growing membership in both traditional target market and new segments.
2. To address the perception that SACCOs are not as efficiently run as 'for profit' rivals – particularly amongst young Kenyans.
3. The need for deposit-taking SACCOs to comply with the new SACCO Regulations.
4. Lowering operational costs to actively compete against:
   - Commercial banks downscaling to rural and lower income demographics;
   - Micro-finance institutions with the ability to provide dynamic community focused services in addition to core financial products;
   - New entrants from non-financial industries expanding into financial products e.g. M-PESA.

Success has been mixed due to the way automation projects are approached

The SACCO sector needs to reconsider the way it views ICT:

- Where ICT spend has been low to date, to embrace and increase the use of automation alongside process optimisation.
- Where investment has occurred, ensuring ICT investment Is conducted in a targeted and cost-effective manner.

Essential project management activities are required to ensure SACCOs manage spending, alongside a clear approach for engaging with ICT suppliers. Progress then needs to be actively monitored and controlled against a defined schedule and budget.

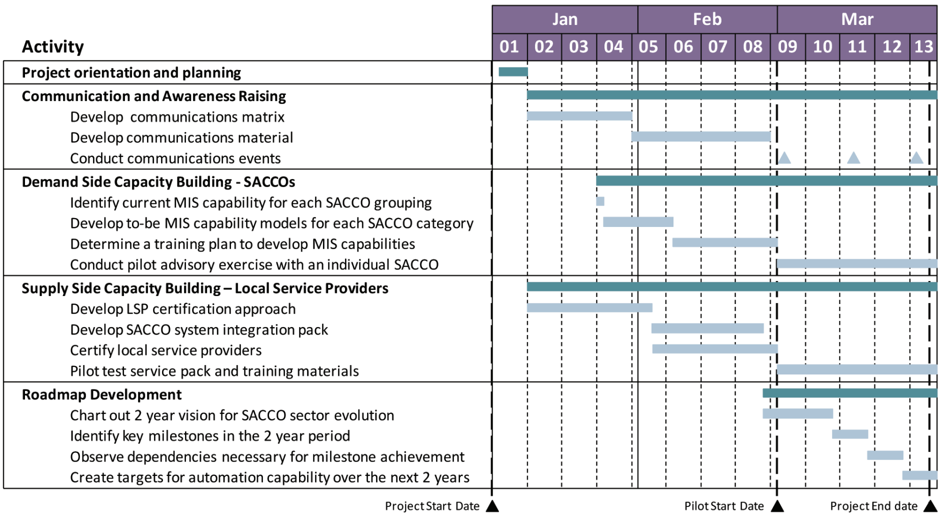
While ICT spend is mainly being prompted by the need to comply with the regulatory requirements, many SACCOs have been on the automation journey for several years with varied success:

- Some have already embraced automation as a driver of growth and successfully implemented high performing systems.
- Others have made significant investments in ICT, but failed to realise the associated benefits and value due to product and implementation challenges.
- A limited number have yet to begin the automation journey at all.

The industry leaders are going beyond SASRA's requirements and have been able to increase their growth and profitability by adopting systems that enable them to offer sophisticated products and efficiently manage their business operations real-time with quantitative analyses, empowering objective decision making.

Planned actions to address the uncertainty

The project recognises that managing implementation end-to-end is critical for success in SACCO automation. Activities are aimed at helping SACCOs to identify and partner with competent service providers with a proven track record of on-cost on-schedule delivery with benefits realised post-automation. This involves working with service providers and SACCOs to both strengthen what is being offered in the market and to improve the buying decision.



The project activities for the next few months are summarised above. This will involve: 1) Communications and awareness raising; 2) Demand-side capacity building; 3) Supply-side capacity building; and 4) Road map development.

EVENTS CALENDAR

2 - 3 March 2011 — **AITEC Banking & Mobile Money COMESA,** Nairobi - Kenya
For information, email: *info@aitecafrica.com* Website: *www.aitecafrica.com*

11-16 April 2011 — **Housing Finance Workshop for Sub-Saharan Africa,** Nairobi - Kenya
For information, email: *uechebiri@worldbank.org* Website: *www.go.worldbank.org/HEFJ6215L0*

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