ANNUAL REPORT

2010

FSD Kenya
Financial Sector Deepening

Supporting the development of inclusive financial markets in Kenya

Kitale town, Western Kenya.

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). In addition to the Government of Kenya, funders include the UK's Department for International Development (DFID), the World Bank, the Swedish International Development Agency (SIDA), Agence Française de Développement (AFD) and the Bill and Melinda Gates Foundation.

Government of Kenya

UKaid from the Department for International Development

THE WORLD BANK

EMBASSY OF SWEDEN Nairobi

afd AGENCE FRANÇAISE DE DÉVELOPPEMENT

BILL & MELINDA GATES foundation

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Acronyms

AFC	Agricultural Finance Corporation
AFD	Agence Française de Développement
ASCA	Accumulating savings and credit association
AMFI	Association of Microfinance Institutions
ASCA	Accumulating savings and credit association
CBK	Central Bank of Kenya
CGAP	Consultative Group to Assist the Poor
CRBs	Credit Reference Bureaus
DFID	Department for International Development
DFS	Decentralised Financial Services project
DTM	Deposit-taking Micro-finance Institution
EAGC	Eastern Africa Grain Council
FSA	Financial Services Association
FEPP	Financial Education and Consumer Protection Partnership
FSD	Financial Sector Deepening Kenya
GDP	Gross domestic product
GSL	Group savings and loans associations
G2P	Government to person
HSNP	Hunger Safety Net Programme
IFC	International Finance Corporation
ILRI	International Livestock Research Institute
KARF	Kenya Access to Rural Finance (KARF)
KBA	Kenya Bankers Association
KCB	Kenya Commercial Bank
KCISI	Kenya Credit Information Sharing Initiative
KCPA	Kenya Credit Providers Association
KFS	K-Rep Fedha Services Ltd.
KPOSB	Kenya Post Office Savings Bank
KSHs	Kenya shilling
KWFT	Kenya Women's Finance Trust
MFI	Micro-finance institution
MFMI	Micro-finance Management Institute
MVK	Mobile Ventures Kenya
PIC	Programme Investment Committee
POS	Point of sale
ROSCA	Rotating savings and credit association
SACCO	Savings and credit Co-operative
SASRA	SACCO Societies Regulatory Authority
SIDA	Swedish International Development Cooperative Agency
SME	Small and medium sized enterprise
USAID	United States Agency for International Development
WOCCU	World Council of Credit Unions
WRS	Warehouse receipts system

DIRECTOR'S NOTE

Kenya continues to make steady progress in developing financial inclusion. Although we will not be able to quantify accurately the scale of this progress until the next round of the FinAccess survey on financial inclusion in 2012, data from leading institutions is very positive. This report provides our commentary on the market developments we have seen and sets out the activities in which we have been engaged over the year. Our primary aim in publishing this report is to ensure that FSD remains accountable for what we do. We understand accountability to be very much a two-way process. Feedback on what we present in this report or on our work more broadly, positive and negative, is essential to ensuring that we remain responsive to you, our stakeholders. We also hope it offers a useful perspective on financial market development in Kenya.

All FSD's work is essentially aimed at trying to **make financial markets work better for the poor.** We eschew the short-run fix in favour of long-term solutions, which can be provided through sustainable market development. The last five years have shown the effectiveness of financial markets in finding solutions to financial exclusion. We have worked hard on our goal of **"generating sustainable improvements in livelihoods of poor people through reduced vulnerability to shocks, increased incomes, and employment."**

In the first section of this report we provide a brief overview of how we try to harness markets to benefit the lower income population. The second section summarizes the highlights of our achievements during the year. The third section offers our perspectives on recent developments in Kenya's financial markets and the impact on financial inclusion.

Following these introductory sections, the report on our activities is organised according to our four focal theme areas: (i) formal financial system, (ii) rural finance, (iii) finance for growth, and (iv) knowledge. The **formal financial system** theme area provides the foundations for extending financial inclusion and remains an important area of work for FSD. As markets develop our work here is moving away from working with individual retail providers to addressing the system as a whole. Our activities under the **rural finance** theme areas aims to address the poor provision of services to lower income households across the rural areas. Agriculture finance is now a major focus under this theme area. The **finance for growth** theme area is focused on supporting the growth potential from the small and medium enterprise (SME) segment. And finally we expanded our **knowledge** theme area with research activities that will help to focus our efforts on where they are most needed and where we can have the most impact.

At FSD we take a very proactive approach to assessing project performance, which is done on a quarterly basis. A summary of our projects is provided in Annex 1. At the programme level, FSD has benefitted from two reviews in 2010 – an impact assessment and a programme completion report. The impact assessment concluded that:

- at the macro level, **FSD's work has contributed in a significant way** to the development of an improved enabling policy and regulatory environment;
- at the meso level, the programme has helped to build significant capacity in the support service market and has also **contributed to the shift to a market that is more client oriented.**
- at the micro level, FSDs support has **helped to enable the transformation and institutionalization of key providers** with the sector.

The programme completion report reviewed progress against targets at the FSD purpose level - which is **"to deepen the capacity of Kenya's financial sector to meet the financial needs of poor Kenyans and micro, small and medium enterprises on a sustainable basis".** It concluded that overall FSD has **completely achieved its purpose/strategic objective and exceeded the original expectations of stakeholders.**

Of course none of this would be possible without the support of the key stakeholders - our funders. In 2010 we received the majority of our funding from DFID, SIDA and the Bill and Melinda Gates Foundation. The financial statements in Annex 2 show how these funds were applied.

As in previous years, we worked with a range of partners from the private sector, civil society, government and development agencies. The table in Annex 3 lists those with whom we have worked directly during 2010. Inevitably it is abbreviated and omits many with whom we interacted indirectly in various ways. FSD's work is **entirely founded on partnerships**. Any progress we have made towards our goals is entirely based on the achievements of our partners. The foundation for all our partnerships is the shared commitment to the goal of increasing financial inclusion.

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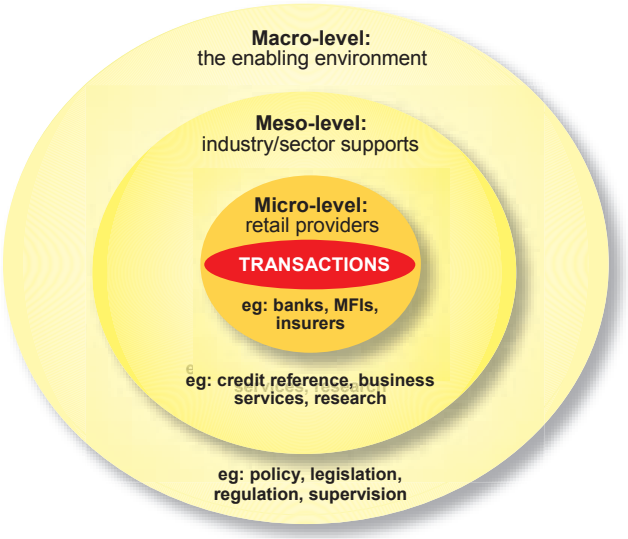
FSD'S APPROACH: BUILDING MARKETS

FSD takes a strongly market-based approach to financial sector development. Evidence from a diverse range of institutions in Kenya and globally shows that financial services can be provided profitably to low income markets and smaller enterprises. Market development requires addressing challenges at three levels:

- At the **macro level**, government policy, legislation, regulation and supervision set the basic framework within which financial services providers operate. An effective and enabling environment reduces the costs and risks of doing business and encourages innovation.
- At the other end of the spectrum, at the **micro level**, it is retail providers who actually deliver services. Developing practical know-how among providers as diverse as commercial banks and community-based associations is at the heart of market development.
- Between these two levels, at the **meso level**, are other services on which retail providers depend. Building the capacity and know-how among relevant service providers such as credit reference bureaus, audit, training, and research can enhance market development.

Figure 1: The structure of financial markets



FSD Strategy 2008 - 2010

FSD's defined objective is to improve the capacity of Kenya's financial sector to meet the needs of poor rural and urban households, micro, small and medium enterprise (SME) on a sustainable basis. To guide its activities FSD develops three-year strategic plans. The 2008-2010 plan identified seven key challenges for market development. These are:

a. strengthening the demand pull from better informed and protected consumers;
b. pro-access policy and regulatory reforms;
c. formal sector consolidation to improve effective competition between strong players;
d. bridging the skills gap in the financial sector;
e. closer integration between players to maximize the efficiency of the sector as a whole;
f. strengthening semi-formal community based financial systems which reach the more remote and poorest; and,
g. strengthening credit risk management especially to address agriculture and growth SMEs.

To properly position FSD in the context of these market development challenges, projects are organised into four theme areas:

Formal financial system: The future development of the formal financial system remains central to the achievement of FSD's objectives. This theme area consolidates two previous focus areas - "building core capacity" and "development of the payment system". While earlier work had placed a strong emphasis on the retail level, the theme area now focuses on development of the formal financial system as a whole. It is gradually evolving towards an emphasis on market infrastructure and away from working directly with market players.

Rural finance: As Kenyans in rural areas are less than half as likely to use banking services as those in the urban areas, rural finance is a key priority for FSD's work. This theme area consolidates two previous focus areas - "strengthening semi-formal rural delivery channels" and "agricultural finance". The focus is on looking for greater integration between developing new delivery channels and new products in order to increase impact. Supporting innovation requires working with individual retail players. Meanwhile scaling up - especially of small community based organizations - requires a more industry-wide approach.

Finance for growth: Constrained access to appropriate finance is a hindrance to the development of SMEs in Kenya. FSD's work in the finance for growth theme area has been both at the micro and meso level. A key meso level project is the development of the credit information system. At the micro level FSD previously focused on providing support to retail players for broadly "increasing SME lending". It is now moving to providing support for developing specific products, such as supply chain financing that can be used by various players.

Knowledge: This is a new theme area introduced in 2010. It builds on FSD's existing research work, with an expanded scope and increased staffing. Experience has shown that FSD's work in generating sectoral knowledge has a significant influence across the market from industry players to policy makers and regulators. In 2010 the knowledge team deepened the analysis of the FinAccess data and added two new projects on impact and branchless banking.

FSD KENYA 2010 HIGHLIGHTS

Formal financial system

- Introduction of regulatory guidelines permitting banks to use agents.
- SACCO regulations gazetted at the end of June 2010.
- Makutano Junction TV programme reaches 7.2 million Kenyans.
- Hunger safety net programme reaches 80% (48,000) of target households.
- Second and third MFI licensed to take deposits by Central Bank.

SUPPORTING FINANCIAL SERVICE PROVIDERS IN THE DEVELOPMENT OF NEW PRODUCTS

Rural finance

- Weather insurance project launched.
- Cost effective GSL model developed.
- EasySave pilots launched.
- SACCO reforms support initiated.

Finance for growth

- First private credit reference bureau licensed.
- Fourth bank joins supply chain finance project.
- Demand side insurance study completed.

Knowledge

- FinAccess: Analysis of FinAccess 2009 completed.
- Impact: Landscapes study initiated.
- Branchless Banking: M-Kesho survey completed.

FINANCIAL INCLUSION IN KENYA

SACCO members waiting to be served at Muramati SACCO, Githumu branch.

Kenya's financial system can be usefully divided into three elements: formal, other formal and informal. The demarcation between these categories is primarily an institutional one: the formal are prudentially regulated, while the other formal are simply registered under law and the informal are unregistered. Although legal definitions are used to set the boundaries between these categories, there is more of a *continuum* of formality. In the informal category for example accumulating savings and credit associations (ASCAs) are usually considerably more complex and formalised in operations than rotating savings and credit associations (ROSCAs).

Table 1: Classification of institutions

Formal	Other formal	Informal
▪ Commercial banks ▪ Deposit taking MFIs ▪ Deposit taking SACCOs ▪ PostBank ▪ Insurance companies	▪ Unregulated MFIs ▪ Unregulated SACCOs ▪ Mobile payment services	▪ ASCAs ▪ ROSCAs ▪ FSAs ▪ Shopkeepers ▪ Moneylenders

Financial access strands

The two FinAccess surveys, conducted in September 2006 and March 2009, provided the first detailed data on financial inclusion in Kenya and recent developments. During this period, **overall financial inclusion increased from 58.7% to 67.3%**, corresponding to a drop in financial exclusion from 41.3% to 32.7% (shown in figure 2). There was a large jump in total formal inclusion (formal + other formal) from 26.3% to 40.5% largely driven by the introduction of the M-PESA mobile phone based payments system categorised as 'other formal'. Meanwhile the use of regulated formal services increased significantly though far more modestly from 18.5% to 22.6%.

Figure 2: Kenya's financial access strand 2006 and 2009

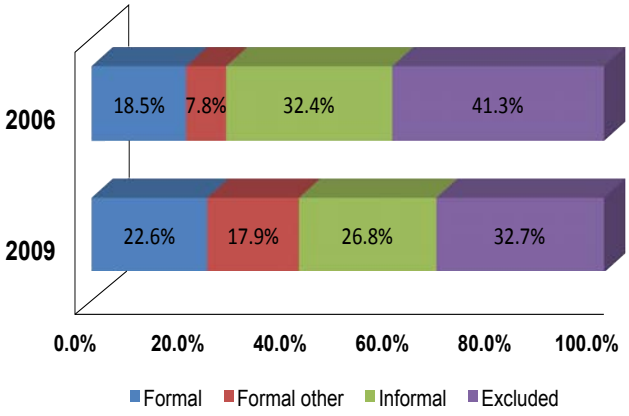
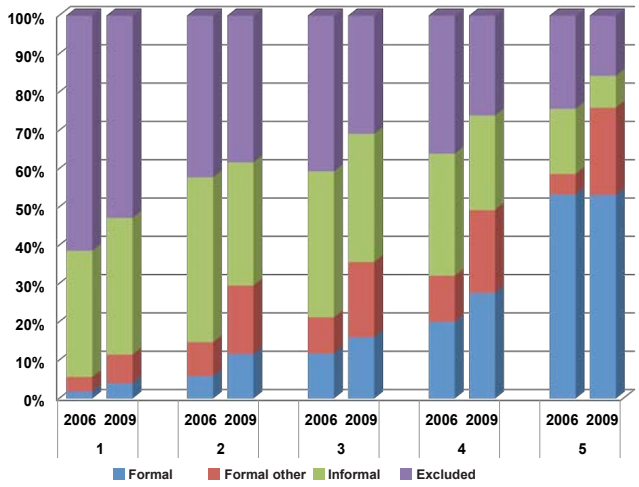
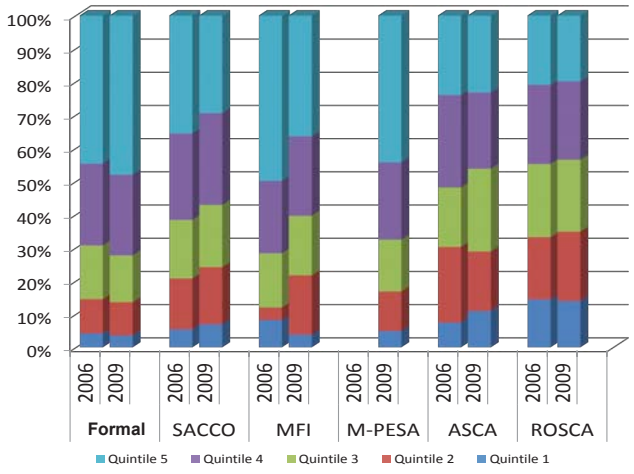


Figure 3: Access strand by poverty/wealth quintile



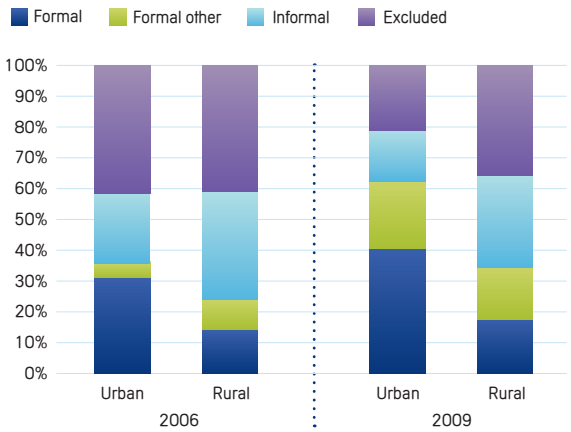
Access by wealth quintile: The usage of services varies very significantly by wealth status as shown in figure 3. Unsurprisingly this shows exclusion increasing with poverty (quintile 1 represents the poorest while quintile 5 the wealthiest). Similarly the use of formal services is greatest among the wealthiest groups and very low among the poorest. However the data clearly shows some encouraging results. The improvements in access have occurred across all groups with an increase in formal inclusion even amongst the lowest income groups at all levels. Interestingly the largest change in formal inclusion occurred in the middle income groups rather than the highest. A breakdown of service use by wealth quintile is shown in figure 4 below. These largely follow an expected pattern with lower income groups using more informal services.

Figure 4: Service use by poverty/wealth quintile



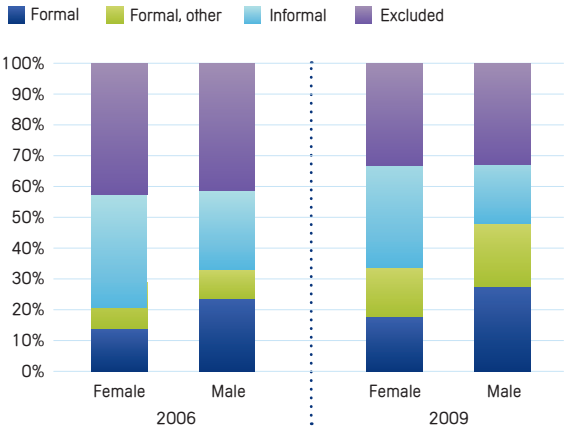
Access by residence: In urban areas the percentage of excluded fell from 42.9% to 20.9%. In the rural areas, while there was an improvement, the change was much less dramatic with exclusion dropping from 40.7% to 35.9%.

Figure 5: Access strand - rural vs urban areas



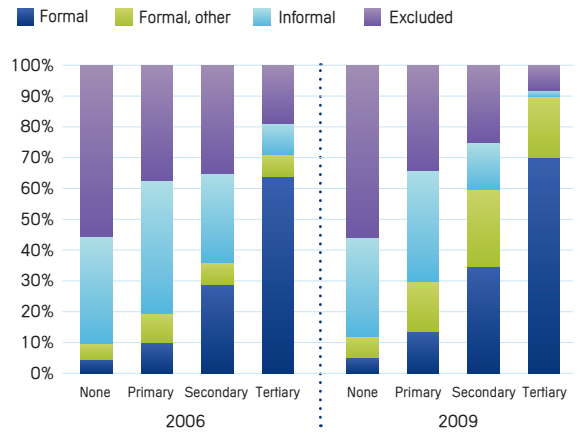
Access by gender: In 2009, financial exclusion was at similar levels for men (32.4%) and women (33%). However men are more likely to use formal financial services (27.9%) than women (17.8%). On the other hand women are more likely to use informal financial services (33.4%) than men (19.5%).

Figure 6: Access strand - men vs women



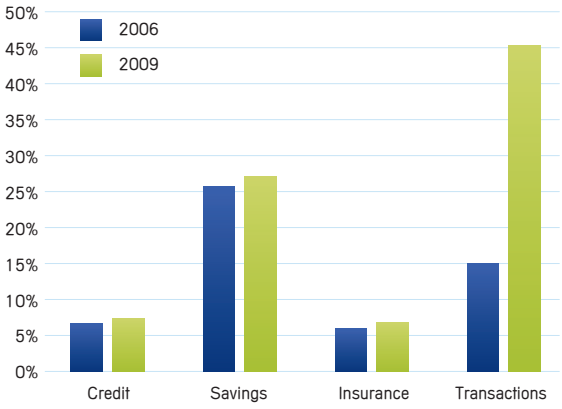
Access by education: Use of financial services increases with education. Only 8% of people with tertiary education are likely to be excluded while 55.9% of those with no education are likely to be excluded. Between 2006 and 2009 the largest increase in inclusion was for those groups with secondary and tertiary education. There was almost no change in inclusion for those with no formal education, thus highlighting the continued challenge of improving access for this group.

Figure 7: Access strand by levels of education



Access by type of service: The FinAccess survey breaks down services into four basic product groups: Transactions, savings, credit and insurance. At the aggregate level, while there has been a significant increase in use of transactions (primarily money transfer through M-PESA), the use of savings has remained largely unchanged at about 52%. This is disappointing given that savings often provide a better way to deal with certain risks than insurance or credit. Furthermore, a strong argument can be made that savings represent the one financial service for which there is universal need. On the positive side there was a modest increase in the number of people saving with a formal provider (see figure 8).

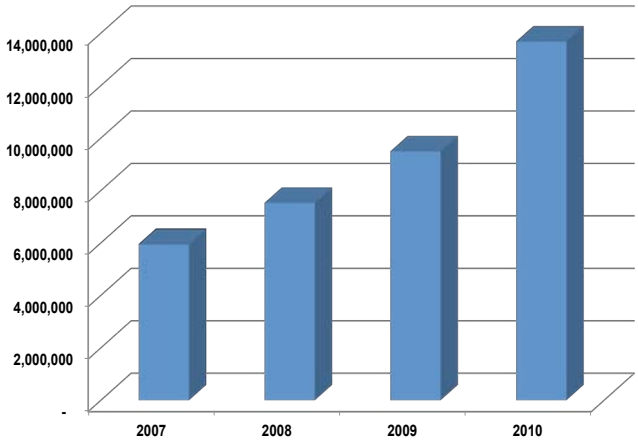
Figure 8: Access by type of service (formal providers only)



Financial service providers

Commercial banks: The commercial banks form the most significant part of Kenya's financial system. They have sustained a strong expansion over the last four years (see figure 9). Comparing data over a similar period to the two FinAccess surveys shows that the expansion in the number of accounts is much greater than the increased usage reported through FinAccess. This suggests significant dormancy in accounts and churn arising from growing competition for the mass market. Unsurprisingly this battle for the mass market appears largely confined to the institutions with large national retail networks. As at the end of June 2010, 94% of the accounts in the system were held in the ten large retail banks with over 100,000 accounts (which now include a former MFI, Jamii Bora Bank). The top four banks (Equity, Co-operative, PostBank and Kenya Commercial Bank) account for 69% of the total. Equity Bank, which led the expansion into the lower income market, now has 41% of the total number of accounts.

Figure 9: Commercial bank accounts



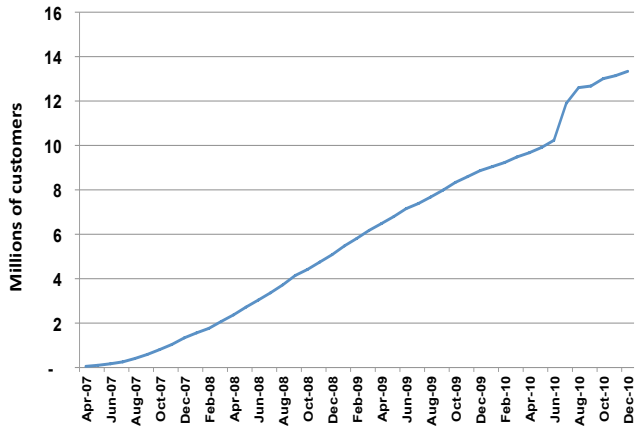
Micro-finance institutions: FinAccess data confirms a strong expansion in the contribution of the micro-finance segment, doubling over the period of the two studies, to reach 3.4%. The more recent account data suggests that this expansion has been maintained. The three former non-deposit taking MFIs (KWFT, Faulu and Jamii Bora Bank) already make up 10% of the deposit accounts in the regulated system. While the larger institutions are clearly making significant impact there are signs that the smaller ones are being left behind. It seems unlikely, at this stage at least, to suppose that the smaller MFI segment is set to make a significant impact on financial exclusion.

SACCOs: The use of SACCOs declined significantly over the period of the two FinAccess surveys, from 13.1% in 2006 to 9.0% in 2009, a 31% loss of market share over two and a half years. Institutional analyses of a number of SACCOs explain this trend. Many are in a weak financial position, unable to meet the demand for loans from members, have poor products and offer weak service levels. Reform is long overdue if the movement is to survive the competitive threat from the downscaling banks. Although these recent developments are clearly unfavourable, it is worth highlighting that SACCOs still contribute substantially more to financial inclusion in Kenya than MFIs. Furthermore as figure 4 shows the client basis is weighted more towards lower income groups (the bottom three quintiles) than MFIs. A major impetus has been given to reform with the introduction of prudential regulation for deposit taking SACCOs giving some grounds for optimism that the sub-sector could recover.

Mobile banking: The success of M-PESA has resulted in a seismic shift in Kenya's financial landscape. At the time of the 2009 FinAccess survey the service had over a quarter of the adult population registered as users. By the end of June 2010 this had increased to more than half. In less than four years from its launch, the brand 'M-PESA' has entered the language in Kenya, reflecting its dominant position in the small value retail payments system. FinAccess 2009 showed that many users of M-PESA were also users of other financial services.

There are also growing linkages between M-PESA and the formal banking system, which is expected to deepen its impact. A number of the larger retail banks have connected to the system allowing direct transfers between M-PESA and bank accounts. In the second quarter of 2010, Equity and Safaricom launched a new joint product, M-KESHO, which is a specialised bank account held by Equity and accessed through M-PESA. Equity has also launched another solution with Orange, which provides a direct link to a full function Equity bank account and allows transfer across all mobile networks.

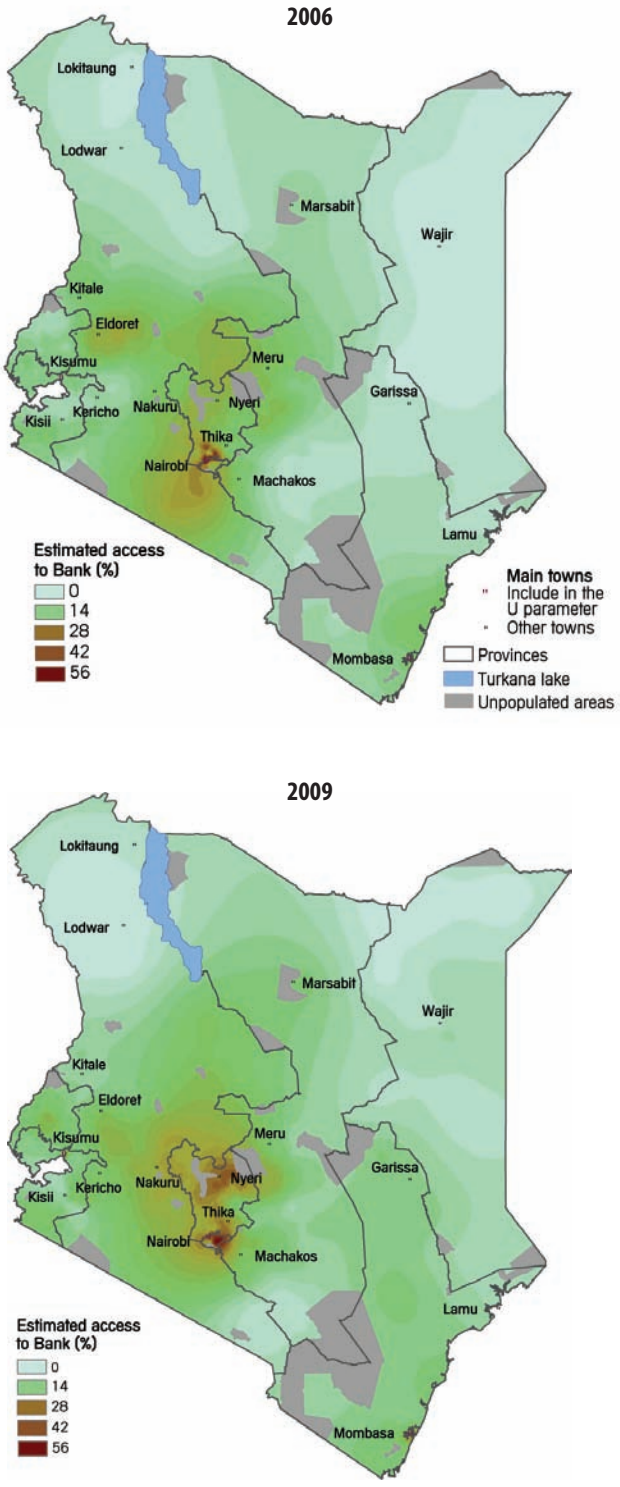
Figure 10: M-PESA customer growth



Informal providers: Informal services are a major part of the landscape of in Kenya. Over the Finacess surveys there was a modest expansion in overall usage from 37.5% to 38.7% of the population. However there was a significant reduction in the proportion of people depending only on informal services (from 32.4% to 26.8%). The introduction of M-PESA is largely repsonsible for this decrease in reliance solely on informal services.

The category of the informal covers a diverse range. ASCAs are among the more sophisticated offering more flexible ways to save and borrow. Usage is building strongly from a relatively small base, increasing from 5.4% to 7.8% over the survey period. Meanwhile usage of the relatively simple ROSCA model has increased by a similar amount but from a much higher level of usage - from 29.3% to 31.7%.

Figure 11: Spatial maps showing estimated access to banks



FORMAL FINANCIAL SYSTEM

FSD has been working closely with the Central Bank of Kenya on the policy and regulatory framework.

Between 2006 and 2009 the biggest contributors to increased financial inclusion were formal institutions (commercial banks) and semi-formal providers (M-Pesa, MFIs and SACCOs). While this impact was primarily in the urban areas, where 62% of the population is formally served, there is significant potential for formal institutions to make a contribution to reducing exclusion in the rural areas. Consequently supporting the development of the formal financial system is a key priority for FSD.

Under the Formal Financial System theme, FSD's initiatives are geared towards improving the policy and regulatory framework, increasing financial capabilities, leveraging social protection, and improving retail capacity.

2010 Highlights

- Introduction of regulatory guidelines permitting banks to use agents.
- SACCO regulations gazetted at the end of June 2010.
- Makutano Junction TV programme reaches 7.2 million Kenyans.
- Hunger safety net programme reaches 80% (48,000) of target households.
- Third MFI licensed to take deposits by Central Bank.

Improving the policy and regulatory framework

During 2010 FSD continued supporting the regulatory efforts for banking channels, branchless banking, and SACCOs.

Banking channels: Amendments to the Banking Act allowing banks to make use of agents were included in the 2009 Finance Bill, which passed into law at the end of the year. In order to develop new guidelines to regulate the use of agents under the legislative amendment and re-examine the role of branches, CBK and FSD commissioned a study into the policy options for future regulation of commercial banking channels. This work looked carefully at relevant evidence from around the world, examining the overall impact the risk of change and risk of various approaches and the way in which oversight has been implemented. The study helped CBK to produce the guidelines. Several thousand agents were subsequently appointed across a number of retail commercial banks.

Branchless banking scenario building: In order to help develop a common understanding of the possible futures for the retail financial landscape in Kenya, CBK and FSD launched a scenario building process involving leaders from the financial sector. The process asked the question: 'How can government and the private sector most affect the uptake and usage of branchless banking among the un-served majority in Kenya by 2020?' After a high-level workshop and further consultation with the regulatory authorities, a background analytical report was completed. FSD also worked directly with CBK in examining the longer-term policy options.

SACCO regulation: FSD supported the completion of the formal planning process for establishment of the SACCO Societies Regulatory Authority (SASRA). The SACCO regulations were effected in June 2010 and all deposit-taking SACCOs were expected to apply for licences within one year. Unfortunately implementation has been delayed due to funding problems. SASRA has not been able to complete its staffing and begin operations fully as intended. As a consequence it has been forced to change tack. The strategy is now to prioritise the licensing of those SACCOs which analysis shows are clearly compliant with the new regulatory framework. SASRA anticipates that this approach could help build its stature as a regulator in the market while it sorts out its funding and staffing challenges.

Increasing financial capabilities

There is growing recognition of the importance from the demand-side, of pro-poor market development. Simply making more appropriate financial services available does not inevitably lead to positive impacts on people's livelihoods. Users must be able to make good, and well-informed choices. Evidence from FinAccess 2009 showed that many people in Kenya lack understanding of even basic financial concepts. The Financial Education and Consumer Protection Partnership (FEPP) was set up in 2009 with the aim of establishing a comprehensive and sustainable national programme of financial education. The FEPP continues to thrive and now has 73 organisations participating. The FEPP brings together public and private sector institutions with a keen interest to promote the financial literacy agenda. The FEPP also launched a website (*www.fepkenya.org*) with information to assist members in developing financial literacy programmes. The FEPP continues to oversee the implementation of four pilot projects and constantly monitors them to assess their impact on consumer behaviour. With leadership from the Governor of the Central Bank, who is also the Financial Education Champion, the taskforce is in the process of establishing working groups which will deliver four core pillars including policy development, consumer education, consumer protection and rigorous and continuous research. To ensure an effective reach to consumers, the FEPP invited representatives from the media to participate in development of a communication strategy. FEPP has also supported and partnered with 13 public service institutions to develop a national led curriculum. The taskforce remains strongly committed to driving the project towards realisation of a comprehensive national strategy and it is expected that FSD Kenya will continue to support the project to test new outreach methods that particularly impact the financial capabilities of the under-served poor.

Leveraging social protection

Small regular social grants or payments to the poorest and most vulnerable are increasingly recognised as a key tool in the fight against extreme poverty. Delivering these small value social protection payments safely and cost effectively presents major challenges. FSD took on responsibility for the management of payments under the Kenya's Hunger Safety Nets Programme (HSNP) funded by DFID. The programme started the piloting of cash transfer

Members of the Kirinyaga District Farmers SACCO Society Ltd, being served at the Kagumo branch. The SACCO regulations which became effective in June 2010 and the underlying prudential regulation are expected to restore the market's trust in the SACCO sector and hence to be a boost to rural inclusion.

Box 1: Results of financial education partnership grants

- **Television drama:** The Makutano Junction TV series developed by Mediae and aired on Citizen TV reached an estimated 7.2 million Kenyans. The end-line survey carried out revealed positive impacts on consumers' knowledge and attitudes towards banking services, budgeting and saving. Although self-reported, changes in behaviour were quite remarkable. For example 72% of viewers claimed to budget more often as a result of watching the show.
- **Youth peer-to-peer learning:** In collaboration with Equity Group Foundation, 332 Kenyatta University student trainers reached approximately 5,000 youths across eight provinces.
- **Child education:** Child Savings Kenya developed a child-led curriculum based on findings from a baseline study carried out in collaboration with Catholic University. The study indicated that children, their parents and teachers were keen to learn more about money management. Whilst 60% of children were found to have knowledge of savings they knew little about banking services and kept their savings in tins or buried in the garden.

Leveraging social protection. A poster advertising an HSNP payment point outside a shop in Turkana.

payments to poor and vulnerable households across northern Kenya. Through a competitive process Equity Bank was selected to provide the payment services to the HSNP. Payments to recipients are being made through a network of agents with point of sale (POS) devices in locations convenient for the recipients. These HSNP Paypoints are typically local shopkeepers who have cash available from day-to-day business activities. Where there is no power a solar panel is used to charge the POS device. The payment recipients are issued with cards to access their payment. Payments to participants in the programme are made every two months. Agents simply swipe the card through the POS device, which then validates the identity of the bearer with a fingerprint scan. Once confirmed, cash is paid out from the till of the agent who immediately receives a corresponding credit to their account with Equity. Strong progress was made on the Hunger Safety Net Programme (HSNP) over the year. The eleventh payment cycle was completed and the programme continued to add beneficiaries with 48,000 households (80% of the target of 60,000) reached by year-end. In addition 95 paypoints (79% of the target of 120) were active. The success of the scheme is demonstrating the potential of the financial sector to solve the payments problem in one of the most challenging areas of the country.

Left: Part of a comic strip developed from a financial literacy television episode of the Makutano Junction developed with FEPP grant. Right: On -set with the crew of Makutano Junction.

Improving retail capacity

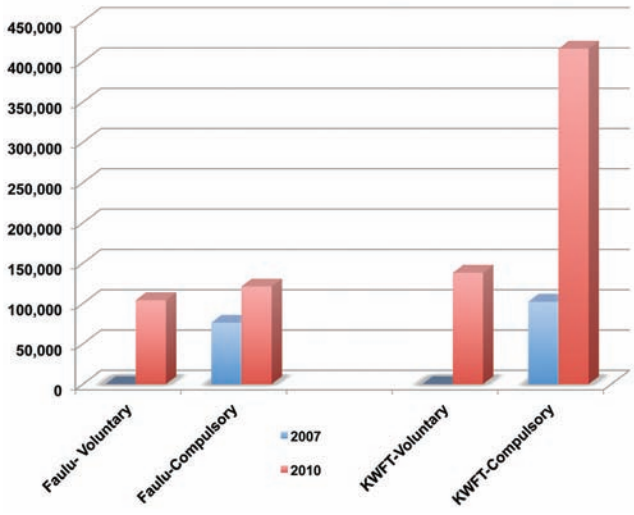
The new regulatory framework of micro-finance allows transforming MFIs to significantly expand their market, offering savings services to their clients and competing with downscaling banks. FSD provided technical assistance to two of the leading MFIs in Kenya, Kenya Women Finance Trust and Faulu Kenya, to prepare for licensing and entry into the deposit taking business. Transformation from a credit only model to full financial intermediation and accepting deposits has involved a major shift in the business model and operations of both institutions.

Kenya Women Finance Trust (KWFT): In April 2010 KWFT received its deposit-taking license, effectively realising the overall objective of this project which was to help it become a fully-fledged financial institution providing a broad range of services to low income households and microenterprise. By December 2010 KWFT had already launched seven deposit-taking branches and opened approximately 140,000 voluntary savings accounts, mobilising KShs 458m in deposits. In addition, the institution is now legally able to make use of the KShs 5.7bn it holds in collateralised deposits to support its credit business. Despite the significant costs and efforts related to transformation, KWFT continued to grow in outreach and business during the transition period (see figure 12). Overall the institution has remained profitable throughout the transformation. KWFT was able to harness support both in the form of grants (for technical capacity) and subsidised credit from its partners, in addition to institutional reserves, to drive this process. The project has now been concluded and the lessons identified will be disseminated through the joint Faulu/KWFT transformation study which is underway.

Faulu Kenya: Faulu was licensed in May 2009 as the first deposit-taking micro-finance institution (DTM) in Kenya. It has to date launched 25 branches out of the 27 planned and the focus now is on growing its business. By the end of 2010 it had opened 104,000 voluntary savings accounts and mobilised about KShs 350m in voluntary deposits. In addition the institution is now able to make use of the KShs 1.5bn it holds in collateralised deposits. The overall performance of the Faulu transformation project has generally been good but with some challenges. While most of the targets have been realised, the institutional financial performance (particularly profitability) suffered due to the large initial transformation investments (notably in the core banking system) and increased personnel costs. By unfortunate co-incidence the drought of 2009 had a major impact on Faulu's loan book which was overexposed to the agricultural sector. However, the available information indicates that the situation is gradually turning round even though performance still lags behind the original projections. The project has been formally concluded but FSD will continue to monitor the performance of the institution for project impact through collection of quarterly financial data and operational statistics.

The Governor of the Central Bank of Kenya Prof Njuguna Ndung'u issuing a deposit-taking license to KWFT Managing Director Mwangi Githaiga in May 2010. Looking on is KWFT DTM Chair Dr Mary Okello (centre) and KWFT CEO Dr Jennifer Riria (extreme right).

Figure 12: Faulu Kenya and KWFT savings growth



RURAL FINANCE

A typical scene in rural eastern part of Kenya.

As per the 2009 demographic census, 63% of the adult Kenyan population lives in the rural areas, with many of these relying directly or indirectly on agriculture for their livelihoods. Results of the FinAccess 2009 demand side survey show that 35.9% of this rural population had no access to any form of financial service. Furthermore the proportion of the adult rural population using formal service providers was only 17.8% compared to 40.3% for the urban area. Rural finance and working with semi-formal and informal providers, thus remains a priority for FSD in its endeavour to build inclusive financial markets.

Under the Rural Finance theme, FSD's initiatives are mainly geared towards reducing the risk inherent in financing agriculture, promotion of community based financial intermediation models, and making use of mobile phone infrastructure to drive inclusion.

2010 Highlights

- Weather insurance project launched.
- Cost effective GSL model developed.
- EasySave pilots launched.
- SACCO reforms support initiated.

Support to agricultural finance

FSDs efforts have been focused on identifying ways to make financial service providers more willing to provide financing for agriculture, which is perceived as being highly risky. Support has been provided through three key projects - weather insurance, warehouse receipts, and agricultural value chain finance.

Weather insurance: Adverse weather remains one of the primary risks in agricultural production and a key inhibitor of an expansion in agricultural finance. FSD is tackling this problem through an index-based weather insurance project in partnership with the Rockefeller Foundation, the World Bank and the International Livestock Research Institute (ILRI). The aim is to test the potential of weather insurance to mitigate risks for both crop and livestock production. Four financial institutions, four insurance companies, one re-insurer and the Kenya Meteorological Department are currently participating in the project. The project pilots started in March 2010. A total of 47 differentiated insurance contract prototypes have been developed for maize, wheat, coffee, bananas, sorghum and livestock.

Warehouse receipts: FSD has been working with the East African Grain Council to develop a sustainable warehouse receipts system (WRS). The main impediments to the use of warehouse receipts as instruments of title for security/collateral by financial institutions have been unreliable collateral management and the lack of an enabling legislative framework. In the 2010-

2011 national budget the government committed to support legislation for the development of a WRS. Subsequently a taskforce comprising the Ministries of Finance and Agriculture and other key stakeholders was constituted to work on the policy formulation and the legislation.

Value chains: Rigorous, quantitative analysis of agricultural value chains offers considerable promise for identifying more effective ways to finance smallholder production. FSD and USAID's Kenya Access to Rural Finance (KARF) project developed a joint activity that supported three financial institutions to undertake market surveys and develop products for financing the dairy sector. A subsequent agricultural value chain finance synthesis study highlighted other agricultural sub sectors with high potential. It is expected that the planned Value Chain Finance Centre, which will be supported by FSD and USAID, will provide support for developing products for these sub-sectors.

Box 2: Weather insurance project

Started in 2009, the project introduced a new way to adjust for losses using a predetermined contract without any need for physical farm inspections. The crop insurance products are designed using historical weather data and monitored using real time weather data from the Kenya Meteorological Department automated weather station. The livestock insurance products, managed by the International Livestock Research Institute (ILRI), are modelled from satellite images using the normalised data vegetative index. The project is currently working with three financial institutions (Equity Bank, AFC, and Ntimanyikiru SACCO), four insurers (APA Insurance, UAP Insurance, CIC Insurance and Jubilee Insurance) and one reinsurer (Swiss Re) to underwrite products.

Maize, wheat, banana, coffee, sorghum and livestock (beef) have been piloted in different regions in Narok, Machakos, Muranga, Nakuru, Meru, Kibwezi, Marsabit and Embu. In 2010, approximately 3,400 farmers insured about KShs 160m of assets (about $600 per farmer). Some farmers have already benefited from the project. In Machakos 6 smallholder farmers insured for the October 2010 season pilot received KShs 138,880 from APA insurance as compensation for crop failure due to drought.

Building financial inclusion through community based finance

FSD continues to promote financial inclusion through community based service providers. Support has been provided to Group Savings and Loans Associations (GSLs), Accumulating Savings and Credit Associations (ASCAs), and Financial Services Associations (FSAs).

GSL support: GSLs are a simple financial intermediation model where members of a group (usually between 10 and 30) contribute an agreed set amount of savings during regular meetings. FSD in partnership with CARE

A well secured automated weather station in Kibwezi district.

Members of new Odowa group during a GSL cluster meeting in Rachuonyo, Nyanza province. FSD has been partnering with CARE International (Kenya) since 2008 in a GSL development project in Kenya whose aims are to refine the basic GSL model and test the use of innovative channels for delivering training and support to groups to improve cost-effectiveness.

Kenya has supported a GSL development project since 2008. The project promotes the use of innovative channels for delivering training and support to GSLs. Under the new approach, CARE works with franchisees (local entrepreneurs and faith based organisations) to identify community based trainers. The project has been highly successful in increasing outreach and improving cost effectiveness of support. As at December 2010, support had been provided to 4,177 GSLs with a total of about 114,000 members at an average cost of $9 per member. This rate is markedly below the costs in the CARE pilot ($75 per member) and rates reported by similar projects globally ($25-$40 per member).

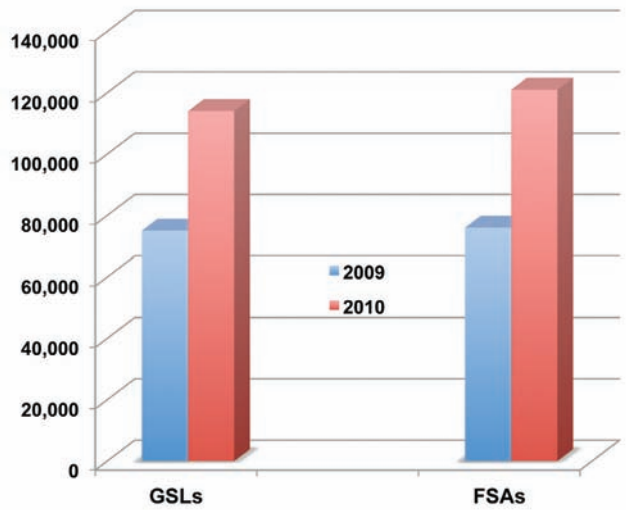
ASCA support: The focus of the third phase of the Decentralized Financial Services (DFS) project was to support the expansion of ASCAs through ASCA management agencies (AMAs) and independent service providers. Overall, the project has only had limited success as the new methodology is seen as threatening to the AMAs' basic business model which is driven by maintaining group dependency on the AMAs. While dissemination of the methodology through independent service providers indicates some potential, it has not yielded the expected outreach as it has been hard for the service providers to charge potential group members for training in advance. Although this is a largely negative result, it does demonstrate the importance of up-front investment by donors to reach low-income groups – the approach used under the significantly more successful GSL project discussed above.

FSA support: FSAs are relatively sophisticated community based institutions providing a range of financial services - savings, credit and money transfer - to their members. With front office services, flexible products and membership reaching several thousands, FSAs truly represent village banks. FSD has been working closely with the K-Rep Group over the last four years to create a specialist management services firm, KFS, to support FSAs and transform them into sustainable financial institutions. The 50 FSAs supported currently serve about 121,000 members and have shown strong potential for growth. A key component of the project is the automation of the FSAs. The planned automation is expected to bring effectiveness in oversight through generation of timely and reliable reports while supporting the growth of the FSA business and hence strengthen sustainability of the support network.

Using technology to expand financial access

Technology driven financial services are already dramatically changing the financial landscape in Kenya. The preeminent example has been the rapid expansion of the M-Pesa system which was developed with FSD support. While the initial uptake of mobile financial services has been by those already

Figure 13: Membership of FSD supported GSLs and FSAs



banked, there is significant potential to use technology to reach the excluded. FSD is at the forefront of supporting new ventures that use technology for financial inclusion.

EasySave: FSD is supporting Mobile Ventures Kenya (MVK), a company that has developed a new savings product delivered through M-PESA. The product is based on a highly innovative product, "P9" developed in Bangladesh by a leading micro-finance practitioner, Stuart Rutherford. "P9" seeks to address the key financial service need of the poor – to manage liquidity in the face of low and irregular incomes. While many poor people know that saving is a better way to manage liquidity than using credit, it is often difficult to practise with the urgent demands for any cash on hand. P9 takes deposits, but does so at the same time as offering liquidity in the form of interest-free loans. At the start the client takes an interest-free loan, one-third of which is immediately placed in a savings account. Once the loan is repaid a larger loan is provided with again one-third being put aside for savings. After the fourth cycle the client is a net saver but still has access to liquidity. With support from FSD and the Consultative Group to Assist the Poor (CGAP), MVK has piloted the product during the year across both rural and urban areas. The results from the initial pilots have been positive and have provided valuable lessons for the final design and rollout of the product.

Innovation Centre: FSD has been working with Unitus, CGAP and the Bill and Melinda Gates Foundation on the idea of a new centre to support innovations in this area. A feasibility study undertaken at the end of year revealed strong potential for the concept and considerable interest from key stakeholders in the market. FSD and CGAP are now looking to take this forward. There is consensus among the partners that it will be critical to find appropriate entrepreneurial leadership for this envisaged centre before considering moving forward.

Top: The entrance to the Itoleka FSA in Kitui district.
Below: Itoleka's customer service officer Josphat Kaloki attending to Christina Kavinya, a member of the FSA.

FINANCE FOR GROWTH

SUPPORTING FINANCIAL SERVICE PROVIDERS IN THE DEVELOPMENT OF NEW PRODUCTS

Members of the public receiving their credit reports on request at a CRB Africa tent in Mombasa. This was during a business community visit organised by the Kenya Credit Information Sharing Initiative (KCISI).

Small and medium enterprises (SMEs) play a major role in the economic development of any country in the world. Studies have shown that SMEs can contribute up to 45% of employment and up to 33% of GDP in developing economies. The Kenya government in the Vision 2030 plan has identified the SME as an important priority. In order to achieve growth, adequate sources of finance are needed for SMEs. This is not the case in Kenya where access to finance remains a key constraint to SME development.

FSD's focus has been on building market driven financial solutions targeting SMEs. During 2010 FSD continued to support projects in the following areas: credit bureau implementation, SME financial product development, skills development and knowledge generation. FSD also began preparing a new project for stimulating investment in Northern Kenya.

2010 Highlights

- First private Credit Reference Bureau Licensed.
- Fourth bank joins supply chain finance project.
- Demand side Insurance Study completed.

Credit bureau implementation

Credit information sharing is an essential financial infrastructure to facilitate SME lending to a significant portion of a country's population. FSD has been supporting the credit information sharing efforts since 2009. A significant milestone was the gazetting of regulations in July 2008, which provided for licensing and supervision of multiple private sector Credit Reference Bureaus (CRBs) by CBK. A joint taskforce of the CBK and KBA was formed to drive the implementation process and with FSD support, the taskforce was able to hire a project manager in 2009.

During 2010, CBK licensed the first CRB, Credit Reference Bureau Africa limited. With the licensed bureau in place, test runs were conducted for the transmission of data between the banks and the licensed bureau. A communication strategy was launched and focused on intensive sensitisation to gain public support for reporting of positive information. The taskforce also commissioned a study to develop a strategic plan to build structures needed to achieve comprehensive, full-file credit reporting in Kenya. The study recommended that the project office for the Kenya Credit Information Sharing Initiative (KCISI) based at the KBA be transformed into the "Kenya Credit Providers Association (KCPA)" to represent the wider interests of the credit provider community.

SME finance - product development

Management of cash flow is an imperative part of successful small business operations. The period between accruing income and receiving payment or between incurring expenses and paying bills is critical for small businesses.

Table 2: Credit information - proposal for Kenya Credit Providers Association

KCISI	KCPA
No legal status	Full legal status
Mandatory data submission	Voluntary data-sharing basis
Open only to CBK licensed institutions	Open to all credit providers based on data reciprocity
KBA and CBK "principle sponsors"	KBA members become part of the association; CBK has only observer status
Supports mandatory "negative only" data submissions	Work towards full file positive/ negative data submission

Small businesses will invariably be faced with situations where they face a liquidity crunch and may fail. Such situations can be prevented if SMEs have access to supply chain finance products that would help them to optimize working capital between them and their trading partners.

FSD's supply chain product development project was designed to support the piloting of new products and build the capacity needed in banks. The project began in 2009 and the first partner was ABC Bank. Two other partner banks, NIC Bank and Diamond Trust Bank, received support in product design and will be piloting the new products in the market in 2011. Chase Bank became a partner at the close of 2010 and product design is expected to begin in 2011.

A supply chain finance workshop was held in June 2010. The workshop brought together purchasers, suppliers and financial institutions and participants expressed strong interest in the formation of an association of supply chain finance professionals. Networking at the workshop led to an international factoring company expressing interest in setting up a factoring company in Kenya. FSD will support these initiatives to make supply chain finance products easily available to SMEs.

Skills development

For Kenyan financial service providers to design and promote products which are SME oriented, they need to acquire additional skill sets to complement their traditional risk assessment and commercial lending competencies. FSD in partnership with Strathmore University developed a pilot training workshop which was designed and delivered by an international expert in the area of SME development and SME relationship management. The course was well attended and received good reviews from participants.

Digital registration of students at Catholic University of East Africa conducted by Intellicom Ltd. The University is replacing old student identification cards with digital swipe cards that will be used to borrow books from the library, pay school fees and access the ATM. Intellicom is an SME that has received credit from ABC Bank to undertake this project.

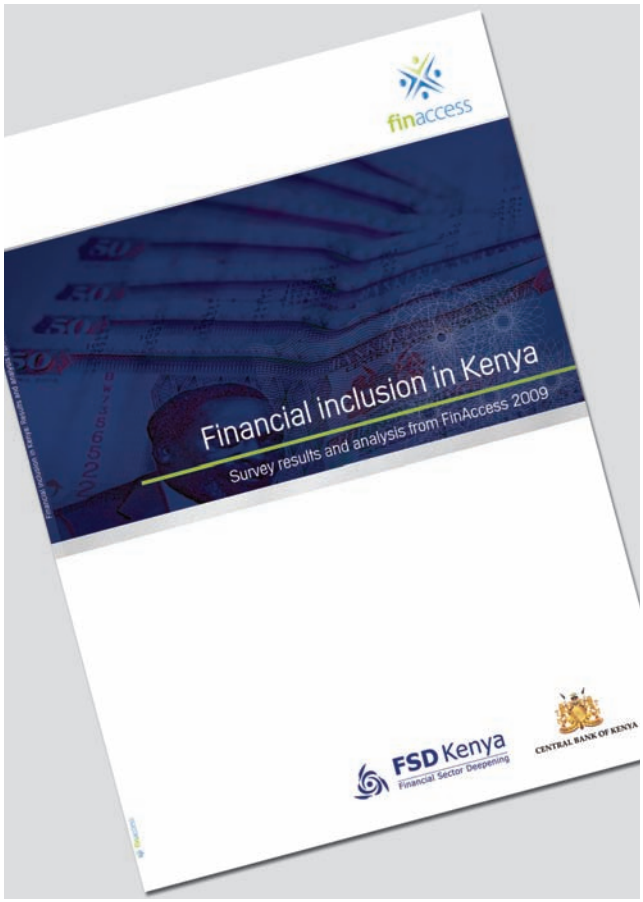
Knowledge generation

FSD has been at the forefront of knowledge generation in the specific constraints and issues affecting SME finance and getting a clear understanding of the market. In 2010, under the GrowthFin project, FSD supported a demand side insurance study. The study examined the constraints to the uptake of insurance by SMEs. The study was conducted under the auspices of the government's Private Sector Development Strategy (PSDS) Secretariat and forms part of FSD's commitment to support the implementation of the PSDS.

Northern Kenya investment fund

The objective of the project is to support the development of private sector investment in Northern Kenya. CARE and USAID did preliminary work on the project. During 2010 FSD began supporting a feasibility study to assess the financial and economic viability of the proposed fund. The study involves a review of the value chains for various sectors including livestock, hides and skins, tourism, agriculture, gums and resins.

KNOWLEDGE



Top: Survey results and analysis from FinAccess 2009. The report provides in-depth analytical papers on the results of our first two financial access surveys conducted in 2006 and 2009.
Below: Mobile financial services are frequently offered at independent agent shops or as an add-on service for a large range of other types of businesses. Branchless banking is expected to dramatically improve access to financial services, especially in rural areas.

FSD's knowledge agenda was significantly expanded in 2010. This involved establishing a new knowledge theme area to provide a cross cutting look at the three other FSD theme areas. In line with FSD's overall mandate, the knowledge program spearheads policy-directed research to support pro-poor, pro-access policy formulations. Experience has demonstrated the importance of informing policy dialogue through a grounded analysis on how financial inclusion is actually evolving in Kenya. Research and analysis can also inform industry players about potential new market opportunities. The knowledge theme is building an evidence base to strengthen FSD's impact at policy and industry forums.

During 2010 FSD's knowledge theme consisted of three projects – FinAccess, Impact, and Branchless Banking. The FinAccess project implemented together with the Central Bank of Kenya, remains a centerpiece of FSD's knowledge agenda. FinAccess surveys build time series data on the demand and supply side dynamics of Kenya's financial markets, and have proven to be an important evidence base for policy and industry forums. The Impact project was launched in 2010 and is intended to provide a deeper understanding of the ways in which financial sector developments are impacting on longer-term poverty dynamics. With the new Branchless Banking research project, FSD is positioning itself to take a more central role in understanding the impact and potential of branchless banking for low-income populations.

2010 Highlights

- FinAccess: Analysis of FinAccess 2009 completed.
- Impact: Landscapes study initiated.
- Branchless Banking: M Kesho survey completed.

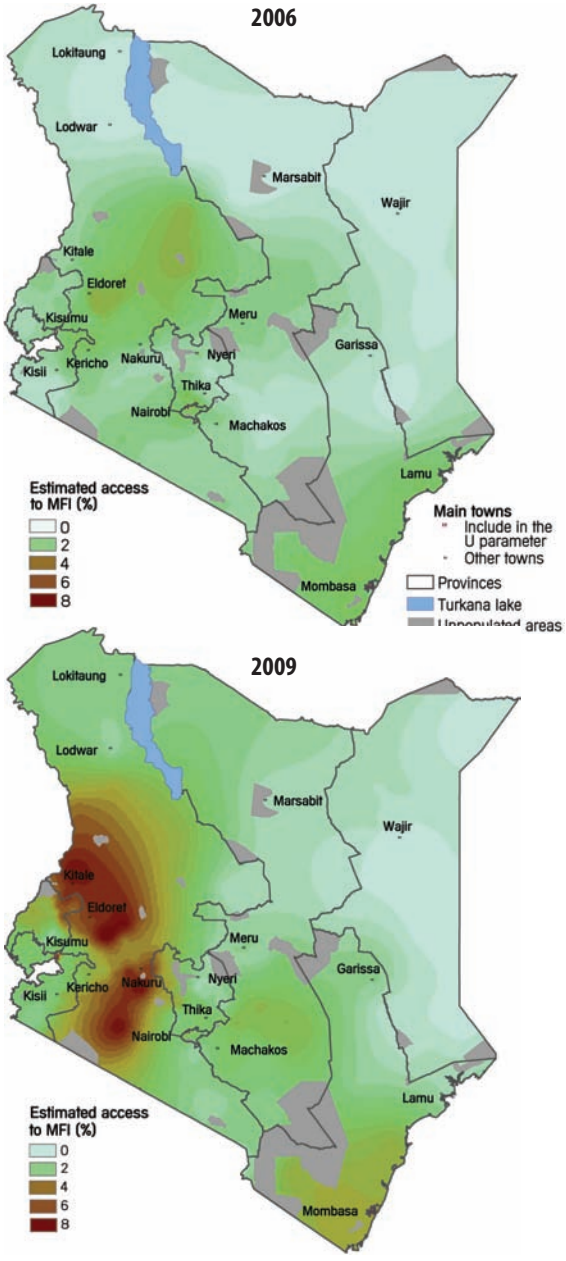
FinAccess surveys

The on-going implementation of FinAccess surveys increases their value as a source of time series data on Kenya's financial sector. With two rounds of the FinAccess demand side survey (2006 and 2009) now completed, preparation is underway for a third round in 2012. FinAccess demand side surveys are documenting important trends in financial inclusion in relation to poverty, while supply side surveys complement this picture through annual updates on the geographical coverage and market size of financial service sub-sectors. The overall goal is to transition the FinAccess surveys to a more sustainable institutional base within the Central Bank of Kenya. In the meantime, however, FSD continues to be closely involved in developing and implementing the surveys and improving their quality and scope.

Analytical work on the 2009 FinAccess demand survey was completed during 2010. The result is a new publication that includes valuable analysis of the impact of formal inclusion on household investment and growth and the complementary role of formal and informal financial institutions. A new feature is the results of a trial spatial analysis of the 2009 data, presenting a

series of maps that highlight the comparative changes in the financial access landscape between 2006 and 2009. Also included is a paper on financial exclusion, highlighting the extent to which nation-wide increases in financial access do not necessarily translate into greater equality of access.

Figure 14: Spatial maps showing estimated access to MFIs



During 2011, under the FinAccess project, FSD will launch a business survey to document trends in small and medium enterprise development. The business survey is intended to provide a benchmark on current levels of access to guide policymakers and donors, insights on market opportunities for market participants and a rich data source for researchers seeking to better understand the landscape of SME finance in Kenya. This will support FSD's strategic commitment to improving financial instruments for SMEs as a means to support pro-poor growth.

Impact research

During 2010, FSD embarked on an impact research programme for selected areas of focus within its project portfolio. This is aimed at developing a better understanding of the causal pathways by which FSD projects impact on markets. This is relevant not only to FSD, but also for partners sharing FSD's goals in Kenya and elsewhere. Understanding how FSD's current projects impact on poor people's lives through this project is instrumental in establishing an institutional learning agenda. It is expected to directly improve FSD's project implementation capacity over time. At a more strategic level it will enable FSD to take more informed decisions on where to target its future investment to maximise developmental impact.

In 2010, the Impact project kicked off with a broad based, meso-level study of financial landscapes. The study is monitoring how financial inclusion in Kenya is evolving, to analyse who is being included, why and with what effects on development and livelihoods. This will help to better track the impact of FSD's market development approach on inclusion and its effects on poor people's livelihoods. The landscapes study will analyse the changing patterns of financial sector use, the complementary role of the informal sector in the development of financial markets and the constraints to access for marginalized groups such as youth and women, including the implications of expanding services for these groups.

Further work planned for 2011 includes impact research on the effectiveness and poverty outreach of initiatives to support the development of informal financial institutions (savings and loans groups); research on the effectiveness of a government led social transfers programme in Northern Kenya and; research on the impact of a new mobile savings pilot on small-scale enterprises.

Branchless banking research

FSD began developing a joint project with the Bill and Melinda Gates Foundation for research into branchless banking. As there is already research underway, much of it funded by the Bill and Melinda Gates Foundation, the project does not intend to subsume existing initiatives; rather its aims to enhance the value derived from this work and increase implementation efficiency. The project also aims to increase the impact of the research through engagement with policy and industry forums, realising synergies and avoiding duplication within the research community and reducing the transaction costs for key players by providing a one-stop-shop for research activities.

In 2010, a survey of the mobile banking product M-KESHO was successfully completed and is now in the process of analysis along with some other qualitative work on m-savings conducted through national level focus groups. The survey will provide the basis for a series of policy notes on the drivers of mobile savings, and patterns of mobile money usage.

FSD KENYA's IMPACT

FSD takes a very proactive approach to assessing project performance, which is done on a quarterly basis. (see Annex 1 for FSD's portfolio). At the programme level, FSD has benefitted from two reviews in 2010 - an impact assessment and a programme completion report.

Impact assessment

The impact assessment report was completed in January 2010. The methodology involved a combination of document review and semi-structured interviews with key partners, stakeholders and financial service users. The assessment team considered the direct impacts achieved at each of the levels of FSD activity and concluded that :

- at the macro level, **FSD's work has contributed in a significant way** to the development of an improved enabling policy and regulatory environment;
- at the meso level, the programme has helped to build significant capacity in the support service market and has also **contributed to the shift to a market that is more client oriented.**
- at the micro level, FSDs support has **helped to enable the transformation and institutionalization of key providers** with the sector.

The team also examined the final impact on the ultimate FSD goal of generating sustainable improvements in livelihoods of poor people through reduced vulnerability to shocks, increased incomes, and employment. While the team was not able to derive firm conclusions in terms of the final impact it observed that **"the culture of the market has changed to become more focused on reaching poorer clients"**. However it cautioned that while "there are some improvements in outreach to socio-economic groups previously under-represented . . . greater clarity is needed over the poverty profile of who is able to access the services".

Table 1: FSD programme completion report

	Indicator and target	Assessment
1	Proportion of adult population that uses services of formal financial institutions rises to 29% by 2010	Target reached
2	The number of accounts in the financial sector rises to 5.7 million by 2010	Target reached
3	The proportion of total adult population which is financially excluded reduced to 30% by 2010	Target reached
4	Credit extended to the private sector as a percentage of GDP increases to 30%	Target reached
5	Interest rate spreads are reduced to less than 6% by 2010	Not reached

Macro level policy impact: Treasury Permanent Secretary Joseph Kinyua, displays the *Costs of Collateral* reports at the launch event in March 2010.

Programme completion report

The FSD programme completion report covered the period 2005-2010 and was prepared in November 2010. The assessment team reviewed progress against targets at the purpose level - which is "to deepen the capacity of Kenya's financial sector to meet the financial needs of poor Kenyans and micro, small and medium enterprises on a sustainable basis". It concluded that at the purpose level, the targets for four of the five indicators had been reached as show in Table 1. It concluded that **overall FSD has completely achieved its purpose/strategic objective and exceeded the original expectations of stakeholders.**

The programme completion report identified circumstantial evidence of FSD's impact and also outlined the intangible impact achieved by FSD. It concluded that FSD:

- Had become a **source of evidence for policy formulation** and a source of information for innovators.
- Had made a **big contribution in capacity building**, as a partner more than a donor.
- Played a major role as **a facilitator of dialogue**, particularly in helping to smooth the rough edges between different stakeholders.
- Was perceived as **a neutral but expert voice** in policy dialogue.
- Has become **a source of reassurance on risks.**
- Is a source of **timely and useful technical advice**.

FINANCIAL COMMENTARY

FSD was able to continue supporting its ongoing projects and launch innovative new projects due to strong support from funders. With the closure of some high expenditure projects FSD was able to close the year in a healthy financial position that enabled it to continue activities in 2011 pending approval of the new strategic plan.

Funding

The bulk of FSD funding came from DFID (82.9%), SIDA (10.7%) and the Bill and Melinda Gates Foundation (5.3%). FSD also received restricted funding from other international organizations in support of various projects. Among these donors were the Rockefeller Foundation, Unitus, AFD, the National Bureau of Economic Research (USA) and the Standard Bank of South Africa.

Table 4: FSD Funding in 2010

SOURCE	KSh (m)	%
UNRESTRICTED		
DFID	349.9	30.8
SIDA	121.1	10.7
Bill and Melinda Gates Foundation	60.6	5.3
TOTAL UNRESTRICTED	**531.6**	**46.8**
RESTRICTED		
DFID - SPP payments project	591.6	52.1
Unitus	5.6	0.5
Rockefeller Foundation	5.1	0.4
Other	2.2	0.1
TOTAL	**1,136.1**	**100.0**

Project expenditure

FSD's total expenditure on projects grew from KShs 599m in 2009 to KShs 872m in 2010, representing a 45% increase (see Financial Statements in Annex 2). This is attributable largely to the Hunger Safety Net Programme (HSNP) social transfers project which is FSD's single largest project accounting for 68% of total project expenditure during the year. Expenditure on Formal Finance theme area projects declined from KShs 338m to KShs 281m mainly as a result of the closure of major high expenditure projects in 2010.

The increased focus on the rural finance theme area is evident from the numbers. Expenditure on rural finance projects continued to rise and reached 84% of total expenditure in 2010 from 67% in 2009. Meso level projects account for 87% of total project expenditure compared to 71% in 2009. This shift is expected to continue as FSD focuses on industry wide financial sector projects in order to stimulate further market development.

Administrative expenditure

Even though FSD management costs increased 18% in absolute terms during the year, the proportion of administration costs to total expenditure declined marginally from 8.9% in 2009 to 7.4% in 2010. FSD maintains strict controls over administration expenditure, which in turn ensures efficient use of existing resources. There was however a need to strengthen management capacity, which translated into higher staff costs. Other administration costs remained constant even as staff levels and the number of active projects increased.

Figure 15: Breakdown of spend by level

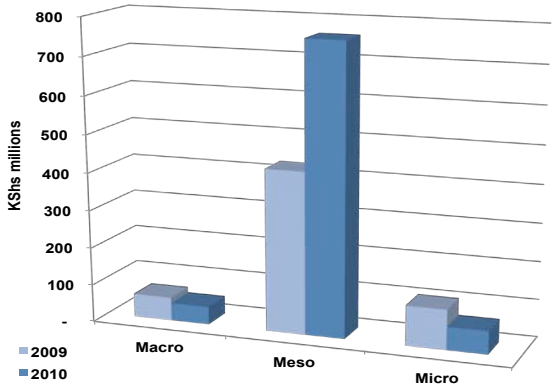
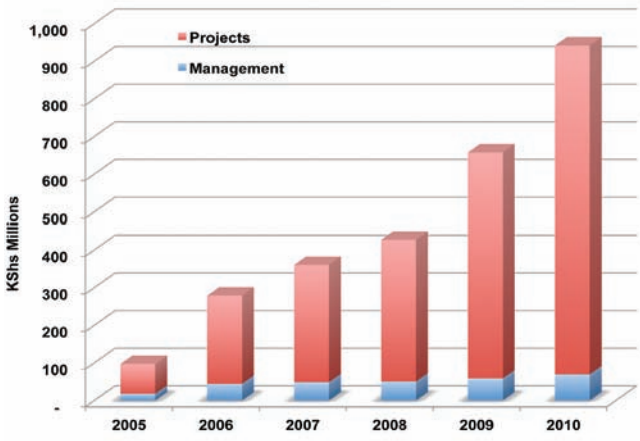


Figure 16: Growth in project investments



Annex 1

FSD KENYA's PORTFOLIO

Project		Objective	Approved (KShs m)	Progress as at December 2010	Actual or expected impact
Theme 1: Formal financial system					
Macro: Policy and regulatory	SACCO regulation development	Support the SACCO Regulation Taskforce to put in place a new regulatory framework for deposit-taking SACCOs.	16.0	Project concluded 2010.	Systemic
	SACCO regulations implementation	Support planning for the SACCO sub-sector reforms in line with the new regulatory framework.	7.0	Recruitment of key staff concluding.	Systemic
	Banking channel regulation	Support the development of new pro-access regulation of commercial banking channels.	6.9	Project completed and guidelines in place.	Systemic
	Mobile banking regulation II	Develop an enabling environment for mobile phone banking in Kenya.	6.3	Report redrafted	Systemic
	Scenario building	Develop a scenario building process to address the question: "How to enhance the uptake and usage of non-traditional and electronic channels to deliver financial services."	7.2	Analytical report completed and policy paper drafted.	Systemic
Meso: Financial education and consumer information	Consumer info I	Improve the generation and dissemination of consumer information on financial services to improve competition and consumer choice	6.9	CBK developing web based portal	Systemic
	Consumer info II	Improve the generation and dissemination of consumer information on financial services to improve competition and consumer choice.	6.2	CBK set to release new bank disclosure requirements in 2011	Systemic
	Financial education	Determine the overall vision and agenda for a programme of financial education in Kenya and pilot initiatives to test ways to most effectively deliver financial education.	63.0	Pilots on going and strong progress in developing strategic framework.	Systemic
Meso - Social protection	G2P Payments development project	Catalyse the expansion of private sector driven payments systems to allow the delivery of social payments and significantly expand access to financial services	106.0	On track. Payments proceeding well.	Systemic - the long term aim is to use G2P payments to provide a demand driver for service expansion
Meso: Capacity building	SACCO Cap	Develop the capacity of SACCOs through the development of a sustainable business services industry.	166.8	Project concluded	Systemic but entails working directly with institutions to grow membership >50,000
	SACCO sub-sector reforms	Develop the capacity of the SACCOs sub-sector to meet the requirements of the new regulatory framework	162.4	Project developed and Initiated	Systemic- working with the about 200 SACCOs targeted for regulation
	Human resource capacity	Support the growth of market based training and other human resource development business services in East Africa	7.0	Revised report has not been provided despite sustained follow up	Limited

Project		Objective	Approved (KShs m)	Progress as at December 2010	Actual or expected impact
Meso: Capacity building	Jitegemee Trust restructuring	Establish Jitegemee Trust as an investment fund providing equity and debt finance to MFIs and SACCOs with strong growth potential.	184.8	Project cancelled but still active during loan repayment.	Project Cancelled - no impact anticipated.
Micro: Direct retail capacity	Kenya Post Office Savings Bank (KPOSB) II	Support the implementation of a new business model in Postbank in order to enhance the efficiency and service offer of the bank	116.0	Completed -review to be undertaken under KPOSB III	Developed new business model for whole bank.
	Kenya Post Office Savings Bank (KPOSB) III	Exploit Postbank's new business model to significantly increase outreach to lower-income groups in rural areas.	6.0	Prospective project - strategic analysis in progress	Expected to reach large numbers of low-income households
	KWFT transformation support I	Support KWFT to become a licensed national micro-finance institution.	60.0	Project completed. Transformation study draft report produced.	Planned short-term growth over 50,000 clients. Longer term 200,000
	Faulu transformation support I	Support Faulu in undergoing institutional transformation to become a leading provider of financial services to low income households and micro-enterprise.	75.0	Project completed. Transformation study draft report produced.	Planned short-term growth over 50,000 clients. Longer term considerable greater
Theme 2: Rural finance					
Meso - Agricultural finance	Index-based weather insurance	Develop and demonstrate the market viability of index-based insurance products to reduce the impact of weather risk on smallholder farmers and pastoralists in Kenya	61.4	A number of pilots concluded, new crops/ areas now under development	Significant numbers should now be reached
	Warehouse receipts system	Establish and promote a viable and sustainable warehouse receipts system	30.0	Work on legislation started - extension likely to be required	Low - only 8,000 farmers targeted in this first phase project, but the aim is to scale up significantly in subsequent phases
	Value chain finance I	Support the development of sustainable smallholder agricultural finance in the dairy sub-sector using value chain analysis.	17.5	Concluded, two institutions launched products. This was a pilot for the planned Value Cain Finance Centre (VCFC) project.	While the immediate aim is to reach only 1,000 clients products should reach more over time
	Agricultural value chain synthesis study	Establish key lessons from existing initiatives in Kenya relating to agricultural value chain finance and identify new opportunities	3.9	Preliminary study finalised and results to be taken up under planned VCFC project.	Systemic - aimed at informing other value chain finance work.

FSD KENYA's PORTFOLIO CONTINUED

Project		Objective	Approved (KShs m)	Progress as at December 2010	Actual or expected impact
Meso - Community based financial services	Group savings and loan association development	Develop the GSL system to the stage at which a scale-up programme aiming to impact significantly on financial exclusion at a national level becomes viable.	100.0	On track; impact assessment study finalized	Targeted expansion is 90,000 over the project period
	GSL transition	Refine recently developed innovations in the GSL methodology in Kenya in preparation for a national scale-up programme	2.0	New project under development	Systemic, some direct intervention support for CARE
	Decentralised financial systems III	Expand the supply of financial services in rural areas through the rollout of robust decentralised financial systems	60.0	Implementation Underway	Systemic. Outreach / impact much lower than anticipated.
	FSA Transformation project II	Demonstrate sustainability at the regional level and expand the network of commercial FSA management services, laying the foundations for full sustainability of the system	75.0	Planning for automation roll out underway	Targeted growth 52,000 and potential for further expansion
Meso - Technology	Innovations Centre	Radically expand access to finance via scaling startups focused on mobile-enabled financial services and products aimed at the bottom of the pyramid with an emphasis on the rural poor.	6.8	New idea to support technology start ups	Systemic if successful
Micro - Technology	EasySave	Develop a commercialisable savings and loan scheme targeting low income rural people based on the M-PESA payments platform	22.6	Piloting proceeding according to plan	The immediate impact from the first phase project is likely to be limited but the aim will be to scale-up subsequently
Micro - SACCOs and smaller MFIs	SACCO Fund I	Support to institutional strengthening of SACCOs with a view to strengthening governance, financial stability and operations to comply with the new regulatory framework	20.0	Concluded	Aim is to produce demonstration models of reform. Actual growth impact has been small
	SACCO Fund II	Support to institutional strengthening of SACCOs with a view to strengthening governance, financial stability and operations to comply with the new regulatory framework	60.0	Project activities underway	Aim is to produce demonstration models of reform. Actual likely impact should be at least moderate given targeting of larger institutions.
	MFI growth programme	Development of the capacity to effectively manage rapid growth in high potential micro-finance institutions	64.0	Activity concluded, monitoring of MFI partners to continue	Aim was to develop a growth model to allow smaller MFI/SACCO segment to grow much more rapidly. Impact so far only 56,000 clients

Project		Objective	Approved (KShs m)	Progress as at December 2010	Actual or expected impact
Theme 3: Finance for growth					
Meso - Credit information	Credit reference	To support the creation of an effective credit information sharing environment in Kenya	44.3	On target - negative information now being shared among banks	Systemic
Meso - Product and industry development	GrowthFin	Develop capacity in the financial services industry to reach SME markets through action research and development of service providers	100.0	Activity concluded	Systemic
	Supply chain trade finance facility	To support the financial sector in the piloting of structured working capital supply chain finance products for SMEs	70.0	Some delays but activities now moving forward well	Outreach for already identified interventions likely to be < 10,000.
	Northern Kenya investment fund	To support the development of private sector investment and expansion in Northern Kenya	6.7	Feasibility study underway	Too early to assess the number of clients likely to be reached
Meso - Skills Development	GrowthCap	To support the growth of market based training and other HR business services for SMEs	6.0	Project development well advanced; to be completed in 2011	Systemic
Micro - Direct Retail Capacity	FINA Bank II	Develop an SME lending business at scale within FINA Bank, demonstrating the viability of lending to the SME market	41.0	Completed. Diagnostic study undertaken.	Significantly lower direct impact than expected.
Theme 4: Knowledge					
	FinAccess 2009	To develop FinAccess as a comprehensive, reliable and sustainable mapping of the financial landscape in Kenya, measuring household demand and supply	60.0	Final analytical report well advanced. Some progress on supply side work	Systemic
	Impact Assessment Project	To provide evidence of the impact of FSD on its goal to generate sustainable improvements in the livelihoods of lower income households .	78.0	Project development. Studies being initiated.	Systemic
	Branchless banking research project	Elaborate a joint research agenda between Bill and Melinda Gates Foundation and FSD, and fund a first study to kick off this cooperation.	6.0	New project - pilot study on M-Kesho underway	Systemic
New directions					
	Micro-insurance market analysis	To conduct a demand-side, supply-side and regulatory analysis to map the insurance and micro-insurance landscape in Kenya and identify the drivers of and challenges to market development	6.0	Stakeholder workshop held, draft report produced	Systemic

Annex 2

FINANCIAL STATEMENTS

INCOME AND EXPENDITURE STATEMENT FOR THE YEAR ENDED 31ST DECEMBER 2010

	2010	2009
INCOME	KShs Millions	KShs Millions
Grants	1,136	703
Other income	19	38
TOTAL INCOME	**1,155**	**741**
EXPENDITURE		
PROJECT EXPENSES		
Core projects[2]	274	333
Designated projects[3]	598	266
	872	**599**
ADMINISTRATIVE EXPENDITURE	69	59
TOTAL EXPENDITURE	942	658
FINANCE COSTS	-	-
TOTAL COSTS	**942**	**658**
SURPLUS FOR THE YEAR	**213**	**83**

[1] Other income constitutes all non grant incomes such as interest earned on bank deposits and foreign exchange gains.

[2] Core/non designated projects are projects funded by donors through unrestricted funds. Unrestricted funds have no conditions regarding the projects they can fund.

[3] Designated projects are funded by donors through restricted funds. Restricted funds can only be used on the project specified by donors.

BALANCE SHEET
AS AT 31ST DECEMBER 2010

	2010	2009
ASSETS	KShs Millions	KShs Millions
Non-current assets		
Property and equipment	3	3
Intangible asset work in progress	2	2
Loan advance[1]	-	77
Total non-current assets	**5**	**82**
Current assets		
Loan advance[2]	77	77
Receivables	2	1
Contract advances	0	1
Fixed deposits	201	-
Bank and cash balances	518	356
Total current assets	**798**	**435**
Total assets	**803**	**516**
RESERVES AND LIABILITIES		
Reserves: Accumulated fund	448	235
Non-current liabilities		
Deferred income	-	0
Current liabilities		
Unexpended projects fund	281	192
Deferred income	0	0
Accruals	18	41
Tax liability[3]	55	48
Total current liabilities	**355**	**282**
Total reserves and liabilities	**803**	**516**

1 Refers to a loan advanced to Jitegemee Trust for on-lending to MFIs and SACCOs.

2 Refers to future incomes expected from an asset donation by an FSD donor.

3 FSD has applied for tax exemption on some tax categories. This amount is the accrual of these taxes pending finalization of the tax exemption application.

Annex 3

FSD KENYA's PARTNERS

Government/ regulators	▪ Ministry of Finance ▪ Ministry of Co-operatives Development and Marketing ▪ Ministry of Home Affairs ▪ Ministry of Agriculture ▪ Ministry of Industrialisation ▪ Ministry for the Development of Northern Kenya	▪ Central Bank of Kenya ▪ Insurance Regulatory Authority ▪ Kenya Bureau of National Statistics ▪ Kenya Meteorological Department ▪ SACCO Societies Regulatory Authority (SASRA) ▪ Women Enterprise Fund
Financial service providers	▪ FINA Bank ▪ Equity Bank ▪ ABC Bank ▪ Commercial Bank of Africa ▪ NIC Bank ▪ Diamond Trust Bank ▪ Chase Bank ▪ KCB Bank	▪ Kenya Women Finance Trust ▪ Faulu Kenya Ltd ▪ K-Rep Fedha Services Ltd ▪ Kenya Post Savings Bank ▪ Blue Shield Insurance ▪ APA insurance ▪ Co-operative Insurance Company ▪ Mobile Ventures Kenya
Non-profits/ industry associations	▪ Kenya Bankers Association (KBA) ▪ Association of Micro-finance Institutions (AMFI) ▪ East Africa Grain Council (EAGC) ▪ Centre for Financial Regulation and Inclusion (CENFRI) ▪ CARE Kenya	▪ Unitus ▪ International Livestock Research Institute (ILRI) ▪ Mediae ▪ Plan International
Development partners	▪ DFID ▪ SIDA ▪ The World Bank ▪ AFD ▪ CGAP ▪ FSD Tanzania ▪ International Labour Organisation (ILO)	▪ FinMark Trust ▪ World Council of Credit Unions (WOCCU) ▪ International Finance Corporation (IFC) ▪ Rockefeller Foundation ▪ Bill and Melinda Gates Foundation ▪ USAID's Kenya Access to Rural Finance (KARF) programme
Consultants	▪ Development Alternatives Incorporated (DAI) ▪ ShoreBank Consulting ▪ Investeq Capital ▪ Bankable Frontier Associates ▪ MicroSave ▪ Paul Rippey	▪ Oxford Policy Management ▪ Microfinance Management Institute (MFMI) ▪ Accenture Development Partnership (ADP) ▪ Synovate ▪ Pipal Ltd ▪ Inspired International

Towards a new financial frontier

Group Savings & Loans clustered meetings in Rachuonyo

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FSD Kenya
Financial Sector Deepening

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