KENYA
COMPANION REPORT

UNCDF MICROFINANCE PROGRAMME IMPACT ASSESSMENT 2003

EBS Mobile Banking unit

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December 2003

Abbreviations

AFCAP	Microfinance Capacity Building Programme in Africa
AFRICAP	AfriCap Microfinace Fund
AGM	Annual General Meeting
AMFI	Association of MicroFinance Institutions
AFRACA	African Rural and Agricultural Credit Association
BIMAS	Business Initiatives and Management Assistance
BPED	British Partnership for Enterprise Development
CBK	Central Bank of Kenya
CCA	Common Country Assessment
CCF	Country Cooperation Framework
CGAP	Consultative Group for Assisting the Poor
CEO	Chief Executive Officer
COO	Chief Operations Officers
DANIDA	Danish International Development Agency
DFID	Department for International Development
EAB	East Africa Building Society
EBS	Equity Building Society
EU	European Union
FAO	Foreign Agriculture Organization
FGDs	Focus Group Discussions
FM	Finance Manager
GOK	Government of Kenya
ICEG	International Center for Economic Growth
IFC	International Finance Corporation
IIA	Independent Institutional Assessment
KANU	Kenya African National Union
KBA	Kenyan Bankers Association
KCB	Kenya Commercial Bank
KEPP	Kenya Enterpreneurship Promotion Programme
KPOSB	Kenya Post Office Savings Bank
KREP	Kenyan Rural Enterprise Programme
KSH	Kenyan Shillings
KSTES	Kenya Small Traders Society
KWFT	Kenyan Women Finance Trust
LAN	Local Area Network
LAPO	Lift Above Poverty Organisation
LDC	Least Developed Country
MAB	MicroStart Advisory Board
MDG	Millennium Development Goals
MESP	Micro-Enterprise Support Programme
MFI	MicroFinance Institution
MF	MicroFinance
MOLHRD	Ministry of Labour and Human Resource Development
MSE	Micro and Small Enterprises
NARC	National Rainbow Coalition
n.a.	Not available

N/A	Not Applicable
NBFI	Non-bank Financial Institution
NBK	National Bank of Kenya
NCCK	National Council of Churches of Kenya
NGO	Non-governmental Organisation
NORAD	Norwegian Agency for Development Cooperation
NPEP	National Poverty Eradication Plan
NPL	Non-performing Loans
PAR	Product Attribute Ranking
PIA	Programme Impact Assessment
PRA	Participatory Rapid Appraisal
PRSP	Poverty Reduction Strategy Paper
OPA	Organisational Programme Assessment
RBA	Regional Bureau for Africa
SACCO	Savings and Credit Cooperative Society
SMEP	Small and Micro Enterprise Project
SUM	Special Unit for Microfinance
TA	Technical Assistance
TSP	Technical Service Provider
UN	United Nations
UNDAF	United Nations Development Assistance Framework
UNDP	United Nations Development Programme
UNCDF	United Nations Capital Development Fund
UNOPS	United Nations Office for Project Services
WAN	Wide Area Network
WCK	World Concern Kenya
WEDCO	Wedco Enterprise Development Limited
WEEC	Women 's Economic Empowerment Consort
WVI	World Vision International

TABLE OF CONTENTS

Abbreviations i
Kenya Project Data Sheet vii

PART I – INTRODUCTION 1
1.0 BACKGROUND 1
2.0 KENYA PROGRAMME DESCRIPTION AND ACCOMPLISHMENTS 2
2.1 MicroStart 2
2.2 MicroSave 3
3.0 COUNTRY CONTEXT 4
3.1 Demographic and Social Indicators 4
3.2 Macroeconomic Context 4
3.3 Financial Sector 5
3.4 The Political Situation 6

PART 2: CLIENT IMPACT ASSESSMENT 7
1.0 INTRODUCTION 7
2.0 CLIENT SATISFACTION FOCUS GROUP DISCUSSIONS 7
I. Introduction and Background 7
II. Research Objective 7
III. Methodology 8
IV. Tools and Techniques 9
V. Results Analysis and Main Findings 10
VI. Conclusions 18

PART 3 – INSTITUTIONAL ASSESSMENT OF EQUITY BUILDING SOCIETY 19

INTRODUCTION 19

1.0 EXECUTIVE SUMMARY 21

1.1 Key Data 21
1.2 Summary of Major Conclusions and Recommendations 22

2.0 INSTITUTIONAL FACTORS 23

2.1 Legal Structure 23
2.2. History 24
2.3 Ownership and Board of Directors 25
2.4 Alliances 26
2.5 Leadership 27
2.6 Human Resource Management 28
2.7 Organisational Structure 30
2.8 Management Information System 32
2.9 Internal Control System, Audits and Supervision 34
2.10 Financial Manager 36
2.11 Gender Dimensions 36
2.12 Technical Assistance 37
2.13 Experience and Recommendations of Earlier Evaluations 37

3.0 SERVICES, MARKETS AND CLIENTS 37

3.1 Services 37
3.2 Outreach 37
3.3 Clientele 41

4.0 STRATEGIC OBJECTIVES 44

4.1 Mission and Objectives 44
4.2 Objectives for the Near to Medium-Term 45

5.0 FINANCIAL PERFORMANCE 46

5.1 Income Statement and Balance Sheet 46
5.2 Adjustments for Inflation and Subsidies 49
5.3 Profitability 50
5.4 Efficiency 50
5.5 Loan Portfolio Analysis 51
5.6 Liquidity Management 53
5.8 Liabilities and Cost of Funds Analysis 54
5.9 Capital Management (solvency) 54

PART 4 – POLICY IMPACT AND REPLICATION 62

1.0 INTRODUCTION AND RESEARCH OBJECTIVE 62

2.0 METHODOLOGY 63

3.0 BACKGROUND: MAYOR PLAYERS IN MICROFINANCE 64

4.0 POLICY ISSUES FINDINGS 68

4.1 Broad Policy Direction 68
4.2 The Statutory and Legal Framework 70
4.3 Regulatory Framework 73
4.4 Norms, Prescribed Systems, Procedures, Guidelines and Practices 75
4.5 Conclusion of UNCDF Policy Impact 76

5.0 REPLICATION FINDINGS 77

5.1 Expanding a Programme through Co-financing 77
5.2 Upscaling a Programme Sequentially and Private Sector Replication 77
5.3 Ad Hoc Influence and Inspiration 78
5.4 Replication in the Wider Development Community 79
5.5 Conclusion on the Replication of UNCDF Programme 80

PART 5 – UNCDF STRATEGIC POSITIONING 82

1.0 INTRODUCTION AND RESEARCH OBJECTIVE 82

2.0 METHODOLOGY 82

3.0 INDUSTRY ANALYSIS FINDINGS 83

3.1 Demand and Supply Estimation 83
3.2 Key Changes in the Microfinance Sector 85
3.3 Remaining Gaps in the Microfinance Sector 88

4.0 CUSTOMER, CAPABILITY, AND COMPARATIVE ADVANTAGE FINDINGS 89

4.1 National Priorities, UN Kenya Cooperation Frameworks and UNDP Programme 89
4.2 UNCDF's Capabilities 91
4.3 UNCDF Comparative Advantage 94

5.0 CONCLUSIONS ON STRATEGIC POSITIONING 95

5.1 Positioning in the Past 95
5.2 The Way Forward 96

APPENDIX 1: TERMS OF REFERENCE 98

APPENDIX 2: REFERENCES 101

APPENDIX 3: PEOPLE INTERVIEWED 103

APPENDIX 4: COMPARATIVE OVERVIEW OFCASE STUDY COUNTRIES 12/2003 104

APPENDIX 5: MAP 106

KENYA Project Data Sheet

Project and Project Area:

Country	Kenya
Project Title	MicroStart: Assistance to Microfinance Institutions in Kenya
Project Number	KEN/99/300/A/01/99
Project Sites:	Kenya

Project Sector and Focus

Sector	Economic Management (code010), Employment code (015)
Sub-Sector planning (014)	Employment/livelihood/policy and
	Employment Promotion (code 0120)
Primary Type of Focus:	Capacity Building, Institution Building
Primary Type of Intervention:	Promoting Poverty Eradication and Sustainable Livelihood, Enhancement of Income-earning Potential
Primary Target Beneficiaries	NGOs, Productive and Credit Associations & Organisations
Development Objective	To contribute to poverty alleviation through improved access to appropriate financial services offered by microfinance institutions on a sustainable base to low income entrepreneurs
Immediate Objective:	To strengthen the institutional, organisational and technical capacity of at least six organisations to provide microfinance services to micro entrepreneurs

Project Period

Approval Date	October 1998
Starting Date	October 1998, TSP recruited October 1999
Estimated Ending Date	September 2001, extended until July 2003

Project Execution

Executing Agent	Ministry of Planning and National Development
Implementing Agent Development	Ministry of Planning and National

Project Financing

UNDP	US$1,754,000 (budget) US$1,219,000(actual)

PART I – INTRODUCTION

1.0 Background

The Microfinance Programme Impact Assessment (PIA) is a component of the United Nations Capital Development Fund (UNCDF) Independent Insitutional Assessment (IIA) which seeks to assess whether the UNCDF has effectively implemented its new policies and whether its projects and programmes, under the main programming areas (local governance and microfinance), have had the desired impact on the individuals, households, communities and institutions that were targeted. The independently conducted impact assessments also provide the UNCDF with an opportunity to evaluate the relevance and effectiveness of the organization's operational policies *in supporting its overall goal of poverty reduction*. The assessments were requested by the UNCDF Executive Board in its decision 99/22.

The microfinance goal of the UNCDF, as stated in the organisation's Strategic Results Framework (sub-goal 2), is:

"To increase access of the poor, especially women, to financial services on a sustainable basis through strengthened microfinance institutions and an enabling environment."

Enterprising Solutions Global Consulting, a private sector international development firm specializing in microfinance and small/medium enterprise, was contracted by the UNCDF to undertake the Microfinance PIA, which is only concerned with the UNCDF's microfinance operations, as implemented by the agency's Special Unit for Microfinance (SUM). The SUM's specific objectives are:

- To increase the number of sustainable microfinance operations which provide quality financial services to poor and low-income customers, particularly women; and

- To increase the number of UNDP country offices that consistently apply international best practices in microfinance.

The Microfinance PIA seeks to assess four key impact areas: client impact, institutional sustainability, policy and replication and UNCDF positioning, based on the assessments of four "case study" countries: Haiti, Kenya, Nigeria, and Malawi.[1]

This report compiles the data gathered for the Kenya assessment.[2] It is divided into five sections:

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[1] Haiti replaced Nicaragua as an assessment country.

[2] Because of the large amount of information that underpins the overall Microfinance PIA, four Companion Reports – one per country – have been compiled as supplementary documents to the Summary Report. The country focus format serves to facilitate the dissemination of the specific information and findings of the numerous sub-reports that form this document to UNCDF/UNDP country offices as well as for use by programme officers in the Special Unit for Microfinance (SUM), based at the United Nations (UN) headquarters in New York.

Part 1: Introduction – Provides background information on the assessment, the project being assessed and the country context;

Part 2: Client Impact Assessment – Presents the four sub-reports from the quantitative impact survey, the loans and savings use studies, empowerment studies and the client satisfaction focus group discussion;

Part 3: Institutional Sustainability – Presents the CGAP appraisal of EBS;

Part 4: Policy Impact and Replication – Presents a review of evidence of UNCDF policy impact and replication in Kenya; and

Part 5: Strategic Position of UNCDF in Kenya – Assesses past and future positioning options

A summary analysis of the findings is presented in the main report

2.0 Kenya Programme Description and Accomplishments

Since 2000, MicroStart and MicroSave have been UNDP/SUM Kenya's main microfinance programs The focus of the PIA was on Equity Building Society (EBS) for the client impact and institutional assessments where it considered the UNCDF's broader role in the microfinance sector in Kenya in the policy impact and replication and strategic positioning assessments. To assist the reader, a brief overview of the programme is provided here as well. In addition, a brief description of each is given below.

2.1 MicroStart

The Kenyan Government and UNDP signed the MicroStart project document in November 1998, with an estimated completion date of September 2001. K-Rep Advisory Services (KAS) was selected and contracted by UNDP as the technical service provider (TSP) in October 1999. The programme became fully operational in April 2000, with the selection of the first two MFIs by the MicroStart Advisory Board (MAB). The project deadline was extended to July 2003.

MicroStart partnered with five MFIs: Equity Building Society (EBS), Women's Economic Empowerment Consort (WEEC), Business Initiatives and Management Assistance (BIMAS), Kenya Enterpreneurship Promotion Programme (KEPP), and (World Concern Kenya). The potential of some of the selected institutions was somewhat unclear, but decision makers were betting on MFI leadership, other potential donors, and the MFIs themselves to exploit their market niches: WEEC targeting women from a Maasai community, KEPP targeting graduates from a polytechnic institute, and BIMAS with a combination of urban and rural outreach (MicroStart evaluation; 2002).

To date, MicroStart Kenya has been funded solely by UNDP. The project document provided for a total funding of US$1,754,000 for three years, of which $1 million was allocated to capital grants, $500,000 for the TSP contract, $55,000 for a resource

centre, $60,000 for audits, evaluations and baseline studies, $95,000 for visits/training, $8,000 for policy, and $36,000 for missions and duty travel. It was later revised down to $,1219,000.

Actual expenditures fell short of the budget. Notably funds that were not disbursed/reallocated included: $55,000 for a resource centre and $30,000 for base line and impact studies

In addition, the capital grants were disbursed according to a schedule based on performance indicators. Incidentally, by the end of 2002, less than 50% had been disbursed.

2.2 MicroSave

Though the MicroSave programme was not a part of the in-depth programme assessment, it is, however, referred to in parts 4 and 5, when UNCDF's policy and replication impact and strategic positioning are assessed. For the reader's convenience, a brief overview of the programme is provided here.

MicroSave-Africa was originally conceived at a conference on savings in Kampala organised by donor members of the CGAP Working Group on Savings Mobilisation. UNCDF/SUM, on behalf of UNDP Africa, played a key role in organising the conference and providing financial sponsorship to a number of the participants. As the technical manager of UNDP Africa's Regional Programme, UNCDF/SUM, was also instrumental in launching the initial MicroSave Africa programme jointly with DFID.

Phase I of the project began in 1998 with funding amounting to $880,000 from UNCDF/SUM managed UNDP Africa funds and $148,000 of DFID funding, for a total budget of $1,028,000. The project, initially based in Kampala, conducted research and worked directly with MFIs in the three East African countries. Its dissemination activities covered other African countries and the wider microfinance community. MicroSave-Africa IIcover a three-year period from October 2000 to September 2003, with funding coming from three sources. DFID ($1.4m), CGAP ($1.4m) and UNDP ($0.5m). UNCDF/SUM was instrumental in securing the additional funding from UNDP's Regional Bureau for Africa (RBA) for the project's second phase, and currently plays an active role as a member of the Projects' Advisory and Management committees which meet on a semi-annual basis and provide managerial and technical oversight and guidance.

SUM also mobilised $0.45m in complementary resources through UNDP/RBA for a sister programme in West Africa. It is actively promoting the application of tools and techniques developed and refined by MicroSave-Africa in the francophone African context.

MicroSave-Africa II represented a significant expansion of the project's first phase in a number of ways. Its mandate was broadened to include the goal of "increasing the availability of high quality financial services for poor people" (i.e., not just savings but credit, insurance, money transfers, etc.). The purpose of the project has likewise been

broadened to "inform and build the capacity of MFIs seeking to provide high quality financial services for poor people."

MicroSave's Project Management and Advisory Committee recently approved Phase III, with funding from DFID, Norway, CGAP and UNDP Africa.

3.0 Country Context

3.1 Demographic and Social Indicators

Situated on the equator of Africa's eastern coast, and bordered by Somalia, Ethiopia, Tanzania, and Uganda, Kenya has been described as "the cradle of humanity". In areas of the Great Rift Valley, palaeontologists have discovered some of the earliest evidence of human ancestors. Kenya covers a total of 582,650 sq. kms and consists of the following administrative regions: seven provinces – Central, Coast, Eastern, North Eastern, Nyanza, Rift Valley, Western and one area – Nairobi Area.

It has a total population of 31 million (UN 2002) which has been growing at a rate of 1.53% per year (2000 est.). The population is made up of over ten ethnic groups; the major ones include the Kikuyu (22%), Luhya (14%), Luo (13%), Kalenjin (12%), Kamba (11%), Kisii (6%), and Meru (6%). Kenya's ethnic diversity has produced a vibrant culture but, at times (for instance, during the period leading up to the elections) this diversity has also been a source of conflict.

Kenya's official languages are English and Kiswahili, although numerous indigenous languages are also spoken. Historically, Kenya has had relatively high human development indicators, compared to other countries in Africa. However, by the mid-1990s, Kenya, had lost some of its advantages as its physical, economic and social infrastructure have all been drastically reduced (see Table 1), and poverty-related diseases, such as cholera, began to surface.

The HIV/AIDS situation is a national disaster. Kenya is estimated to have the ninth highest prevalence of HIV in the world, with about 14% of the adult population infected. There are an estimated one million orphans in the country, which represents only a fraction of the population of children affected by AIDS. This includes children who have been withdrawn from school to care for the sick, those in families caring for orphans, and those who have become breadwinners to replace the income of a sick family member. As such, HIV/AIDS has significantly affected the Kenyan economy, with resources being taken from other economic activities to fight the epidemic.

3.2 Macroeconomic Context

For nearly two decades after gaining its independence in 1964, Kenya was poised to be an African success story. With GDP growth rates averaging 6.5% per year, the economy was buoyant, investor confidence was high, the international community was generous in its support, and agriculture and trade thrived. In 1991 interest rate controls were abolished and in 1993 foreign exchange controls and regulations were repealed.

Public mismanagement and deep-rooted, "institutionalised" corruption, however, caused poverty rates to rise from 48% at the start of the 1990s, reaching 56% by the end of 2002, a period during which global poverty rates decreased. By 2002, the Kenyan economy was growing by only 1.1%; primary education enrolment rates fell to 82% by 1995 after peaking at 91% in 1989; and the infrastructure had deteriorated dramatically (see Table 1).

Table 1: KENYA – KEY INDICATORS

Poverty (2002)	Kenya	Sub-Saharan Africa	Low-income
GNI per capita (Atlas Method, US$)	360	450	430
GNI (Atlas method, US$ billions)	11.3	306	1,072
KEY ECONOMIC RATIOS AND LONG-TERM TRENDS			
Average annual growth	1992-02	2001	2002
GDP	2.1	1.1	1.8
GDP per capita	-0.4	-1.0	-0.2
% Change	1992	2001	2002
Consumer prices	27.3	3.9	5.0
Implicit GDP deflator	17.5	11.3	4.9
Overall surplus/deficit (% of GDP, incl. current grants)	-3.3	-0.9	-0.9
Conversion rate *(local/US$)*	32.2	78.6	78.7

Source: World Bank website, KENYA At A Glance

The last *Country Assistance Strategy*, which focused entirely on governance and reform, was produced in 1998. However, continued poor performance resulted in both the World Bank and the IMF suspending disbursements in 2001. Today, there is optimism that the recent elections which brought in a coalition of parties, called the National Rainbow Coalition (NARC), headed by Mwai Kibaki, will bring change. The new president was elected on an anti-corruption platform and government clean-up has been a cornerstone of policy development thus far.

By the end of 2002, Kenya's banking system consisted of 55 banks and three non-bank financial institutions (NBFIs), including two mortgage finance companies. There are also four building societies and 48 foreign exchange bureaus. The four largest banks account for over 55% of gross assets within the system and a similar share of deposits. Two of the four, the Kenya Commercial Bank (KCB) and the National Bank of Kenya (NBK), are partially Government-owned, although the divesture of the government's 35% equity stake in KCB to an "anchor" investor is slated for the short-term. The other two banks are primarily foreign-owned (Barclays Bank and Standard Chartered). The majority of the smaller banks are family-owned and operated.

3.3 Financial Sector

Kenya has a relatively well-developed banking sector, supervised by the Central Bank of Kenya (CBK). The NBFIs operate like banks, except that they are not permitted to accept demand deposits. Many of the NBFIs were created as bank subsidiaries during the statist era of interest rate controls, in order to circumvent ceilings on bank lending rates. The sector consolidated after interest rates were liberalised in 1991 and

following the order came from the Central Bank that the numerous indigenous NBFIs either had to convert into commercial banks or merge with banks. In 2003, the number of financial institutions was further reduced by two, when one bank was put under statutory management and another was liquidated.

Table 2: Kenyan Financial Sector Entities

Types of Institutions	June 2002	June 2003
Commercial Banks	46	43
a) Operating Banks	45	42
b) Under Central Bank statutory management	1	1
Building Societies	4	4
Mortgage Finance Companies	2	2
Non Bank Finance Companies	3	2
Total	55	51
Foreign Exchange Bureaus	48	48

Source: Central Bank of Kenya

The market is dominated by the four largest banks which lend primarily to the largest corporations and the Government, mainly through the large scale purchase of treasury bills. The banking sector is plagued by mounting non-performing assets – high average NPL (at 29.4% in May 2003 from 29.8% in May 2002) – which have slashed their net worth.

Interest rate spreads are high in Kenya, depressing both savings and investments, while economic potential in both the productive and financial sectors is reduced . Though interest rates have generally fallen over the past few years, they still average around 15%. Although large banks show a narrower interest margin compared to the small banks, their proportionately high fees and commission income implies higher effective interest rates and a wider effective interest margin. Furthermore, large banks have proportionately higher government securities in their portfolio, which cushions their income from losses on loan income. On the other hand, small banks maintain a wider interest margin as they face a higher credit risk, higher exposure to interest fluctuations and a lower competitive edge in the market. As foreign controlled banks offer lower interest rates, they maintain wider spreads.

3.4 The Political Situation

After gaining independence from Britain in 1963, the political control of the country was dominated by Jomo Kenyatta. In 1978 Daniel Arap Moi succeeded Mr. Kenyatta and remained in power for 24 years. The country was a de facto one-party state from 1969 until 1982 when the ruling Kenya African National Union (KANU) made itself the sole legal party. Moi finally acceded to internal and external pressure for political liberalisation in late 1991. Nevertheless, the ethnically fractured opposition failed to dislodge the KANU from power in the 1992 and 1997 elections , both of which were marred by violence and fraud, but are viewed as having generally reflected the will of the Kenyan people. President Moi stepped down in December 2002 following fair and peaceful elections. Mwai Kibaki, who ran as the candidate of the multiethnic, united opposition group, known as the National Rainbow Coalition, defeated the KANU candidate, Uhuru Kenyatta, and assumed the presidency. Despite its outwardly democratic appearance, Kenya remains high on the international corruption tables. As a result, key donors have been unwilling to release much-needed aid. President Kibaki has pledged to tackle the corruption problem.

PART 2: CLIENT IMPACT ASSESSMENT

1.0 Introduction

Client Impact Assessment research was one of the key areas for evaluation and analysis for the UNCDF PIA for Microfinance. While the case study MFIs in the other Mircofinance PIA countries assessed – Haiti, Nigeria and Malawi – participated in a quantitative survey based on the SEEP/AIMS impact methodology, the Equity Building Society (EBS) in Kenya opted against the quantitative study. Instead, EBS offered to embed the key impact indicators within their qualitative market research program, with the goal of acquiring similar information from clients, albeit through a different method. As a result, not all evaluation questions could be answered in the same manner for Kenya as for the other countries. On the other hand, the methodology provided more information in other areas.

2.0 Client Satisfaction Focus Group Discussions

I. Introduction and Background

From June 4th to June 20th and July 7th to 9th, 2003, the EBS market research team conducted a total of 23 focus group discussions (FGDs), using six of the MicroSave Africa tools, with clients from nine EBS branches: Kerugoya, Kangema, Murarandia, Thika, Tom Mboya, Kangari, Corporate, Fourways, and Othaya (see Table 1).

II. Research Objective

The objective of this exercise was to understand the nature, scope and depth of the impact that EBS services had on the lives of its clients, with a focus on the following topics.

Individual-Level Impacts

- Access to financial services, especially by women;
- Empowerment;
- Client satisfaction; and
- Client recommendations.

Household-Level Impacts

- Household income;
- Poverty alleviation;
- Household expenditures;
- Household asset acquisition; and

- Household welfare (food security, education, type & frequency of coping strategies, access to & use of health services).

Enterprise-Level Impacts
- Enterprise returns; and
- Enterprise assets.

Table 1:. Summary of Group Exercises Conducted with EBS Clients

	Branch	Number of Participants	Group Composition
	Focus Group Discussions		
1	Kerugoya	10	Mixed gender SME owners
2	Kangema	19	Women's group
3	Murarandia	6	Women SME owners
4	Murarandia	N/A	SME owners; majority small scale tea farmers
5	Thika	9	Women SME owners
6	Tom Mboya	10	Mixed gender SME owners
7	Tom Mboya	8	Mixed gender salaried workers
8	Kangari	11	Business women
9	Corporate	10	Mixed gender SME owners
10	Fourways	N/A	N/A
	Product Attribute Ranking		
11	Tom Mboya	N/A	N/A
12	Kangema	10	N/A
13	Kangari	11	N/A
	Household Cash Flow Analysis		
14	Tom Mboya	N/A	Mixed gender SME owners
15	Murarandia	11	Women's group
	Lump Sum Cash Needs over Time		
16	Kerugoya	8	N/A
17	Kangema	9	N/A
	Seasonality Calendar		
18	Kerugoya	10	Mixed gender business people
	Time Series of Assets Acquisition		
19	Othaya	11	Mixed gender SME owners
	Time Series of Crisis		
20	Fourways	N/A	Mixed gender SME owners
21	Thika	28	Women SME owners
22	Kangema	N/A	Mixed gender SME owners
23	Tom Mboya	N/A	Mixed gender SME owners

III. Methodology

MicroSave-Africa focus group discussions (FGDs) and Participatory Rapid Appraisal (PRA) tools were used to address the research questions. Both are qualitative research methods that use a participatory format designed to understand issues affecting clients in greater depth and complexity than typically possible using quantitative survey methodology. The disadvantage of the research methodology used (and which is true for most qualitative research) is that in achieving depth, it sacrifices both breadth and the ability to be representative. However, the possibility of achieving a more in-depth, complete and nuanced understanding of the research issues is considered by many researchers to be worth the tradeoff.

Another limitation of this approach is that the actual implementation does not always match the research objectives. In this case, although EBS offered to embed the key impact indicators within their qualitative market research program, the output was less than desired, even though on-site monitoring of the research did take place. As a result, the analysis that follows represents an attempt to draw inferences from the information collected, presenting general conclusions based on the results of the exercises. Given the non-representative nature of qualitative research, only information for which there appeared to be general agreement across groups and exercises is presented and analysed. In particular, findings related to the use and value of loans and savings from EBS in household livelihood and coping strategies (meeting cash flow needs related to common household needs, large expenditures, and emergencies) are quite robust.

IV. Tools and Techniques

The focus group and PRA tools used were adapted from the MicroSave-Africa market research tool kit. The following tools were implemented by EBS staff members, each of whom completed a comprehensive training course given by MicroSave Africa on the use of the tools.

Focus group discussion: This technique engages a group of individuals in a semi-structured discussion on specific issues in order to obtain client information for the MFI. It is used to discuss a wide variety of issues pertaining to the clients' needs, wants, experiences, loan and savings utilization, perceptions, satisfaction, recommendations, etc.

Time series of crises (current year, previous year, 5 and 10 years before): This tool provides an opportunity to learn about typical crises experienced by clients over a period of time and the typical response to that crisis. It allows the research team to integrate key experiences into the community profile, which helps to simplify problem identification; and to design and organise the range of opportunities for the improved delivery of financial services.

Time series of asset ownership (current year, previous year, 5 and 10 years before): This tool is useful in determining which "productive" and "protective" assets clients value the most. This information can then be used to design or refine the corresponding financial products to assist clients in acquiring assets. This tool also lends itself to identifying the changing patterns of asset ownership among clients for the time period under discussion.

Seasonality of household income, expenditure, savings and credit: This tool is used to obtain information on seasonal income and expenditure flows as well as the demand for credit and savings services. It provides insight into some of the risks and pressures faced by clients and how they use the MFI's financial services to respond to them. The tool also provides insight into the financial intermediation needs of the broader community and possible products the MFIs can design to meet these needs.

Lump sum cash needs over time: This tool is used to determine which of the events require lump-sums of cash; to examine their implications for household income/expenditures; to establish current coping mechanisms; and, finally, to discuss how access to the

MFI's financial services can help meet the clients' needs. The information gathered is useful in designing financial products to match the needs that emerge during a person's life cycle.

Product attribute ranking (PAR): This tool is used to rank the attributes of the products offered by an MFI in order to establish client preferences and design appropriate products and services.

Relative preference ranking: This tool is similar to the PAR except that the MFI's product attributes are compared to the attributes of similar products offered by competing MFIs.

Household cash flow analysis: This tool is used to identify the major sources of household cash-flow needs and how clients meet those needs. It is also used as a first module to train clients in financial literacy.

V. Results Analysis and Main Findings

Household-Level Impacts

Unfortunately, none of the group exercises explicitly discussed the issue of household level impacts. Therefore, evidence for household impact was inferred from other discussions and contexts.

Household Income: The Asset Acquisition Over Time exercise found that financial services may have contributed to higher household income by demonstrating a strong upward trend in spending on household goods and schooling. Participants attributed this increase to several factors, the most important of which were higher incomes, improved socio-economic status, and a greater propensity to save. They did not, however, indicate the role EBS, or broader access to financial services, might have played in increasing incomes, so it is difficult to make a plausible, accurate association between the increase in household income and expenses and the financial services provided by EBS.

Poverty Alleviation: One potentially positive piece of evidence in terms of poverty impact is the consistent theme that EBS clients use loans and savings for a wide variety of purposes (e.g., school fees, enterprises, land investments, house repairs, rent, medicine and other health care, asset acquisition, etc.). It is clear from these FGDs that access to loans and savings through EBS provides clients with an important and highly valued mechanism to meet household cash flow needs and cope with emergencies. Given that one of the primary manifestations of poverty is vulnerability (and often extreme vulnerability) to cash flow shocks, the multiple ways in which EBS clients use their loans and savings demonstrates how EBS products help them to manage risks and to meet household cash flow demands. While this does not necessarily represent a "movement out of poverty," EBS nonetheless contributes to poverty alleviation by helping its clients to cope with one of the primary manifestations of poverty and by cushioning against its effects.

It should be mentioned that EBS offers financial services to a wide range of clients, not only the poor. UNCDF/SUM is one of the support agencies that does not want to be limited to only supporting MFIs that focus exclusively on the poorest of the poor because, in the end, the expansion of services to those reagrded as "poor" is generally necessary to ensure sustainable institutions. If MFIs opt to service a variety of people from different income groups, ranging from the poorest through to lower middle and middle income groups, they are able to advance more quickly towards sustainability, thereby enabling a faster expansion to poorer individuals. What is significant to note is that EBS has downscaled dramatically over the years (see part 3), and currently serves a poorer segment of the population than it has in the past.

Household Expenditures: Possible evidence of the impact MFIs on household expenditures can be seen from the upward trend in spending on household goods and education, as identified in the Asset Acquisition over Time exercise. In addition to higher incomes (see above) participants attributed part of the increased spending to an improved savings culture (or the propensity to save). To the extent that EBS has contributed to an improved savings culture through offering liquid, safe, flexible, and accessible savings mechanism, it can be argued that it has contributed (an undetermined amount) to the trend in increased household consumption identified by group participants.

Other evidence for impact on household expenditures can be inferred from the multiple ways in which EBS clients use their loans and savings. While not evidence of impact in the traditional sense (e.g., an increase in household expenditures due to increased household income resulting from program participation), it demonstrates that loans and savings are used for a variety of expenditures that help clients meet cash flow needs, cope with emergencies, invest in productive activities, and invest in their own and their children's future.

EBS clients used loans for a variety of purposes as identified below (in no particular order):

Investment in Productive Activities

- To invest in business inventory;
- To invest in business start-ups; and
- To pay business salaries.

Investment in the Future

- To spend on school fees; and
- To pay medical costs.

Household Cash Flow Needs

- To pay rent.

Coping Needs:

- To cope with natural crises (e.g., meet immediate cash flow needs, replace lost assets, rebuild damaged property, compensate for lost income);
- To cope with AIDS/sickness (e.g., compensate for lost income, meet daily cash flow burdens, pay for medical care); and

To cope with death (e.g., to pay for funerals and related expenses, etc.).

Savings are used by EBS clients in a number of ways. The most common responses are identified below (in no particular order):

Investment in Productive Activities
- To invest in business inventory;
- To invest in business start-ups; and
- To repay enterprise loans.

Investment in the Future
- To invest in children's schooling; and
- To invest in children's university education.

Investment in Assets
- To purchase plots of land;
- To build a house;
- To purchase a house; and
- To purchase household assets (e.g., appliances, furniture, electronics).

Coping Needs
- To set aside cash for emergencies (insurance);
- To pay for marriage expenses, including dowry;
- To cope with natural crises (e.g., meet immediate cash flow needs, replace lost assets, rebuild damaged property, to compensate for lost income);
- Cope with AIDS/sickness (e.g., compensate for lost income, meet daily cash flow burdens, pay for medical care);
- To cope with death (e.g., to pay for funerals and related expenses, etc.); and
- To pay for medical costs associated with sickness and injuries.

One might reasonably infer from the above lists that access to EBS loans and savings provides clients with additional, efficient, and relatively low-cost financial alternatives (relative to other options) that meet a wide variety of cash flow needs.

Household Assets: In the Times Series of Assets Acquisition exercise, clients identified rising trends in household asset acquisition over the past ten years. Clients also mentioned that the number of people in their communities opening bank accounts had increased significantly over the last decade, and particularly over the last few years. It is reasonable to infer that EBS has played a role, albeit undefined, in this trend. In other group exercises (e.g., Time Series of Crises, Household Cash Flow Analysis, Lump Sum Cash Needs over Time, Seasonality Calendars) clients repeatedly mentioned how they used EBS loans or savings to pay for many of the assets identified in the Time Series of Assets Acquisition exercise.

While it cannot be inferred from the group exercises that increased asset acquisition is a function of increased household income resulting from programme participation (as typically hypothesised in impact studies), it can be claimed that increased household asset acquisition is owed directly to the use of loans and savings to acquire assets. What remains unclear is whether or how clients would have acquired these assets

without loans and savings from EBS. However, the weight and context of evidence from the group exercises strongly suggests that loans and savings from EBS were integral to the clients' ability to purchase household assets at higher levels than possible previous to their participation in EBS.

Tangible assets acquired by EBS clients through use of EBS loans and services, as mentioned during the FGDs, include:

Household goods, including: appliances, furniture, and electronics;
Home purchase and home construction;
Home improvements;
Land; and
Means of transportation, including: cars, bicycles, and motorcycles/scooters.

Household Welfare: The most robust finding to emerge from all of the group exercises was the central role played by financial services (and EBS in particular, one assumes) in clients' livelihood and coping strategies. In five of the seven group exercises (Household Cash Flow, Lump Sum Cash Needs over Time, Seasonality Calendars, Time Series of Assets Acquisition, and Time Series of Crises), clients identified the ways in which they used loans and savings from EBS to meet household cash flow needs. Whether coping with cash flow shocks, meeting day-to-day needs, or investing in the future, the evidence suggests that loans and savings from EBS play an important role in all these activities. This finding suggests that participation in EBS can and does enhance the overall household welfare of clients.

Loans and savings are used to finance a variety of welfare-enhancing activities, including:

Setting aside cash for emergencies (insurance);
Coping with natural crises (e.g., meet immediate cash flow needs, replace lost assets, rebuild damaged property, compensate for lost income);
Coping with AIDS/sickness (e.g., to compensate for lost income, to meet daily cash flow burdens, to pay for medical care);
Coping with death (e.g., to pay for funerals and related expenses, etc.); and
Paying for medical costs associated with sickness and injuries.

The use of loans and savings is frequently discussed within the context of payment/investment in children's school expenses, as well as for higher education. Education repeatedly emerges as one of the most important expenditure items (cash flow needs), both in terms of its importance to the future of clients' children and also in terms of the size of the related cash flow demands. The use of loans and savings appears to be a crucial part of household strategies to pay for education costs.

It should be noted that use of loans and savings is just one of many coping strategies used by EBS clients. In fact, clients identify spousal salaries as the most important coping mechanism within the household. It should be noted that EBS loans and savings are often supplemented by using the financial services of other financial providers such as SACCOs, where EBS clients continue to borrow and place savings. The importance of EBS relative to these other coping strategies and sources of

financial services is unknown. The group exercises revealed that clients continue to patronise other financial service providers at a fairly high rate. One might infer from this that EBS fails to satisfy client demand for the whole range of financial services which implies, in turn, that its impact on clients is not as significant as it might otherwise be. Thus, while the evidence from the group exercises points to a positive impact of EBS loans and savings on client household well-being, the actual size of this impact is indeterminate. The most that can be said is that use of EBS loans and savings appears to be an integral component of a "portfolio" of livelihood and coping strategies used by EBS clients.

Enterprise-Level Impacts

None of the FGDs explicitly discussed the issue of enterprise level impacts. Therefore, evidence for enterprise impact was inferred from other discussions and other contexts.

Enterprise Returns: Indirectly, the most appropriate way to assess enterprise-level impacts is to point to the fact that clients indicated that they used business proceeds to meet a variety of household cash flow needs, including:

- To pay for medical costs due to injury or illness;
- To purchase cars and motorcycles;
- To purchase food and clothes;
- To finance university education;
- To support dependants; and
- To purchase cows.

The fact that clients identify business proceeds as an important coping mechanism might be interpreted as evidence that their businesses are generating positive returns; that is, using business proceeds to meet household cash flow needs implies positive enterprise returns. Unfortunately, the information from the group exercises does not allow for a reasonable guess about the extent to which EBS loans contribute to positive enterprise returns.

Enterprise Assets: The information from the group exercises does not allow us to address this issue either.

Does participation in UNDCF-supported microfinance programs lead to increased creation of non-family full-time paid jobs? This will be asked only for programs that had job creation as an explicit objective (as per Project Document)

The information from the group exercises does not allow us to address this question.

Individual-Level Impacts

Increased Access to Financial Services: It appears that EBS has enabled increased access to financial services by the poor as corroborated by the following:

According to the Time Series of Assets Acquisition exercise, the number of people in Kenya with bank accounts has increased significantly over the past ten years. Although

the exercise did not explicitly address the issue of gender and access to back accounts, it can be inferred that a substantial number of poor women have benefited as they represent many of EBS' clients as well as those of many of the microfinance providers in Kenya

A repetitive theme in many of the exercises was that clients use savings and loans to meet a wide variety of household cash-flow needs. Although the specific issue of gender was not raised in the related FDGs, it is apparent from the context of the discussions that the above is generally true among both female and male clients lending support to the inference that these conclusions apply to women as well as to men.

Women's access to EBS, however, appears constrained relative to their potential access because of EBS collateral requirements. This concern was raised repeatedly during the FDGs, together with the suggestions that EBS accept chattel as collateral or introduce group loans that rely on "social" rather than physical collateral. Furthermore, many women lack the capital necessary to start a business and would benefit from EBS offering start-up loans.

Client Empowerment:

> Does participation in UNCDF-supported microfinance programs lead to increased control over resources by women?
>
> Does participation in UNCDF-supported microfinance programs lead to increased income contribution by women to the household?
>
> Does participation in UNCDF-supported microfinance programs lead to increased self-esteem, the ability to negotiate and an increase in decision-making power on the part of women?

There is no relevant data to allow us to address any of the above-mentioned questions.

Client Satisfaction: Group participants mentioned several sources of satisfaction and dissatisfaction with EBS.

Source of Satisfaction:
EBS management and staff received overall high marks with participants viewing them as friendly, willing to listen, and helpful.

Participants also appeared pleased with the speed, efficiency, and convenience of EBS services. This includes both the time required to conduct business in the branch offices and the speed with which products and services are dispensed.

Two groups mentioned that they liked the variety of products EBS offered. Specific aspects of the EBS products and services they liked include:
Flexibility in rescheduling loans (one group mentioned in particular that it appreciated that EBS does not repossess land quickly but instead first tries to find a way to work out the repayment of the loan).

Payments against uncleared cheques:

- No limits on savings withdrawals;
- Affordable ledger fees; and
- Long opening hours.

Sources of Dissatisfaction:

Participants raised several concerns about service delivery quality, particularly:

- Poor customer service at times;
- Lack of offices in rural or other marginal areas;
- Lack of technology (ATMs), which limits outreach and, at times, imposes high transaction costs; and
- Failure to keep commitments/promises made to clients. A number of participants raised this issue; in particular some mentioned that the deduction of loans from the proceeds of tea sales is not done as agreed upon by EBS and that loan recovery should be done according to the agreement and not to fully recover the annual tea proceeds.

EBS compared favorably to informal lenders and SACCOs on overall customer service, minimum balance requirements, notice on withdrawals, and security/stability. In contrast, clients compared EBS unfavorably to commercial banks on overall customer service, length of queues/waiting times, public relations, and trust placed in customers.

Client Recommendations:

Clients offered several recommendations to improve EBS products and processes as listed below. The recommendations are clustered under product attributes, service delivery attributes, information and institutional strategies to facilitate analysis but appear in no particular order.
Product Attributes:

Loan terms, in particular loan size and loan repayment period: Clients suggested that EBS increase loan amounts, with subsequent borrowings and repayment of previous loans, as well as increase loan repayment periods.

Security and collateral requirements: This topic was raised in several of the group exercises. The specific concern was that EBS's current collateral policies discourage borrowing by women and poor clients, as discussed above. To remedy this, clients suggested that EBS:

- Allow borrowers to pledge chattel as collateral;
- Offer group loans using group-based social collateral instead of physical collateral; and
- Offer start-up loans.

Interest Rates: There was near universal agreement among group participants that interest rates were too high and should be reduced, even though EBS prices are relatively competitive and has been reducing its interest rates.

Charges: It was recommended that EBS reduce the LACE charges.

Loan Products: It was recommended that EBS enhance its menu of products by introducing new loan products such as auto, home and medical loans as well as emergency loans.

Service Delivery Attributes:

Service Quality: Improve speed and efficiency by increasing personnel in order to better accommodate peak times, hire more credit officers, and provide customer service representatives and counters to accommodate cash deposits or bulk transactions.

Information:

Information Dissemination: As awareness of the full range of EBS products and services is not uniform, clients recommended that EBS supply more and better information about its product and service offerings. According to some participants, one reason many EBS clients continue to borrow money from other banks or informal lenders (SACCOs, merry-go-rounds, shylocks, etc.) is because they lack information about how EBS products might meet their varied financial needs.

Transparency of Rates and Fees: Participants also mentioned that clearer explanations and more transparency about the basis for interest rates and fees would help to reduce misunderstanding and confusion by clients on requirements and payments.

Institutional and Outreach Strategies:

1. More Effective Promotion of EBS: Several participants mentioned that EBS does not do enough to reach out to the community or promote itself or its products. Specific recommendations to remedy this were: i) promote savings products more aggressively ii) advertise through more media outlets iii) participate more in community activities, and iv) provide incentives for current clients to bring new clients into the bank.

2. Market Outreach: Clients would like EBS to take actions to expand its services to rural and other marginal areas. Specific recommendations were to open a mobile bank or to expand branch networks to cover these areas.

VI. Conclusions

The most obvious finding is the wide-ranging use of EBS products and services by its clients. Clients appear to use the financial services for production (business) and consumption purposes. Specifically, loans and savings are used to finance productive activities such as business expansion and new businesses; household expenses such as children's tuition fees and rent; coping with crises such as death and sickness, loss of job by family member etc.. Either directly or indirectly (through the investment of loans and savings in business and the surplus generated therein), financial services are

used to acquire household assets ranging from appliances and furniture to land and vehicles (cars and motorcycles). In an indirect way, one can detect a rise in household income among EBS clients but there is no way to establish a plausible association between the rising incomes and EBS' role.

Although 31% of EBS borrowers are women, one of the features of EBS is the difficulty in accessing loans for female clients who often lack the collateral required by EBS to obtain a loan. As a building society, EBS is operating on the fringes of its license, and making non-collateralised loans to poor women is difficult. EBS is in the process of applying for a commercial bank license that could remove this impediment and allow it to offer a full range of its products to poor women. In the interim, it has worked with WEEC to intermediate in areas that it cannot reach, providing Kshs 10 Million to date for WEEC to on-lend.

Overall, clients appear to be satisfied with the management and staff, as well as the efficiency, variety and general terms of EBS services. Clients would like to see an improvement in outreach/accessibility in rural areas, more transparency regarding the costs to be incurred when a client accesses the products and customer service. Clients suggested many improvements to EBS in terms of product and process attributes, some of which were on increasing the loan repayment period and reducing interest rates and other charges such as LACE, outreach strategies to reach more clients and more accessibility in rural areas, as well as information and transparency of products and costs for clients.

It would have been useful to corroborate these findings with a quantitative impact survey targeted at understanding the impact effects of EBS rather than the market research and product development information delivered by EBS.

PART 3 – INSTITUTIONAL ASSESSMENT OF EQUITY BUILDING SOCIETY

Introduction

This institutional appraisal was conducted in September 2003 by Enterprising Solutions Global Consulting, LLC. The purpose of the appraisal was to assess the institutional and financial sustainability of Equity Building Society and to investigate the impact of the UNCDF/UNDP MicroStart support to EBS since 2000. The review was part of a larger Programme Impact Assessment (PIA) exercise, selecting programmes in four countries as "case studies" to assess the impact outcomes and indications of UNCDF's microfinance programme interventions. These findings feed into a subsequent Organisational Performance Assessment (OPA), which will assess UNCDF's organisational effectiveness, efficiency, relevance and sustainability in formulating and managing its microfinance programmes. The appraisal was carried out using the CGAP Appraisal format, the field standard for appraising institutions (as opposed to rating them). This method is particularly appropriate for MFIs involved in doing appraisals themselves, as it is a relatively easy performance assessment tool in that it utilizes an Excel spreadsheet that can be easily learned by MFI staff.

The additional components added to this review focused on gender and the technical assistance provided under the MicroStart program. For a comparative analysis of Equity's performance with other institutions, the reader can refer to the data presented in the MicroBanking Bulletin.[3]

The intended audience for this document is the UNDP country office, UNCDF staff and indirectly the Executive Board as the assessment is part of the broader UNCDF global Program Impact Assessment. Equity staff, Board and donors are obviously part of the audience, though Equity has now gone through a number of institutional assessments and has been rated by Planet Finance. Nevertheless, this appraisal took place at a critical time for Equity, and management was genuinely interested in hearing the appraisal team's opinions.

[3] http://www.mixmbb.org

Acknowledgements

Enterprising Solutions would like to express our deep appreciation to Equity staff and board members for their assistance during our mission. Everyone, from the executives to the branch staff, accommodated the demands of the appraisal team, answering our many questions with openness and patience. Whenever possible, documents were presented without hesitation, reflective of the transparency we found in Equity's operations, their analysis of past decisions and their plans for the future. The team would like to especially acknowledge James Mwangi, who gave us many of his precious hours. Last but not least, we wish to thank UNDP and UNCDF for giving us this opportunity to undertake the assessment.

1.0 Executive Summary

1.1 Key Data

Table 2: Summary of Key Data

		ACTUAL			PROJECTED	
		Dec – 01	Dec - 02	Jul - 03	Dec - 03	Dec - 04
1.	Number of active loans	16,883	41,503	61,531	69,000	112,000
2.	Total outstanding loan balance (US$)	10,905,824	15,445,344	18,832,572	24,386,667	35,480,000
3.	Average loan balance (US$)	646	372	306	274	326
4.	Number of voluntary savings clients	105,987	155,883	183,000	215,000	283,000
5.	Total balance of voluntary savings accounts (US$)	20,470,108	27,820,328	34,567,396	39,253,333	51,866,666
6.	Loan loss rate	1.8%	2.55	0.1%		
7.	Portfolio-at-risk_delinquency rate (more than 30 days late)	0.0%	8.5%	5.6%		
8.	Administrative efficiency	26.4%	24.6%	22.9%		
9.	Portfolio yield	28.4%	29.6%	25.2%		
10.	Operational self-sufficiency	122.1%	132.8%	148.7%		
11.	Return on assets	4.1%	5.6%	7.5%		
12.	Adjusted return on assets	2.3%	1.6%	-2.9%		
13.	Year-end free market exchange rate	78.6	77.0	75.0		
14.	Per capita GDP (US$)	318	351	360		

1.2 Summary of Major Conclusions and Recommendations

The Equity Building Society provides loans and saving services to over 183,000 Kenyans via 13 branch offices. Both its deposits and loans have grown steadily, by over 25%, over the last four years. Its profitability, high ratings and positive external evaluations during this period reflect the institution's ability to manage growth while at the same time upgrading its technology.

This period coincides with two UNDP support initiatives, i.e., MicroStart and MicroSave-Africa. The report "Understanding the Re-birth of Equity Building Society in Kenya" states that, "in terms of quantitative and visible impact, perhaps MicroStart's partnership in helping to establish Equity's MIS could have had the greatest impact. This particular development assistance could be seen as a truly strategic contributor to Equity's overall, albeit recent success."

Subsequently, the improvements in EBS's product development and demand driven orientation have made EBS an extremely popular institution.

This year, Equity rolls out its new corporate structure complete with a new Chief Operating Officer and eight new middle managers. This is a dramatic shift from the small executive team that has led Equity through its recent success period. The new structure will be accompanied by an improved IT infrastructure, redesigned policies and procedures, as well as remodeled offices. Additional capital has been secured through a new institutional shareholder and Equity is laying the ground-work to transform themselves from a building society into a commercial bank.

This proposed restructuring will enable Equity to achieve its aggressive growth targets for the coming three years, as reflected in the business plan. The Board of Directors continues to play an active role in leading the institution and has approved a detailed business plan to guide management through this new phase.

Since 1999, Equity has set its sights high and has imbued staff with the vision of becoming not only the biggest, but the best microfinance service provider, as evidenced in the repeated goals of becoming "the provider of choice" and reaching one million borrowers within the next five years. While the likelihood of reaching this figure may be questionable, the sentiment conveys the sense that growth is as much a part of Equity as customer service.

The new corporate structure is just taking shape. Most positions have been filled, though managers are not assuming their full responsibilities just yet. As a result, it is difficult to draw conclusions as to the system's efficacy. However, one area which has not yet received sufficient attention from management is addressing the possible downside to restructuring. Specifically, staff who once had access to the executives and who now must go through a middle manager could feel disgruntled. New policies, procedures and technology which decrease the ability of those responsible for customer service, such as the branch managers, to be flexible could hurt both employee and customer morale. Customers may feel that the personalised service they have come to expect from Equity has been replaced by a more centralised decision

making process. For example, credit scoring technology will make loan processing much more efficient and decrease costs, but customers will have much less recourse to persuade managers to change decisions. Likewise, credit officers and branch managers may feel that their role has become nothing more than a "rubber stamp" or a compliance officer. This personal dimension to restructuring must be taken into account if Equity is to retain the high level of staff and customer commitment to the institution.

The following recommendations will ensure Equity's continued success throughout and beyond the restructuring:

1. *Appoint a transformation project manager*. Management is already considering hiring a change manager, but it is recommended that a project manager be appointed to track the progression of the activities outlined in the business plan. This would be an interim position for a period of 18-24 months. The individual hired would report to management on progress towards the successful implementation of the business plan objectives. By that time the department managers should have developed performance monitoring systems to take the place of the project manager.

2. *Design and implement a comprehensive risk management strategy*. Planned strengthening of the internal audit function will contribute to improved risk management. However, the board should increase its attention to risk management in all areas, especially the new risk present in an IT-dominant environment and the increased risk of fraud as the personnel profile changes as more employees are hired.

3. *Ensure business plan guide operating plans*. The new business plan was only approved in August 2003 and has yet to be communicated fully to staff. For Equity to achieve its objectives, the plan must incorporate each branch and department's operating targets. This will be particularly important as the new departments integrate themselves into Equity's operations.

4. *Implement a policy of writing off non-performing loans*. Currently, all loans are secured and there have been very few instances of Equity liquidating a security. However, there is a need for a clear policy. With the coming introduction of non-secured lending, writing off bad debt will be an important part of asset and liability management.

5. *Closely monitor the administrative cost ratio*. The current administrative cost ratio of 24% is relatively high, although this can be explained by rapid growth. Management should monitor this indicator carefully to avoid having a negative impact on profits.

2.0 Institutional Factors

2.1 Legal Structure

As the name implies, Equity Building Society was registered in 1984 under the Building Societies Act. From its inception, Equity has pushed the limits of this legislation by accepting deposits and offering loans unrelated to mortgage banking. In fact, it was a microlender years before management even knew what "microfinance" was. However, it has acted with the implied consent of the Central Bank of Kenya

(CBK) and over time the Act has been amended to bring it more in line with the types of practices carried out by Equity. As a building society, however, Equity is prevented from offering certain services including chequing, current accounts, international transactions and offering unsecured loans. To position itself for significant expansion, Equity will seek a change in registration from a Building Society to a commercial bank over the next two years. Because Equity is already supervised by the CBK as a Building Society and, in recent years, has increased its capital to exceed the minimum capital requirement for a commercial bank, this transition should be fairly straightforward.

2.2. History

Equity Building Society was started in 1984 by Chairman Peter Munga and four friends who saw an opportunity in the relaxation of rules governing financial institutions in Kenya. By 1986, Equity had grown to five branches and appointed experienced executive John Mwangi as CEO. But the institution was financially unstable. Equity, which had had 20 staff members who worked hard to ensure its survival as other institutions were failing amidst a stagnant market and corruption. During these challenging times, only the CEO and Chairman remained on the board. In 1993, the Central Bank of Kenya declared Equity insolvent, as 54% of its loan portfolio was non-performing and liquidity was a meager 5.8%.

Benefiting from a new openness in Kenya and a loosening of the lock-grip of the government controlled banks, the Chairman persuaded his friend and banking professional, James Mwangi, to help raise capital for a turn-around of the institution. The focus was on reaching out to customers and providing the kind of services they needed. Since management knew that customers were not really using loan funds for housing, it embraced microfinance as its niche. As a result, since 1995 the deposit base has grown by 40–50% each year and James Mwangi joined Equity as the Executive Director. Although he is technically responsible for finance, in practice, he runs operations as well.

By 1999, Equity had become profitable and was growing quickly. It turned to international partners to help manage this growth. First, it benefited from a MicroStart grant to improve its management information system, and then MicroSave-Africa was brought in to help Equity improve its products based on market research. Most recently, AFRICAP purchased 16% of the shares, providing a necessary capital injection for continued growth. Additionally, Equity received a technical assistance grant that it is using to increase IT and product development capacity.

Table 3: Donor Support

Source	Date	Amount	Terms	Currency	Status
1. EU – MESP	1999	70,000,000	Two loans over 3 years, 6% flat rate	KSH	Loan repaid. Ended
2. UNDP – Microstart	2000	150,000	Grant for MIS development	$US	Fully disbursed. Ended
3. EU – ACP-EBAS	2000	69,540	Two grants for business development services for customers (third party provider).	Euro	Fully disbursed. Ended
4. Swisscontact	2001	800,000	Grant for product mix, HR restructuring and process mapping.	KSH	Ongoing
5. DFID - FDCF	2001	277,500	Mobile banking centers	£STG	Fully disbursed. Ended
6. AFRICAP/DFID	2003	800,000	Technical Assistance (Provide staff)	$US	Began 9/2003

As Equity celebrates its twentieth anniversary this year, it is continuing the positive trend of the post 1993 era and has just completed what could be considered its first corporate re-structuring. It has established and filled the position of COO as well as seven of the eight new departmental manager positions.

2.3 Ownership and Board of Directors

2.3.1 Ownership

Equity is owned by 2,463 individual shareholders and one recent institutional investor (Africap), which holds 16% of the company. The next largest blocks of shareholders are the directors, together holding 12% of the shares, and staff who own about 10% of the company. The remaining 62% of shares are held by individual Equity customers.

Ownership diluted among many small shareholders has allowed Equity's management to control the direction of the company, including the change of direction in 1994 that led to Equity's current success. Broad grassroots ownership has also shielded Equity from political interference and corruption that may have made it difficult to operate. The limitation of this strategy is the inability of small, grassroots owners to mobilise significant capital for growth. Thus, the Africap investment brings international knowledge of best practices and potential access to more capital in the future to the table as well as US$800,000 in technical assistance funds.

2.3.2 Board of Directors

Equity's Board of Directors is comprised of eight individuals who have strong complimentary skills as well as experience in banking, business and microfinance. The board has grown in recent years as Equity has built up its business. In 2000, four new Directors were appointed to the Board and, in 2003, an additional director was appointed to represent AFRICAP, bringing the total number of directors to eight. Directors are elected by shareholding members of the Building Society and serve for a three year, renewable, term.

Table 4: Composition of Board

Name	Skill area/current affiliation
Chairman Peter Munga	Retired civil servant
Mr. John Mwangi	Equity Executive Director
Mr. James Mwangi	Equity Finance Director
Mr. Fredrick Muchoki	Director of Office Equipment Co.
Mr. Benson Wairegi	Insurance Executive
Mr. Ernest Kimani	Lawyer
Prof. Mwangi Kimenyi	CEO of Research Institute
Mr. Stefan Harpe	AFRICAP Investment Manager
Prof. Maria Otero (alternate)	CEO of ACCION International

The Board meets twice annually, plus holds additional special meetings where it actively considers Equity's business. Board meetings this year were held on August 13, June 6 (special meeting to discuss the CBK inspection report) and January 30. The board sets the organisation's strategic direction and is actively involved in reviewing and overseeing the implementation of the business plan. Given that two members of the board are Equity Executives, there is a great deal of coordination between the board and the management. This allows for quick decision-making, a factor that has contributed to Equity's rapid growth.

Because of the longstanding relationships, in the past, the Board has not formally evaluated the CEO's performance. However, in recognition of the increased oversight necessary for an institution as large as Equity, this year the board adopted a Code of Corporate Practice and Conduct, which includes a formal evaluation of the Chairman and the individual board members, including the CEO.

Three Board committees were reconstituted just last month to accommodate the expanded board: I) Audit, ii) ALCO and Risk Management, and iii) Remuneration and Staffing.

2.4 Alliances

2.4.1 Overview strategic alliances

Equity has only tapped into international community funding over the past three years, beginning with its MicroStart grant in September 2000. Since that time it has created alliances with a number of international microfinance donors and technical assistance providers. After a brief flirtation with small grants from 1999-2001, Equity decided to limit its alliances to strategic interventions. More than financial support, Equity seeks alliances that can add value to its operations. For example, Equity recently declined a $50,000 grant but has asked CGAP to perform a thorough appraisal of operations. It has also chosen to use MicroRate for its second rating rather than invite Planet Rating back due to the potential for added learning from new methods and insights employed by a new rating service. It has also created alliances with other financial service providers such as Western Union and Postbank, all of which served to improve its capacity or its product mix and add value to the firm.

As noted in section 2.3.1, Equity also gained a strategic alliance with AFRICAP this year when it purchased 16% of shares. This alliance includes US$800,000 in technical assistance, most of which goes towards paying the salaries of the COO and some additional management staff (a lack of which had been noted as a weakness in previous reports).

2.4.2 MicroStart

The purpose of the MicroStart Programme is to build a new generation of MFIs that have transparent track records and solid institutional and financial performance, which enable them to reach poor clients while operating on a sustainable basis. Since its inception in 1997, MicroStart has become operational or is being developed in 20 countries, and grants have been approved for 68 microfinance institutions (MFIs). A central thrust of the MicroStart Programme is the contracting by UNDP Country Offices of a Technical Service Provider (TSP), often a leading microfinance institution, to provide technical assistance to selected local MFIs. To ensure the development of local capacity, these TSPs subcontract a local institution as a partner to provide the technicalassistanceservices.

MicroStart's chosen niche is distinct from, and complements that of other donors. MicroStart is aiming at supporting "breakthrough" organisations. Such organisations are those which become a major service provider in its geographic area, attaining substantial independence from donors through financial viability and influencing other

providers. The programme is overseen by a MicroStart Advisory Board, a public-private partnership comprised of NGO representatives, the private sector, the government, UNDP, donors and other U.N. agencies active in microfinance. MicroStart Kenya has supported five MFIs with grants and technical assistance. The Equity Building Society was the first organisation to be approved as a partner MFI. In December 2000, EBS received US$150,000 to improve its management information system (MIS).

MicroStart's funding of MIS improvements made a significant contribution to Equity's growth. For 16 years prior to receiving this funding Equity had been operating on manual systems. An article in a local paper, at the time, had deplored Kenya's "Stone Age Bankers". Increased efficiency as a result of the MicroStart grant for computers and training decreased average customer service time from 30 minutes to 7 minutes (it is now closer to 2 minutes). Equity credits MicroStart with improving its level of service so significantly that all other financial institutions were forced to follow suit. For example, computerisation significantly decreased the time necessary to reconcile the books at the end of the day. Therefore, Equity extended its operating hours until 4:30 pm instead of the traditional 2:00 pm. Banks soon followed suit.

2.4.3 Technical Service Provider

K-REP Advisory Services was selected as the Technical Services Provider (TSP) by UNDP to provide technical assistance to MicroStart grantees. Equity does not attach much value to the TSP and the budget allocation for technical assistance was not fully utilised. This issue was brought up a number of times during MicroStart Advisory Board meetings, during which it was agreed to allow EBS to search for other types of TSPs, though this never materialised. Equity found UNDP programme staff helpful in getting through the bureaucracy and procedures of the MicroStart programme. But did not have much contact with the Advisory Board. It should be mentioned that there are places where MicroStart works with amazingly little bureaucracy. It seems that the places where the process is bureaucratic, it has more to do with the bureaucratic inclinations of local offices than official programme processes.

2.5 Leadership

Leadership at Equity is shared by the CEO and the Finance Director who was successful in turning the institution around in 1994. He challenges people to think big and generates excitement among the staff to achieve the growth that has become the hallmark of Equity's success. The CEO's graceful leadership reassures the staff that the rapid growth is an expansion of Equity's historic mission, not a departure from it. These two different styles are united in a belief in transparency that has resulted in a collaborative management, drawing on external assistance to manage growth when necessary.

This year, Equity significantly expanded its middle management by hiring or promoting eight new managers. This was critical as the current CEO approaches retirement age and Equity will need to fill an important senior position. Growth from within will continue to be possible as Equity expands its branch network and the number of staff. An excellent training program and incentives to pursue outside job-

related educational opportunities will help to ensure that staff members are qualified to move to the next level.

2.6 Human Resource Management

2.6.1 Introduction

As of August 31, 2003, Equity had a total of 266 staff members. Table 5 provides an overview of staff turnover, number, percentage, and compensation and benefits of loan officers.

Table 5: Human Resources Statistical Summary

	2000	2001	2002	8/2003
Number of total staff, end of period*	147	170	192	291
Number of staff hired during period	32	41	46	115
Number of staff who left during period	9	19	24	16
Turnover rate (staff who left as a percentage of average number of staff)	N/A	0.12%	0.13%	0.07%
Number of loan officers, credit officers, loan clerks, credit clerks and account opening clerks, end of period	24	28	39	53
Loan officers, credit officers, loan clerks and credit clerks and account opening clerks, as a percentage of total staff	N/A	9.5%	14.5%	15.4%
Number of administrative staff, end of period [a]	6	6	7	9
Number of female staff	29	43	59	82
Average annual loan officer compensation (US$)[b]	1650	2400	2700	4500
Average loan officer compensation as multiple of per capita GDP	N/A	7.6	7.7	12.5
Average loan officer compensation as multiple of average outstanding balance per loan	N/A	2.03	1.06	0.85

* Total staff: 2001: 21 students; 2002: 16 students; 2003: 8 students as of September

a. Administrative staff includes management, finance, bookkeeping, internal control, and management information system (MIS) staff. It does not include loan officers, cashiers, and others who spend most of their time dealing with clients.

[b] Loan officers' annual compensation includes such benefits as the "thirteenth-month" premium, accrued severance pay (even if not paid annually), typical incentive bonuses, etc., as well as employer social security contributions.

2.6.2 Structure

Human resources have been and remain an essential and recognised factor in Equity's success. Equity devotes approximately 3% of its income to training and recruitment. In 2002 this amounted to nearly 12 million KSH (US$150,000). Equity recently established its human resources and marketing department. The new department manager is a veteran human resources and marketing manager whose previous positions have included Shell Oil and other multinational and national companies. She has a staff of 13, of which five are HR and eight are marketing. All staff members are young with some work experience. However, as with most of the new positions, the HR Manager has not yet assumed full control of the department. There is a written recruitment policy manual, although it is not found in the branches and many human resource decisions are still made by the Director of Finance.

2.6.3 Recruitment

The head office is in charge of all recruitment, which has been identified as a critical issue in the business plan, given that the staff is doubling every other year and will likely continue to do so. Internal appointments are handled on a case-by-case basis, where an employee is identified by management as having the requisite skills, capabilities and experience for a given position. There is no formal system of internal recruitment (such as internally advertised positions). However, as with many small companies, positions are usually filled internally. External candidates are identified

through a review of nearly 800 C.V.s housed in their database (which is growing at a rate of over 25 per day) matched against the requirements of the position. If no candidates are found, the position is advertised in local daily newspapers. Candidates are then short-listed based on qualifications and interviewed. A second interview with a member of the executive management team precedes an employment offer.

Equity also recruits staff members through the education sponsorship program which is open to the most outstanding students under the 'Kenya Certificate Secondary Education'. This is a community programme that encourages bright students (understood as those who have scored full marks in all their subjects) from poor families to continue with their university education under full sponsorship. Such students are extended job offers at Equity. Equity also offers internship for top students in various schools in the provinces. Such students are employed at various branches and are encouraged to save whatever they have earned to pay for their education at the university.

2.6.4 Formal Training

All employees participate in a mandatory induction programme at the head office upon hiring. This training lasts between two and four weeks, depending on the position. Credit officers receive the most extensive training. In addition, staff can be reimbursed for external training, and even degree courses, as long as they show continued improvement in their the jobs. Last year, nine employees were reimbursed for external training.

2.6.5 Loan Officer Profile

The average credit officer is 25-28 years old and is either a university graduate or a diploma holder with little work experience unless he is hired from another financial institution. Twenty-eight percent of credit officers are women, and this number is increasing. Equity prefers to hire young credit officers with little previous experience as this gives them the opportunity to mold them into Equity's corporate culture. Staff is placed where needed and occasionally rotated. As Equity increases its microbanking portfolio, credit officers will be spending more time in the field working directly with customers at their place of business.

2.6.6 Salary

Salaries ranges are within the norm for the banking sector in Kenya, possibly slightly higher than average. Secondary benefits include a "thirteenth month" bonus, access to reduced rate staff loans, group life insurance, personal accident coverage, medical coverage and study sponsorships. To date, there is no employee incentive scheme in place, although one is planned.

2.6.7 Turnover and General Level of Job-Satisfaction

Turnover is very low, with less than .5% of staff leaving over each of the past three years (not including students who work for Equity while on break from their studies).

In general, people seem to have a high level of job satisfaction. They enjoy a high degree of teamwork and camaraderie. Nevertheless, it can be difficult working in an environment of constant growth and change. Branch office staff must combine work

with training which makes for a long day, and some complain of tiredness. There is also some evidence that the new middle management structure has alienated some long-term employees who feel that the head office is paying high salaries to new people and not adequately recognising the contributions of those who have been with Equity for some time. Management has attempted to ensure that all staff members are rewarded for their efforts with cash bonuses and cocktails or sponsored trips for high performing branches. As with any organisational restructuring it is important for Equity to continue focusing on staff morale in the months ahead and coming years.

2.6.8 Atmosphere

The atmosphere at Equity, whether in the head office or in the branches, is one of activity. The physical infrastructure is being updated, office space is very open and there is constant activity. The public areas of the bank appear to be a never-ending crowd of customers. The staff seems professional, capable and generally happy to be working for Equity.

2.6.9 Dependence on Outside Consultants

There is little dependence on outside consultants. Although outside consultants are brought in for specific projects, and their expertise is utilised, they are not indispensable.

2.7 Organisational Structure

Equity's organisational structure is now a standard corporate model. Its lack of middle management and reliance on the CEO and Finance Director had been a concern thus is being addressed by the creation of a middle management level. The position of Chief Operating Officer has aslo been created. This restructuring should ultimately improve Equity's ability to manage growth. However, it presents some immediate challenges as well. Six of the eight new managers and the COO have been hired from outside Equity; only two have been promoted from within.

The new managers at Equity are still in the process of on-the-job training. Managers are not yet in full control of their departmental budgets, staff or decision-making. The organisational chart itself has not been fully implemented. For instance, there is one regional manager not found on the chart, and the operations manager is still carrying out the duties of chief accountant instead of operations.

Five years ago Equity was small enough that everyone knew each other, profits were non-existent and sacrifice by all employees was necessary to keep operating. Current reporting and lines of authority are not yet clear so that branch managers and most head office staff report to the finance manager. Some long-term employees feel aggrieved and alienated by the restructuring. This is normal in any restructuring and Equity will likely lose some staff. Nevertheless, the human resources manager will have to address these issues especially in the case of serious grievances, to avoid a widespread morale problem.

Figure 1: Equity Building Society

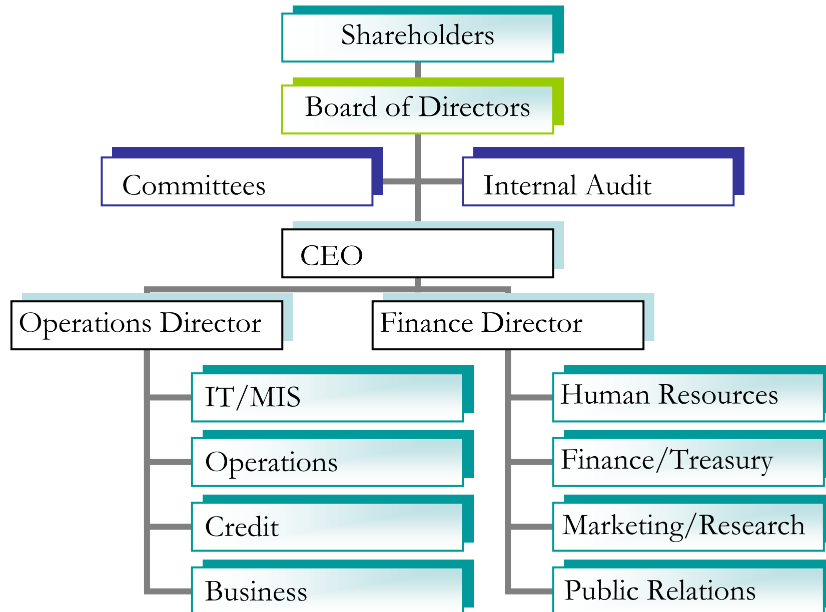
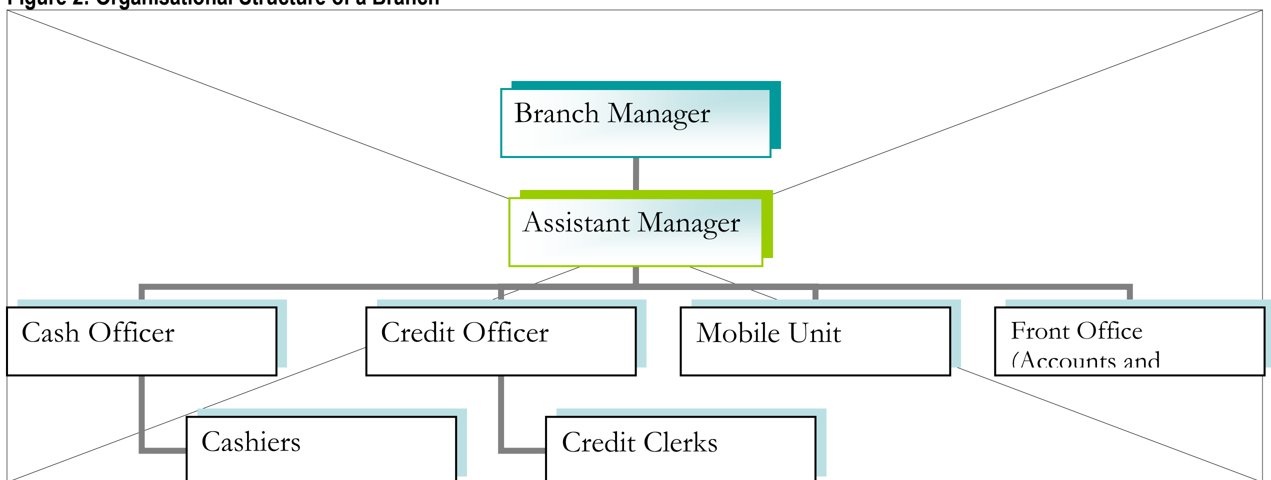


Figure 2: Organisational Structure of a Branch



Lines of authority are generally clear only on paper. The new managers have been in place for between four and twelve months but many decisions are still being made by the finance director until the new managers have acquired sufficient skills and company culture to take on their full responsibilities. The operations director is focusing on only IT issues for now.

The branches are treated as profit centres, although headquarters costs are not allocated to the branches. Operational decisions are largely decentralised, with branch managers responsible for the performance of their branch. There appears to be more interference from the head office in the operations of the Nairobi branches than the in up-country branches.

Operational procedures are not standardised among branches. However, all procedures are currently being mapped and documented. The new procedures should be in place by the end of the year at which point all of the branches will be following the same procedures.

Management holds quarterly meetings where branch performance is compared to targets and targets are revised as necessary. Branches that have exceeded their targets are eligible for a branch reward in the amount of 100,000 KSH (US$1,500).

2.8 Management Information System

EBS has a total of 12 branches, excluding the head office. The branches operate independently from the head office and, for operational purposes, are treated as profit centres. Equity uses a software system called *Banker's Realm*, which was developed and copyrighted by Craft Silicon. The system is used by a number of banking institutions in Kenya and is supported locally. It was rolled out at the beginning of January 2002 and by October 2002 all the branches were fully operational.

2.8.1 Hardware and Software

The 12 branches and the head office are not interfaced on a wide area network (WAN) so each operates independently using a Microsoft SQL and the Bankers Realm database. The branches, including the head office, are on a local area network (LAN), and updating of the master database is done on a daily basis, off-line. At the end of each day, the branches run end-of-day processing and perform a backup of all of their daily transactions. First, the data is backed up onto a local workstation and then to a digital data tape; this process is done at end of each day. The digital data tape is then sent by courier to the MIS department in the head office to update the master database. The MIS department downloads the information and sends a confirmation of the updated copy back to the branch. The confirmation is sent in the form of a summary report to the branch so that they can double check and confirm that the information is complete, accurate and valid.

This manner of updating data is cumbersome and costly in terms of the use of courier services. Equity recognises this deficiency and has started implementing a WAN which will allow for automatic updates.

Head office performs backups on a daily basis and sends one digital data tape to the Fourways Branch to ensure that data is kept off site.

2.8.2 Staff

The MIS department has seven staff members and is headed by Andrew Kimani, an experienced consultant who was responsible for the initial implementation and subsequent rollout of the Banker's Realm software. The department has been

reinforced by the employment of John Staley, credited with the successful implementation of data warehousing and credit scoring for a successful South African MFI.

Initial training is provided to all new staff members. Equity is focused on providing additional, ongoing internal and external training for all of its employees. This has helped to ensure that all personnel are trained in the use of Banker's Realm. In addition, operational manuals are given to staff. The MIS department is currently reviewing the implementation of online help, which could assist operators in solving glitches without opening a manual.

2.8.3 Reports

The system Banker's Realm has a total of 64 reports that are readily available on the system. In addition, an application called Crystal reports is provided so that the user can design any additional reports required. Equity has chosen 32 reports for use in its daily, weekly and monthly reporting. The most common reports used by branches include:

- Cash register summary;
- Chart of accounts;
- Cash register credit/debit;
- Accounts opened for the day;
- Balance Sheet;
- Profit and loss;
- Customer Arrears Report;
- Days transaction audit trail (deposit/advances/internal transfers); and
- Installment due report.

Equity has selected a standardisation of reporting formats, which addresses a weakness that was identified in the five-year plan. Surveys revealed that, in one of the branches, management did not utilise the ageing analysis and could not give a clear position of accounts that were in arrears nor were they able to track delinquencies.

2.8.4 System Development

The continuous development of the current system is clearly articulated in Equity's five-year plan. Management is sold on the idea of "customisation" in the form of credit scoring and client profiling to assist Equity in better appraising clients and providing unparalleled service. It is not clear at this stage if the MIS department has documented the process of system development nor the required controls.

Branch Network

To reduce the costs of transporting data, delayed updating of information and occasionally, the manual consolidation of branch information, Equity has taken a strategic step to implement a wide area network (WAN). The WAN will enable Equity to provide a virtual institution and better service for its customers. John Staley was brought in to provide expertise in implementing the network. The project plan to

achieve the rollout for the network has not been documented, as Mr. Staley has been with Equity for less than a month.

Data Warehousing

Equity has acknowledged that in order to provide better products and service to clients, it needs to understand its clients better. In order to understand them, it needs information about their socio-economic circumstances. It is primarily for this reason that Equity has begun the process of building a data warehouse to provide credit scoring and client profiling for the appraisal process. At this stage it is difficult to assess the timing and personnel requirement because the project plan has yet to be documented.

2.8.5 Security / Disaster Recovery

Security within the system appears adequate with entry controlled by password and access to certain screens controlled in line with seniority. The branch management procedures document covers disaster recovery procedures in the event of a major failure, which could destroy the entire information system. These procedures need to be tested "live" to ensure that they are capable of providing continuity without loss of data. It is not clear at this stage that the procedures have been tested nor that the disaster recovery plan is adequate and workable.

2.8.6 Process and Supporting Information

Equity has process manuals that are used for training which are given to users for ease of reference. The institution is currently engaged in a process of mapping all of its processes and designing procedures to mirror its operations. This process will ensure that the institution has standardised its procedures and all personnel, including management, have a good understanding of the system. The current MIS is fairly new and has just been upgraded as part of the institution's five-year plan to become a commercial bank.

The current chart of accounts used by the institution is part of its branch reporting and adequately reflects the required accounts for this type of institution.

2.9 Internal Control System, Audits and Supervision

2.9.1 Internal Control System

All cash received is recorded, verified by management and approved based on cash counts and document review. Payments are authorised, approved and witnessed by management who must sign off on every transaction. Segregation of duties is clearly mapped and personnel responsible for safeguarding assets are not responsible for recording transactions of these same assets.

Reconciliations are performed for all balance sheet items and approved by management on an independent basis.

Equity is currently documenting all policies and procedures in manuals that are standardised and uniform throughout the branch network, including the head office. In the past, the branches have not uniformly applied internal control procedures. This

new process will address this weakness. It is evident that management has applied resources and employed the services of international consultants to ensure that the process will produce documentation to meet regulatory requirements.

2.9.2 External Audit

Munga and Associates, Certified Public Accountants of Kenya, have audited Equity since its inception. The firm has three partners, a number of associates, several managers and an audit clerk. It is a reputable firm that has been operating for a number of years. According to the CEO, the firm is highly regarded by the CBK. According to the requirements of the Building Society and Companies Act, Equity must appoint external auditors every year through their AGM. The CBK has never rejected the shareholders choice of external auditors, demonstrating its approval of the company.

The firm is responsible for performing statutory audits on behalf of shareholders in accordance with the International Standards on Auditing. The standards require the auditors to plan and perform the audit to obtain assurance that the accounts are free from material misstatements.

In our opinion, this external audit has been done well over the past three years and a management letter has been produced for each year audited.

We noticed that the following issues raised in the year 2002 management letter remainl outstanding:

- The existence of stale checks as reconciling items in bank reconciliation in some branches;
- The inclusion of bank charges as reconciling items; and
- The clearing and/or reconciliation of inter-branch accounts.

It is evident from the corrective actions taken by the management with respect to institutional weaknesses that these issues are taken seriously. The Board of Directors has gone further by appointing an Audit Committee of the Board to specifically ensure that external audits play a significant role in shaping the institution for the better.

2.9.3 Internal Audit

The internal control department is made up of three internal auditors led by Allan Mwangi, a manager with extensive experience in internal and external auditing. The department reports to the Audit Committee of the Board / the Chairman of the Board and indirectly reports to the CEO for administrative issues.

The manager of the department has only been with Equity since February 2003. During this time, he has been involved in two areas of internal audits, special investigations and the mapping of processes. Process mapping is critical for Equity and its completion will assist the organisation in standardising its procedures and eliminating several problems. It was discovered that some branch managers:

- Do not wait the prescribed six months after a customer opens an account to make a loan; and.
- Did not use the ageing analysis to track arrears/delinquencies.

These involved processes have, to a limited extent, affected the work of the internal auditors in that they triggered an audit in some branches in 2002. It is commendable that, even at this stage, the audit team has begun visiting some branches to implement these uniform policies and procedures.

The growth of the institution will raise a number of challenges for the audit team. Equity is becoming computer dominant and will finally eliminate manual processes. This situation calls for an internal audit team literate in computer assisted audit techniques.

2.9.4 Fraud Control

Large numbers of new, low level employees, coupled with weak internal audit oversight and some disgruntled employees indicate a higher risk of fraud than in the past. In general, fraud control appears to be a low priority, which is detrimental to the safeguarding of Equity's assets.

There was an incidence of float shortages noted that resulted in an investigation by the internal auditors and led to the dismissal of the staff member involved. Currently, there is no specific system designed to prevent or detect fraud, but general internal controls are meant to safeguard Equity's assets. The internal audit function, including a set of policies and procedures, assists in the prevention and detection of fraud.

2.9.5 Public and Prudential Supervision

Equity is currently supervised by the Central Bank of Kenya and is governed by prudential regulations as set out for building societies. It has had a close working relationship with CBK and this relationship has helped shape the future of the organisation.

2.10 Financial Manager

The Finance Manager is a Certified Public Accountant and has worked for reputable firms such as Ernest and Young, Lonrho. The Finance Manager has only been with the firm for a couple months, and has already taken over key functions in the accounting area. The reason he has not taken over all the Finance Manager functions is that he is also involved in process mapping which needs to be in place first given that it will standardise the accounting processes that he is going to manage.

2.11 Gender Dimensions

Equity does not market its services specifically to women or men. Approximately one third of its total clients are women. The percentage of woman served per product varies. For instance 23 % of female clients have medical loans and 42% education loans. Women are also reasonably well represented among the largest market segment of farm input loans, at 39%.

Within EBS itself, women comprise 31% of its staff, up from 20% at the end of 2000. Women are starting to be represented in senior positions, though they are still highly under represented at those levels, as in other areas of the organisation. See also sections 3.1.1, 3.2.2, 3.3.2 and 4.1 demonstrating aspects of gender sensitivity.

2.12 Technical Assistance

In conjunction with Africap's equity investment, Equity is benefiting from a DFID technical assistance package. This package pays the salary of the newly hired COO as well as two additional technicians. Equity plans to include these salaries in its operating budget in 2005, when this technical assistance package is terminated.

2.13 Experience and Recommendations of Earlier Evaluations

Equity was rated by Planet Rating in June 2001 using the GIRAFE methodology and received the highest rating to date (G4*) and had a positive trend.

3.0 Services, Markets and Clients

3.1 Services

Equity offers seven loan products, six saving products and about seven other banking services designed for low-income SMEs, employees and small-scale commercial farmers in Kenya. Customers access these services at one of Equity's 13 branches or its mobile banking units (see Appendix 2).

3.1.1 Loans

In 2001, as a result of the market research conducted with the assistance of Microsave Africa, Equity repackaged its loan offerings into six loan products that are available to the public in all the 13 branches (it has recently added one new loan product). The repackaging included a lower cost and pricing scheme that, it is hoped, will reduce customer complaints regarding exorbitant service charges. The Credit Policies and Procedures Manual (which is currently being revised) stipulates that a customer can only access loan products after opening a savings account for at least six months. However, this is not universally applied. Some loans are processed three months after registration.

The loans target school fees, medical bills, business working capital, salary advances, farm inputs, and property development. All loans are repayable within one year except for the farm input and development loans, which can be extended. The interest rate on all loans varies between 12% and 18% per annum. There is no fixed floor on loan amounts. However, an upper ceiling of Kshs.100, 000 has been fixed for the initial loan. The actual maximum loan amount depends on the savings account turnover. Loan products such as farm input, business, and development are available anywhere from Kshs.3,000 to Kshs.20 million.

Repeat loans are processed immediately after clearing the previous ones. Appraisal systems are the same for first-time and subsequent loans. There are no clear loan levels at Equity as all loans are based on the ability of the client to repay as determined during the application process.

Women's participation rate in the loan program is approximately 48%. Equity Building Society works with an MFI called Women Economic Empowerment Consult to intermediate in areas that it cannot reach with services. It has received Kshs.10 million from Equity to on-lend.

See Appendix 1 for an explanation of the different types of loan products, terms, conditions and charges.

3.1.2 Voluntary Savings

The bank has a total of six savings products available to the public: ordinary, business, current (call) and fixed term deposits, Jijenge (Save As You Earn), super junior investment, SAKO and Church accounts. Jijenge is a contractual account with regular remittances while SAKO accounts are relatively new and are still being piloted.

Of the six products, ordinary, business, super junior and Church savings accounts are voluntary while Jijenge is contractual and is operated through standing orders.

Interest is posted to the account at the end of the year.

3.1.3 Other Financial Services

Equity Building Society offers eight banking services to its customers, which are available within the branch network. Special counters and officers are available to offer the services along with the core services.

Table 6: Other Financial Services Offered by EBS

Service	Purpose	Number of Customers Accessing the Services			Benefits
		2001	2002	2003	
Uncleared effects	Accessibility before cheques clear				Equity earns income Clients access funds
Standing order	Faster and safer inter-bank transfers	98,050 (file)	852	-	Transaction income Faster service to clients
Local money transfers (non-customers)	Faster and safer transfer of funds from other financial institutions	-	-	-	Source of income Faster service to clients
Bank references, bids and performance bonds	Available to customers who need recommendations or references from the bank				Source of income Faster access to services from other institutions
Certification of balances for audit purposes	Given to customers' auditors to confirm their balances in the bank	-	-	-	Source of income Faster and guaranteed services for clients
Inter-branches withdrawal	Allow customers to access funds from other Equity branches	8,170	8320	-	Source of income Easier access to funds at any of Equity branches
Banker's check	Make payments without handling cash	29,600	45,122	-	Source of income Safer and secure
Western Union Transfers	Facilitate transfer and receipt of funds from abroad	-		-	Source of income Allows faster international money transfers for clients

3.1.4 Non-Financial Services

Equity has dabbled in donor-funded programs for client training. However, since the funding was terminated, no regular training sessions have taken place. Staff members occasionally organise in-house training for clients but these are more marketing events than a training service.

Every year, Equity hands out awards to the best-maintained tea farms in the tea growing zones. The farms are selected in collaboration with tea estate managers and the Kenya Tea Development Authority. The ceremonies are held at the best-managed farms and other farmers are invited to attend. During the function agricultural experts are invited to demonstrate to the farmers the best practices in tea farm management. Equity provides trophies and cash rewards for the top three farmers while the rest are encouraged to improve so that next time they will also win. This is a source of motivation for customers and creates competition among the farmers, but it is primarily a marketing event for Equity.

3.1.5 Drop Out Rate

Clients drop out through voluntary exits, forced exits or death. Voluntary exits are very common with the savings accounts. When clients exit, they fill out exit forms containing questions related to the customers' reasons for leaving and suggestions for improving the service. Personal interviews are also used to determine the reasons for leaving. The completed exit forms and interviews are used to monitor client drop out rates and are only handled by the branch managers or their assistants before being forwarded to the head office for further research. Information on forced exits, such as delinquency and death, is not systematically gathered and analysed.

It has proven difficult to calculate the drop out rate under the loan services because of the delay in writing off bad loans and the disposal of securities (clients are still considered 'active' until the security is liquidated and/or the loan written off).

Discussions with former clients revealed that the main reasons for exits are family problems and commitments, retrenchment from employment, business failures and poor farm harvests.

3.2 Outreach

Equity customers generally do their banking at one of Equity's 13 branches. To serve certain villages where there is no established branch office, Equity has set up mobile units. These converted four-wheel drive vehicles provide most services and cover villages as far as 65 kilometers from the nearest branch. All branches except Fourways, Tom Mboya, Corporate, Nakuru, Karatina and Nyeri have established mobile units (see appendix 2 for a listing of mobile units).

3.2.1 Branch Structure

Table 7: Branch Structure

Location	Branch	Farming/Business	Urban/Rural	Number of employees	Number of loan officers
Central province	Kangema	Farming	Rural	16	2
	Kiria-ini	Farming	Rural	14	2

	Murarandia	Farming	Rural	9	2
	Kangari	Farming	Rural	16	2
	Othaya	Farming/business	Rural	9	1
	Thika	Business	Rural/Urban	25	5
	Kerugoya	Farming	Rural	18	2
	Karatina	Farming	Rural	20	5
	Nyeri	Farming/business	Rural/Urban	17	3
Rift valley	Nakuru	Farming/business	Rural/Urban	20	3
Nairobi province	Four ways	Business	Urban	19	
	Corporate	Business	Urban	13	
	Tom Mboya	Business	Urban	24	4

3.2.2 Loan Structure

Table 8: Equity Loan Accounts and Balances

Product	**Accounts**	**Outstanding Balances**
Farm input loans	28,018	136,773,897.75
Development loans	1,374	117,230,082.52
Business loans	7, 932	1,116,297,572.69
School fee loans	2,245	17,871,595.35
Medical loans	382	3,216,649.23
Salary advances	20,930	200,248,075.00
SAKO plus loans	650	15,848,082.14
TOTAL	61,697	1.6 billion

3.2.3 Concurrent Loans

A customer can access more than one loan at a time provided he/she can service them all. Clients with multiple loans will often have a business loan and at the same time have medical and educational loans. Since the last two are taken against deposits and spread throughout the year, the financial burden is lower.

By the end of August 2003, there were a total of 14,326 repeat loans (23% of all loans) valued at Kshs. 902,956.440.57 (56% of outstanding balances).

It was not possible to get a statistical summary of concurrent loans based on gender and how they perform (however, this will be possible once the MIS is fully operational).

Outreach Summary

Table 9: Summary of Products

PRODUCTS	2000	2001	2002	2003
Educational Loan				
1. Number of active loans at end of	-	-	2,049	2,245
2. Percentage of female clients	-	-	33%	42%
3. Average balance per loan (Kshs)	-	-	4,937	7,960
4. Average balance per loan as a percentage of per capita GDP	-	-	(20%)	29%
Medical Loan				
1. Number of active loans at end of	-	-	665	382
2. Percentage of female clients	-	-	23%	23%

3. Average balance per loan (Kshs)	-	-	5,168	8,420
4. Average balance per loan as a percentage of per capita GDP	-	-	21%	31%
Salary Advances				
1. Number of active loans at end of	1,619	4,162	8,517	20,930
2. Percentage of female clients	-	-	24%	26%
3. Average balance per loan (Kshs)	20,553	26,380	7,720	9,567
4. Average balance per loan as a percentage of per capita GDP	90%	105%	29%	35%
Business Loan				
1. Number of active loans at end of	2,149	2,934	6,448	7,932
2. Percentage of female clients	-	-	29%	-
3. Average balance per loan (Kshs)	182,931	228,679	140,547	140,733
4. Average balance per loan as a percentage of per capita GDP	806%	915%	562%	521%
Development Loan				
1. Number of active loans at end of	-	-	1,147	1,374
2. Percentage of female clients	-	-	25%	-
3. Average balance per loan (Kshs)	-	-	66,119	85,320
4. Average balance per loan as a percentage of per capita GDP	-	-	265%	316%
SAKO Plus Loans				
1. Number of active loans at end of	-	-	359	650
2. Percentage of female clients	-	-	-	-
3. Average balance per loan (Kshs)	-	-	31,664	24,382
4. Average balance per loan as a percentage of per capita GDP	-	-	127%	90%
Farm Input				
1. Number of active loans at end of	5,265	9,787	22,268	28,018
2. Percentage of female clients	-	-	34%	39%
3. Average balance per loan (Kshs)	13,314	6,987	4,730	4,881
4. Average balance per loan as a percentage of per capita GDP	59%	28%	19%	18%
Jijenge Loans				
1. Number of active loans at end of	-	-	50	84
2. Percentage of female clients	-	-	-	34%
3. Average balance per loan (Kshs)	-	-	14,139	5,071
4. Average balance per loan as a percentage of per capita GDP	-	-	56%	19%

3.3 Clientele

Equity works with economically active women, men and youth, as well as churches that need additional funds for development. Although Equity is known as a Kikuyu bank and operates in heavily Kikuyu populated regions, there appears to be no discrimination, favouritism, bias, closed doors or coercion in delivering the services to the non-Kikuyu clientele. The senior management is clear about this, branch staff practice it and the customers confirm it. Even ex-clients testified that Equity is accessible to everyone, regardless of his or her background.

3.3.1 Target Market

Equity has estimated Kenya's financial market at 11 million potential customers. It seeks to serve between 2-4% of this market over the next three years by capturing under-banked or poorly banked customers of SACCOs, Post Office Savings Bank, Microfinance Institutions as well as the estimated 2.5 million Kenyans who only have access to informal financial services.

Equity reaches its clients through word of mouth and advertising, but keeps them by offering a superior level of service. Account opening procedures are relaxed, flexible and fast; registration forms are short and simple. All the necessary documents are available in the bank and clients spend approximately 30 minutes in the account opening process.

Salaried employees only need to produce an identification card and recent salary slip or payment voucher to open an account. Business accounts require a business name search and certification by the Attorney General first. For the poor, an identification card and a visit by an officer to the home or business are sufficient for opening an account.

Special counters are available within the banking hall for general inquiries and registering new clients. Rapid growth means long queues to the counter, but the queue moves quickly. Branches in Nairobi register almost 100 new accounts per day while rural branches register an average of about 20 new accounts daily. In the Nairobi branches, the crowds were overwhelming. The situation is worse at the end of the month and during tea payment season, when the bank is handling salary remittances and tea bonus payments.

Equity operates in the central province where most households include at least one economically active person. Kenyan household survey bulletins report that the poverty level in the central province is lower than in other provinces in the country. With its flexible and affordable services, it appears that Equity has found a niche in the central province and maintains a sizeable market share in the province. Equity's success in penetrating the market is due to a mix of several marketing strategies designed by the marketing team. It employs the following methods to strengthen its outreach:

- Advertising on the radio and in newspapers;
- Participating in farmers' field days;
- Attending and participating in schools prize-giving days;
- Direct marketing to individuals and companies;
- Cross selling;
- Customers' cocktails; and
- Being involved in socially responsible activities

Equity has openly displayed suggestion boxes and opinion seeking forms in the banking halls. Interviews and discussions with clients are the primary methods used to generate quality information. This feedback is collected at the branch level,

summarised and analysed before it is sent to the head office as suggestions for action by management.

Product Development

Due to increased competition, Equity understands that its survival depends on offering market-driven products that are relevant, flexible and affordable to clients. The ten person Market Research and Product Development team is composed of representatives from all of the departments in the organisation. They meet regularly to analyse feedback from branches, discuss market trends and recommend studies or surveys. Both staff and external consultants carry out the assignments. In 2001, EBS commissioned MicroSave-Africa to review its product development and marketing strategies and suggest recommendations for improvement. The recommendations were adopted by the management and are widely incorporated into the marketing strategies currently in use.

Currently, Jijenge savings and SAKO loans are being piloted and tested in various branches.

Competition

Equity Building Society faces stiff competition from other banks, SACCOs and microfinance institutions. The Co-operative Bank, SACCOs, Kenya Commercial Bank and K-REP Bank are Equity's main competitors, primarily for savings and loans to salaried borrowers.

SACCOs are one of Equity's largest competitors, with Kshs80 billion in savings. They are especially competitive in the tea growing areas, especially in terms of savings.

Microfinance institutions compete based on the flexibility and affordability of their products and their appeal to small borrowers and savers. This is especially true for unsecured and group guaranteed loans, as customers do not have to produce tangible securities to secure loans.

3.3.2 Clients and Poverty Target

Equity is clear in its intent to economically empower those customers in the "missing middle" who need more services than a SACCO or NGO MFI may be able to provide, but who are too small to be attentively served by a large commercial bank. Although this may sound as though Equity is not interested in serving the very poor, it is evident from their small average loan balance (US $306) and their intention to begin offering cash flow based lending, that Equity's services are targeted at the low end of the microfinance market. Indeed, as Equity expands it is targeting both the higher *and* lower end of its current market, as evidenced by the sharp reductions in both average saving and average loan rates.

Equity's client base is composed of:

- Small and medium scale entrepreneurs who are economically active and run licensed and non-licensed enterprises;

- Commercial smallholder farmers who produce cash crops, dairy products and staple foods for sale;
- Employees in both the private and public sectors. These include private, parastatal and civil servants.

4.0 Strategic Objectives

4.1 Mission and Objectives

Equity's mission is:

To mobilise financial resources to maximize value and economically empower microfinance clients and other stakeholders by offering customer-focused quality financial services and solutions.

The mission statement has changed only marginally over the years and has retained the concept of financial performance for the benefit of many stakeholders including customers, employees, the government and others. Staff members of all levels have internalised the mission and even new staff members are thoroughly inculcated in Equity's mission. Equity believes that customer service is the key to its success. When asked how he or she will beat the competition, nearly every staff member states, first and foremost, through better customer service.

The use of the term microfinance is relatively new to Equity, first appearing in its vision statement of 1995: "To become the biggest microfinance provider in Kenya in terms of funding, loan portfolio and profitability". However, this is more a recognition of the type of customer that Equity was serving (and wanted to serve) rather than a change in strategic direction.

Equity's vision is shared equally by its staff members, although changes in the vision statement have led to a more diverse wording. The point everyone understands is that Equity's vision is large. After years of expanding its vision statement from Kenya to East Africa to Africa, Equity now prefers to simply state its vision as being: "To be the preferred microfinance services provider." This vision has been spread from the executive offices and helps explain Equity's aggressive growth targets.

This is a critical time in Equity's development, as it has succeeded in maintaining strong growth for four years and has attained a critical size, with assets totaling Kshs 2.7 billion including Kshs 2.6 billion of savings mobilised, a loan book of Kshs 1.4 billion, 13 branches and 247 staff members. This has all been accomplished through a "family" orientation to the company: a small head office staff, decision making that is concentrated in a few hands, long-term ownership and governance. Equity is just now going through the process of becoming a corporation and positioning itself for the next phase of growth which includes: expanding its head office staff, decentralising decision making to middle management, new, external owners and directors. The challenge for Equity is to ensure that all stakeholders feel that the new structure maximises value for them. This will be the most difficult at the customer and employee level where the stakeholders are not only more numerous and heterogeneous, but also more important. Employees and customers that feel no

special link or, worse, alienation in the new system are a serious threat for Equity. Growth has weakened internal controls as well as channels of communication, making staff member discontent the greatest risk for Equity.

4.2 Objectives for the Near to Medium-Term

4.2.1 General Direction

Equity has an excellent business plan for the period of 2003-2006. The plan contains a realistic SWOT analysis and a review of major issues of concern. The one area that is not addressed sufficiently is the risk of loss due to fraud and mismanagement as a result of large numbers of new employees, neglect of procedures, including internal controls, and the potential alienation of several long-term employees.

In general, growth is strong and there is an equally strong investment in staffing, systems and capacity. Planned growth relies on opening new branches in new areas of Kenya – a significant step as it will mean opening markets that are not overwhelmingly Kikuyu – and possibly beyond Kenya. Establishing itself as a commercial bank also means that Equity will create a new brand as Equity Bank. It is important to note that Equity is not contemplating a change in its mission.. New products may be created at both ends of the market that Equity currently serves (for example, it may offer more products for micro-clients such as unsecured lending and more products for SMEs such as checking and trade finance), but Equity will continue to focus on the low-end of the financial services market.

4.2.2 Key Indicators of Scale and Outreach

Table 10: Projected Performance*

	ACTUAL			PROJECTED	
	Dec-01	Dec-02	Dec-03	Dec-04	Dec-05
Total outstanding loan balance in US$	10,905,824	15,445,344	24,386,666	35,480,000	44,000,000
Number of active loans	41,503	61,531	69,000	112,000	167,000
Total outstanding savings balance in US$	20,470,108	27,820,328	39,253,333	51,866,666	63,040,000
Number of savings clients	105,987	155,883	215,000	283,000	342,000
Number of staff	170	192	291	327	363
Number of branch offices	10	12	14	17	20

* Based on 'most likely scenario'

The new business plan foresees rapid expansion at the rate of three branches per year. While the often-repeated target among Equity staff is one million customers by 2005, the business plan more realistically targets 20% of the commercial bank market in terms of number of customers and 2% by volume (380,000 customers and 7.34 billion KSH), while improving the portfolio by keeping PAR under 10% (5% for microfinance portfolio).

4.2.3 Key Changes

Major expected changes include:

- Increased outreach;
- An increase in the number of staff members;
- The conversion of Equity into a commercial bank;
- The creation of improved, standardised policies and procedures; and
- The development of an IT platform for business practices.

4.2.4 Business Planning and Financial Modeling

Equity's current business plan covers the period from 2003-2006 and contains detailed financial projections under several scenarios. The plan is logical, thorough and detailed enough to serve as an excellent platform for operational planning.

The annual budgeting process begins at the branch level with each branch determining its targets for the year as well as its required financial resources. These branch plans are analysed at a managerial meeting in November, compared to business plan projections and adjusted (managers and the head office compromise where necessary). The board approves the annual budget in December.

Budgets are compared to plans at quarterly manager meetings and targets are adjusted accordingly. This process is important because staff incentives are based on branch performance as opposed to individual performance, and unrealistic targets could lead to employee dissatisfaction.

Head office costs are not allocated to branches.

4.2.5 Challenges

The primary challenge of meeting the objectives as described in the business plan is holding the middle managers accountable for meeting their respective targets. Meeting this challenge requires expanding management's authority and accountability to a newly installed middle management team, and sharing the goals and targets of the newly approved business plan.

5.0 Financial Performance

5.1 Income Statement and Balance Sheet

Equity provides financial services to a large client base of farmers and salaried employees. The chart of accounts is in line with accounts prepared for a financial institution. Equity offers a small amount of non-financial services. These services are not accounted for separately and Equity does not keep separate income statement and balance sheet transactions for them.

Equity accounts for its financial transactions on an accrual basis and provision is made for interest on the outstanding loan balance. Management reviews the quality of the loan portfolio on a monthly basis and a provision is made for all accounts in arrears over 90 days. Interest on these accounts is immediately suspended and interest accruals are no longer affected after the suspension. Equity continues to recover the

loan by means of normal repayment and, in the event of failure, the security is liquidated and the difference is written-off.

End of period stocks in the calculation of financial ratios that compare income statement and balance sheet items are averaged on an annual basis (i.e. average outstanding portfolio). Partial year data up to July 2003 was used to calculate the following ratios: return of asset; adjusted return of equity; administrative efficiency; operational efficiency and yield on portfolio.

Equity provisions are in accordance with the Central Bank's recommendations for bad debt provisioning. Equity uses a general provision of 2% on all outstanding loans and a specific provision for all loans over 90 days. Management is of the opinion that the provisioning is sufficient given that all loans are secured.

It is impossible to determine the method used by Equity to account for donor funds because these funds are not accounted for separately in the income statement or balance sheet. At this stage, the financial statements are not transparently showing the distribution of equity among retained earnings, donor contributions and other accounts.

The income statement (Table 11) reflects the results of Equity's operations for the years ending December 2001, 2002 and July 2003. For comparatives reasons, the seven months to July 2003 have been annualised in the percentage calculation of movement in the income statement. Interest and fee income from loans increased by 59% in 2002 and 13% for the year 2003, but this increase is not in line with 33% loan portfolio increase in 2003. Non-lending income increased by 36% in 2002 and 67% in 2003. This increase is largely due to a 32% increase in savings. The increase in operating costs (unadjusted) was 37% in 2002 and 19% in 2003, which is to be expected because of the increase in staff, the number of new branch openings and

Table 11: Income Statement (in Kenyan shillings)

	Account	(A)Dec – 01	(A)Dec - 02	(U)Jul – 03
	Operating income			
1.	Interest and fee income from loans	175,487,646	278,853,724	184,461,400
2.	Income from other finance-related services	125,003,410	170,477,054	166,285,377
3.	Income from investments			
4.	Total operating income	300,491,056	449,330,778	350,746,777
	Operating expenses			
5.	Interest and fee expense	70,914,438	81,582,128	47,839,635
6.	Loan loss provision expense	12,002,664	25,311,625	20,445,866
7.	Administrative expense, personnel	71,974,110	113,093,907	78,196,744
8.	Other administrative expenses	91,159,349	118,341,720	89,397,585
9.	Total operating expenses	246,050,561	338,329,380	235,879,830
10.	Net operating profit (loss)	54,440,495	111,001,398	114,866,470
	Non- operational income			
11.	Cash donations for financial services			
12.	Other non-operational income (if any)	-33,012,334	-47,335,662	34,460,084
13.	Non-operational expenses			
14.	Total consolidated profit (loss)	21,428,161	63,665,736	80,406,863

other costs. It should be noted this increase is far less than the over 33% increase in the loan portfolio, demonstrating that Equity has reasonably contained costs.

The balance sheet in Table 12 reflects Equity's financial position. The liquidity requirement as articulated by the Central Bank of Kenya for such institutions is 20% and, at the moment, Equity's liquidity ratio is above 50%. This is seen by a cash and investment increase of over 39% in the year 2002 and a slight decrease in the year 2003. The increase in liquidity has been bolstered by an equity injection of Ksh 120 million from the AfriCap fund in the form of a 16% purchase of the issued share capital of Equity. This was largely due to Equity receiving the certificate of Best GIRAFE Methodology rated Micro Finance Institution in the world by the Global Rating Agency, Planet Finance of France.

At this stage it is difficult to assess loan quality because there is no evidence that Equity has written-off any bad debts. The issue of bad debts has been dealt with at Board level and management was authorised to write-off over Ksh 76 million of bad debts. As a result, this transaction has not been effected in the books of accounts. According to policies and procedures, the identification of write-offs is done by branches and effected at the Head Office, but neither the Head Office nor the Branches have done this to date. Equity offers over six different products but no information is available regarding write-offs and provisioning on a product basis. According to management these products are not tracked and accounted for separately as they have the same qualities.

Table 12: Balance Sheet (in Kenyan Shillings)

	Account	Dec – 01	Dec - 02	Jul - 03
	Assets			
15.	Cash and due from banks	254,011,856	243,622,784	394,035,045
16.	Reserves in central bank			
17.	Short-term investments in market instruments	568,466,518	899,511,924	1,003,911,103
18.	Total loan portfolio	857,197,802	1,189,291,509	1,480,748,084
19.	(Loan loss reserve)	-95,613,128	-68,305,109	-88,750,975
20.	Other short-term assets	37,303,783	50,441,616	166,439,360
21.	Long-term investments			
22.	Net fixed assets	261,760,226	260,948,583	262,500,084
	Total assets	1,883,127,057	2,575,511,307	3,218,882,701
	Liabilities			
24.	Savings accounts, compulsory			
25.	Savings accounts, voluntary	1,608,950,482	2,142,165,324	2,592,554,738
26.	Time deposits			
27.	Loans, commercial			
28.	Loans, central bank			
29.	Loans, subsidized			
30.	Other short-term liabilities	46,707,082	110,012,749	83,571,103
31.	Other long-term liabilities			
32.	Total liabilities	1,655,657,564	2,252,178,073	2,676,125,841
	Equity			
33.	Paid-in equity from shareholders	50,828,945	52,861,945	62,861,945

34.	Donated equity, prior years, cumulative			
35.	Donated equity, current year			
36.	Prior years' retained earnings (losses), not including cash donations	37,109,732	58,537,893	122,203,629
37.	Current year's retained earnings (losses)	21,428,161	63,665,736	80,406,863
38.	Other capital accounts	118,102,655	148,267,660	277,284,423
39.	Total equity	227,469,493	323,333,234	542,756,860
40.	Total liabilities and equity	1,883,127,057	2,575,511,307	3,218,882,701

5.2 Adjustments for Inflation and Subsidies

Table 13 provides an overview of the shadow prices used to calculate some of the adjustments to the financial statements.

Table 13: Shadow Prices (in percentages, except where otherwise indicated)

	Dec - 01	Dec - 02	Jul – 03
Inflation rate	5.8%	1.9%	7.9%
GDP deflator	1.2%	1.1%	2.3%
Interbank lending rate	10.4%	8.7%	14.9%
90-day certificate of deposit rate	6.9%	8.4%	8.4%
Prime rate paid by commercial bank borrowers	19.5%	18.3%	18.3%
Marginal commercial rate available to the MFI	20.6%	18.5%	18.5%
Per capita GDP (US$)	317.9	350.6	360.0
Exchange rate (local currency/US$)	78.6	77.0	75.0

The Central Bank of Kenya currently regulates Equity and takes deposits from its clients that are treated as member fees in line with the Banking Society Act. The largest liability in Equity's books is savings and interest is paid out only once a year at a rate of 5%. Other than the interest calculated on voluntary savings, Equity is not liable for any debt costs from any financial institution. The 90-day CD rate of 8.4% was used to adjust for the subsidised cost of funds. This rate appears to be lower than the interbank lending rate of 14.9%. However, Equity is currently raising huge amounts of savings from their clients and will continue financing growth of the loan portfolio in this manner, given that the cost of raising and maintaining such deposits is relatively cheaper than commercial funds. The additional capital necessary to back up these deposits will be raised through sales of shares to staff, customers and through an agreement with AFRICAP/IFC to increase their investment if necessary.

Table 14: Adjustments for Inflation and Subsidies

		Dec – 01	Dec –02	Jul – 03
1.	Unadjusted operating expenses in local currency	246,050,561	338,329,380	235,879,830
2.	Inflation adjustment		266,892	13,534,336
3.	Subsidized cost of funds adjustment	18,328,666	75,964,736	151,018,608
4.	In-kind donation adjustment a. Personnel b. Other			
5.	Adjusted operating expenses	264,379,227	414,561,008	400,432,774
6.	Adjusted operating profit (loss)	36,111,8290	34,769,770	-49,685,997

Equity's income statement and balance sheet do not include an inflation adjustment, which is not a generally accepted practice in the country according to Equity. Therefore, the adjustment as seen above is necessary. According to management, the organisation has not received in-kind donations in the form of a rent-free building or donor paid technical advice in the current year. Partial-year data has been adjusted by using partial-year inflation rates and shadow prices.

The adjusted operating profit is positive for 2001 and 2002, but in 2003 the adjustment results in a loss of Ksh 49 million. If the projected conditions prevail (for example, if the cost of borrowing increases to the 90-day CD rate), Equity may have problems attaining financial financial-self sufficiency in the future. Currently, this is projected at an adjusted rate of 87.6%.

5.3 Profitability

Table 15 reflects profitability ratios after annualising the July 2003 numbers. The table demonstrates a positive 7.5% return on assets, which represents a huge improvement from the 5.6% return in the year 2002. The adjusted return on equity and assets for the first seven months of the 2003 fiscal year reflects a negative return due to inflation and the cost of funding adjustments. It is evident that the cheap source of funding will improve profitability in the long run, but the situation could change if the market drives Equity to seek commercial funding at commercial rates. Operational self-sufficiency, with or without cost of funding, is high at 133 % and 194%, respectively, for 2002. Financial self-sufficiency was a positive 108%, while the projected adjusted rate of 87.6% could indicate problems in the event that Equity is forced to increase its cost of capital.

Equity reflects positive profitability into the future in its forecasts. A review of Equity's comparisons of actual to budget figures revealed immaterial variances, and augurs well for Equity's future profitability.

Table 15: Profitability

		Dec - 01	Dec – 02	Jul – 03
1.	Return on assets	4.1%	5.6%	7.5%
2.	Adjusted return on assets	2.3%	1.6%	-2.9%
3.	Adjusted return on equity	17.1%	12.6%	-19.7%
4.	Operational self-sufficiency (excluding cost of funds)	184.2%	194.1%	209.3%
5.	Operational self-sufficiency	122.1%	132.8%	148.7%
6.	Financial self-sufficiency	113.7%	108.4%	87.6%

5.4 Efficiency

The organisation's operating expenses increased by 37% in 2002 and 19% in 2003. This reflects an improvement in the containment of costs especially when compared to the 33% increase in the loan book and 32% in savings. The 23% ratio reflected in the calculation of administrative efficiency in the year 2003 is above the 15-20% ratio prevalent in microfinance institutions around the world, making this an area Equity will need to monitor carefully in the future.

The annualised operational and administrative efficiency ratios appear to be in line with comparative years 2001/2. Administrative costs per loan have fallen by over 54% from 2001 to 2003. This could be largely due to the phenomenal growth in the loan portfolio, which is expected to decline in line with the current trend.

The three-year business plan (2003-2006) does not reflect any changes in service delivery methodology or loan methodology, and management's comments do not reflect any plans to deviate from the current fundamentals. The management is conscious of the impact of growth on costs and has set the goal of reasonably reducing cost to income as can be seen in the 19% increase of costs from 2002.

The number of active clients per loan officer and outstanding portfolio per loan officer is declining to a manageable level, which augurs well for the management of delinquencies.

Table 16: Efficiency

		Dec - 01	Dec – 02	Jul - 03
1.	Administrative efficiency	27.0%	24.6%	23.0%
2.	Operational efficiency	40.8%	35.9%	32.2%
3.	Administrative cost per active loan	160	103	43
4.	Personnel costs as a percentage of total administrative costs	44.1%	48.9%	46.7%
5.	Number of line staff as a percentage of total staff, end of period	24.0%	31.7%	30.8%
6.	Number of active loan clients per staff member, end of period	94	223	231
7.	Number of active loan clients per loan officer, end of period	993	1,537	1,501
8.	Outstanding portfolio per loan officer, end of period	641,519	572,050	481,544
9.	Number of clients per branch office, end of period	1,688	3,459	5,128

5.5 Loan Portfolio Analysis

5.5.1 Portfolio Data

Table 17: Portfolio Data (in Kenyan shillings)

		Dec - 01		Dec – 02		Jul – 03	
1.	Total principal balance outstanding, end of period	857,197,802		1,189,291,509		1,412,442,973	
2.	Number of active loans (clients), end of period	16,883		41,503		61,531	
3.	Average principal balance per client	50,773		28,656		22,955	
4.	Average principal balance outstanding over the period	680,094,387		1,023,244,656		1,300,867,241	
5.	Loan losses written off over the period*			43,957,000		28,289,000	
6.	Increase in loan loss reserve over the period	12,002,664		25,311,625		750,000	
7.	Loan loss rate			4.3%		3.8%	
8.	Total outstanding balance associated with loans that are:						
	On time (and never refinanced)			1,066,431,000	90%	1,295,691,973	92%
	On time (but have been refinanced)						
	Late (at least 1 payment)						
	1–30 days			22,138,000	1.9%	37,244,0000	2.6%
	31–60 days			17,446,000	1.5%	10,548,000	0.7%
	61–90 days			15,724,000	1.3%	23,710,0000	1.7%
	91–180 days			23,596,000	2%	16,960,0000	1.2%
	181–360 days			43,957,000	3.7%	28,289,000	2.0%
	1 year or more						
9.	Portfolio-at-risk delinquency rate (more than 30 days late)			8.5%		5.6%	

* Theoretical.

Equity has seven different loan products but does not track each loan product separately. The ageing, loan loss reserve, portfolio at risk and bad debt write-off for each product are not separated and it is difficult for management to identify non-performing and performing products. These reports are available in the system according to the systems' manual, but Equity is not using them, indicating that Equity is not utilising its MIS system to its full extent.

The branches produce an ageing analysis for their loan portfolio. This report is consolidated at the Head Office for all the branches. The branches are responsible for following up on their delinquencies and advising the Head Office on the appropriate steps to be taken with respect to defaults. Again, neither the branches nor the Head Office takes responsibility for identifying bad debts and writing them off. It is not clear from communication with the Head Office or the branches that any negative incentives result from poor delinquency management, or that anyone is held responsible. Nor is there any evidence in the audited and unaudited financials from 2000 to 2003 that any bad debts have been written off.

The loan loss rate as shown in Table 17 has been calculated from portfolio at risk over 120 days. The Board has authorised a write off of Ksh 76 million but, to date, no write off has been shown in the book of accounts.

5.5.2 Delinquency Management and Measurement

The ageing analysis used by the branches and the Head Office reflects both the installment and portfolio at risk. The ageing is system driven and reporting appears to be accurate. The fact that Equity does not age its products individually indicates a poor management of risk on individual products.

The branch managers and Head Office review the ageing analysis on a monthly basis and follow up is done at the branch level. It is not clear whether branch managers are held responsible for any bad debts or poor delinquency management. Portfolio at risk in 2002 was 8.5% and 5.6% in 2003. It is clear that this ratio is decreasing, reflecting management's attention to this prior weakness noted in previous analyses.

5.5.3 Provisioning

According to policy, Equity operates a loan loss reserve of 2% as a general provision and a specific provision with respect to loans that are known to be bad and considered irrecoverable over and above the general provision. This is in line with the Central Bank of Kenya's requirements and it is prudent in that either assets or cash flows from salaries or farming revenues secure all loans. It is not clear from communication with the branches or the Head Office who is responsible for identifying items used in the ageing analysis.

5.5.4 Refinancing

Loans over 90 days are suspended and interest is not accrued on such loans. The branches will continue to follow-up in an attempt to recover the loans from clients through deductions from savings and other means. In the event of non-recovery, the Head Office will liquidate the assets held as security and the difference between the value of the loan and funds recovered will be written off.

5.5.5 Collection

Collections are carried out by deducting instalments from clients' savings accounts. In theory, a client will be given a loan only if he or she has saved with Equity for six months. According to management, the decision to authorise a loan before the preliminary six months period is complete is left up to the branch managers. This deviation from policy is not explicit in the policy manuals and, again, branch managers are not aware of this point, which has been reported by internal audits on a number of visits to the branches.

According to management, the loan instalment deduction from clients' savings accounts is done automatically but, on a number of occasions, internal audits have reported that deductions have not been effected on client savings accounts. Management will need to pay special attention to this issue, particularly when the deductions are done manually and the loan portfolio grows.

5.5.6 Crises

Equity has not experienced any crises in terms of late payments.

5.6 Liquidity Management

Equity has over 2,400 indigenous shareholders who have invested in the institution's ordinary shares. AfriCap fund invested $1.6 million making it a 16% shareholder and the institution's single largest shareholder.

Equity signed a Ksh 300 million contract with the IFC for a solar energy loan scheme for small business enterprises operating in rural areas where electricity is not accessible. Equity has obtained another capacity building grant of US $1 million from DFID (Department of International Development of United Kingdom) and AfriCap to strengthen capacity and expand outreach to over 600,000 savers and 300,000 borrowers in the next three years.

To date, Equity has over 187,000 voluntary savers and continues to grow at a phenomenal rate with each branch opening up to 100 accounts per day. The total deposit base is over Ksh 2.6 billion. The liquidity ratio required by the Central Bank of Kenya is 20% but Equity has a liquidity ratio of over 50%. It is obvious that Equity is not going to experience any liquidity problems in the near term, especially with available funding lines and current equity shareholders.

5.7 Interest Rate Analysis

Equity sets interest to achieve the best possible return without overcharging its clients and ensuring that the product cash flows are designed in such a way as to reduce cash flow mismatch risk. There are seven groups of products that are backed by either assets or cash flow. The interest is charged on a monthly basis at 18% flat annual. Loans can only be accessed after a client has been saving with the institution for six months (see Annex 1 for loan product terms).

Table 18: Interest Rate Analysis

No.	Details	Average Loan
1.	Loan	22,000

2.	Interest (fixed), (declining)	18%p.a.
3.	Period (12) months	12mnths
4.	Repayment p.m.	2,163.33
5.	Theoretical Interest p.m.	2.64%
6.	APR	31.72%

The gap between theoretical and actual yield on portfolio is more than 20%. While this difference is not substantial, management will need to monitor it closely. Equity set its interest rate on an annual basis according to its five-year plan. It appears that there is no interest rate constraint in the legal environment within which Equity operates and, currently, Equity has set responsive interest rates.

Table 19: Comparison of Actual and Theoretical Yield

		Jul – 03
1.	Theoretical interest yield (APR)	31.72%
2.	Loan product as a percentage of total outstanding year-end net loan portfolio	100%
3.	Line 1 times line 2	31.72%
4.	Weighted theoretical interest yield	31.72%
5.	Actual yield on portfolio	25.2%
6.	Yield gap ratio	79.3%

5.8 Liabilities and Cost of Funds Analysis

The largest creditor on Equity's books is client's voluntary savings. Currently, the cost to the organisation is minimal and repayment is short term without clear amortisation lines.

Currently the commercial rate available to MFIs is 18.5% p.a. and Equity is only paying 2% on its liabilities. This situation could be volatile if Equity decides to raise commercial funding, particularly since Equity is not currently financially self-sufficient. It is clear in the five-year plan that management will not be raising any commercial funding in the near future.

5.9 Capital Management (solvency)

Equity's current capital structure is able to sustain a reasonable level of business risk. Table 20 demonstrates a relatively high equity multiplier, which could result in minimum leveraging. Equity has a huge liability base arising from savings and this could limit its ability to raise debt because of its high debt-to-equity ratio.

The AfriCap Fund investment, which is crucial to Equity's growth, funding and strategy, carries board representation. Equity intends to raise funds from savings in the future, with planned capital injections from new and current shareholders to maintain sufficient capital adequacy.

Table 20: Equity Multiplier

	Dec – 01	Dec –02	Jul – 03
1. Total assets, end of period	1,909,570,710	2,549,335,316	2,686,629,856
2. Total equity, end of period	227,469,493	323,333,234	542,756,860
3. Line 1 divided by line 2	839.5%	788.5%	495.0%

Annex 1: Loan Products, Terms, Conditions and Charges

Table 21: Loan Products, Terms, Conditions and Charges

Loan products	Education	**Health**	Salary advances	Business	Farm input	Development	SAKO plus (on pilot)	Jijenge (Loans under lien)
Purpose	School fees	Settling of medical bills	Short term financial needs for salaried customers	Working capital	Purchase of farm inputs/requirements	Property development	Other general financial needs	Other general financial needs
Target population	Account holders who pay school fees for dependants	Account holders with hospital bills to settle	Salaried customers with remittances processed by EBS	Working capital. Some sort of security needed.	Farmers whose farm proceeds are processed through EBS	Account holders with plans to buy or develop assets	Customers with regular income	Customers with regular income
Loan ranges	Up to Kshs.100,000	Up to Kshs. 100,000	Up to Kshs. 100,000	Kshs.3,000 to Kshs.20mil	Up to Kshs. 500,000	Kshs. 3,000 to Kshs. 20mil	4 times the existing savings	Up to 90% of the saving balance
Effective interest rates (p.a)	15% - Flat rate	12% - Flat rate	15% - Flat rate	18% - Reducing balance	17% - Flat rate	18% - Reducing balance	15% - Flat rate	15% - Flat rate
Other charges	Initial loans 5% of amount applied for Repeat loans – 3%		Initial loans 5% of amount applied for Repeat loans – 3%	Initial loans 5% of amount applied for Repeat loans – 3%	Initial loans 5% of amount applied for Repeat loans – 3%	Initial loans 5% of amount applied for Repeat loans – 3%		
Timing	Six months after opening savings account but loan processed and credited the same day as the application	Six months after opening savings account but loan processed and credited the same day as the application	Six months after opening savings account but loan processed and credited the same day as the application	Six months after account operation. Loan security determines the processing and disbursement period.	Six months after opening savings account but loan processed and credited the same day as the application	Six months after account operation. Loan security determines the processing and disbursement period.	Six months after opening savings account but loan processed and credited the same day as the application	No minimum limit time

Annex 2: Loans Outstanding by Branches

Table 22: EBS's Branch Loan Portfolio as of August 31, 2003

EQUITY BUILDING SOCIETY BRANCHWISE LOANS PORTFOLIO AS OF 31ST AUGUST 2003			
BRANCH	PRODUCT	LOAN CLIENTS	LOAN PORTFOLIO
CORPORATE			
	FARM INPUT ADVANCE	3	(14,697.00)
	DEVELOPMENT LOANS	4	1,075,777.00
	BUSINESS LOANS	1,213	730,137,348.50
	SCHOOL FEE LOANS	10	216,046.00
	MEDICAL LOANS	13	238,577.85
	SALARY ADVANCE	55	2,056,801.30
	BRANCH TOTAL	1,298	733,709,853.65
FOURWAYS			
	SL01	81	15,278,818.85
	FARM INPUT ADVANCE	8	90,298.00
	DEVELOPMENT LOANS	5	83,882.00
	BUSINESS LOANS	911	103,701,163.58
	SCHOOL FEE LOANS	554	4,753,442.50
	MEDICAL LOANS	225	1,981,904.30
	SALARY ADVANCE	4,694	72,754,265.24
	PREMIUM CREDIT	2	6,094.00
	SAKO PLUS LOANS	2	913.00
	BRANCH TOTAL	6,482	198,650,781.47
KANGEMA			
	FARM INPUT ADVANCE	6,070	31,692,200.19
	DEVELOPMENT LOANS	96	11,890,316.62
	BUSINESS LOANS	676	9,700,686.58
	SCHOOL FEE LOANS	31	225,556.55
	MEDICAL LOANS	4	33,600.00
	SALARY ADVANCE	1,879	11,542,561.10
	PREMIUM CREDIT	2	3,315.00
	SAKO PLUS LOANS	213	6,920,963.92
	BRANCH TOTAL	8,971	72,009,199.96
KARATINA			
	FARM INPUT ADVANCE	1,367	9,913,849.73
	DEVELOPMENT LOANS	364	15,871,311.52
	BUSINESS LOANS	784	54,811,672.94
	SCHOOL FEE LOANS	15	68,318.23
	MEDICAL LOANS	2	22,144.90
	SALARY ADVANCE	3,003	17,361,199.07
	PREMIUM CREDIT	22	84,260.25
	BRANCH TOTAL	5,557	98,132,756.64
KIRIAINI			

	FARM INPUT ADVANCE	2,253	16,947,739.86
	DEVELOPMENT LOANS	61	11,598,895.64
	BUSINESS LOANS	669	46,438,025.04
	SCHOOL FEE LOANS	412	5,523,920.75
	MEDICAL LOANS	18	214,269.48
	SALARY ADVANCE	765	9,225,651.72
	SAKO PLUS LOANS	96	4,500,781.15
	BRANCH TOTAL	4,274	94,449,283.64
MURARANDIA			
	FARM INPUT ADVANCE	8,147	24,434,190.58
	DEVELOPMENT LOANS	275	10,902,302.73
	BUSINESS LOANS	629	6,666,637.16
	SCHOOL FEE LOANS	523	1,797,064.87
	MEDICAL LOANS	5	14,098.00
	SALARY ADVANCE	1,304	3,310,391.66
	PREMIUM CREDIT	37	39,400.60
	SAKO PLUS LOANS	292	3,943,295.07
	BRANCH TOTAL	11,212	51,107,380.67
KANGARI			
	FARM INPUT ADVANCE	4,551	16,342,682.85
	DEVELOPMENT LOANS	77	5,661,824.80
	BUSINESS LOANS	273	18,468,117.07
	SCHOOL FEE LOANS	155	981,809.05
	MEDICAL LOANS	7	31,930.70
	SALARY ADVANCE	1,195	8,197,998.92
	SAKO PLUS LOANS	47	482,129.00
	BRANCH TOTAL	6,305	50,166,492.39
OTHAYA			
	FARM INPUT ADVANCE	1,746	12,879,184.11
	DEVELOPMENT LOANS	120	7,756,665.54
	BUSINESS LOANS	883	22,404,751.25
	SCHOOL FEE LOANS	186	1,594,506.50
	MEDICAL LOANS	22	114,360.00
	SALARY ADVANCE	953	7,466,873.85
	PREMIUM CREDIT	1	-
	BRANCH TOTAL	3,911	52,216,341.25
THIKA			
	FARM INPUT ADVANCE	2,859	18,593,129.24
	DEVELOPMENT LOANS	148	38,656,901.15
	BUSINESS LOANS	467	21,773,068.40
	SCHOOL FEE LOANS	75	621,352.80
	MEDICAL LOANS	48	61,436.65
	SALARY ADVANCE	2,401	29,663,242.95
	PREMIUM CREDIT	8	33,896.75
	BRANCH TOTAL	6,006	109,403,027.94

KERUGOYA			
	FARM INPUT ADVANCE	945	5,169,189.49
	DEVELOPMENT LOANS	174	7,728,827.62
	BUSINESS LOANS	564	16,655,231.05
	SCHOOL FEE LOANS	216	1,061,194.90
	MEDICAL LOANS	22	52,910.50
	SALARY ADVANCE	2,319	8,101,073.29
	BRANCH TOTAL	4,240	38,768,426.85
NYERI			
	FARM INPUT ADVANCE	66	665,521.70
	DEVELOPMENT LOANS	48	2,780,421.90
	BUSINESS LOANS	381	26,629,157.38
	SCHOOL FEE LOANS	23	289,990.50
	MEDICAL LOANS	2	22,268.00
	SALARY ADVANCE	1,893	22,681,483.35
	PREMIUM CREDIT	12	259,008.50
	BRANCH TOTAL	2,425	53,327,851.33
TOM MBOYA			
	FARM INPUT ADVANCE	4	60,609.00
	DEVELOPMENT LOANS	2	3,222,956.00
	BUSINESS LOANS	482	58,911,713.74
	SCHOOL FEE LOANS	45	738,392.70
	MEDICAL LOANS	14	429,148.85
	SALARY ADVANCE	469	7,886,532.55
	BRANCH TOTAL	1,016	71,249,352.84

CONSOLIDATED EBS PORTFOLIO	61,697	1,623,190,748.63

Annex 3: Mobile Locations per Branch

Table 23: EQUITY BUILDING SOCIETY: MOBILE CENTRES LOCATIONS AND LAUNCH DATE				
Mother Branch	Mobile Village Centre	Distance from Mother Branch	Service Days	UNIT Launch Date
Kangema	Kihoya	16 kms	Monday	June-03
	Kanyenyaini	9 kms	Tuesday	June-03
	Mioro	20 kms	Friday	June-03
	Wanjerere	23 kms	Monday	June-03
	Gikoe	12 kms	Wednesday	June-03
	Gacharageini	21 kms	Friday	June-03
	Kiruri	14 kms	Wednesday	June-03
	Ichichi	16 kms	Wednesday	June-03
Kiriaini	Kagicha	8 kms	Thursday	July-03
	Kairo	14 kms	Thursday	July-03
	Mioro	17 kms	Friday	July-03
	Gacharageini	14 kms	Friday	July-03
	Kihoya	16 kms	Monday	July-03
	Wanjerere	13 kms	Monday	July-03
	Gikoe	10 kms	Wednesday	July-03
Murarandia	Ichichi	15 kms	Wednesday	June-03
	Kiruri	14 kms	Wednesday	June-03
Kangari	Ndunyu Chege	26 kms	Thursday	April-03
	Ndakaini	10 kms	Thursday	April-03
	Gikoe	10 kms	Tuesday	April-03
	Mununga	6 kms	Tuesday	April-03
Othaya	Kagicha	10 kms	Thursday	July-03
	Kairo	20 kms	Thursday	July-03
Thika	Mundoro	60 kms	Thursday	November-03
	Gakoe	45 kms	Monday	November-03
	Ituramiro	65 kms	Thursday	November-03
	Gatura	40 kms	Wednesday/Friday	November-03
Kerugoya	Karumandi	25 kms	Wednesday	February-03
	Kimunye	17kms	Thursday	February-03
	Kagumo	7 kms	Friday	February-03

Annex 4: Savings

Table 24: Number of Depositors and Amounts

PRODUCT	ACCOUNTS JULY 2003	BALANCES JULY 2003	ACCOUNTS August 2003	BALANCES August 2003
ORDINARY SAVINGS	148,114	1,022,440,453.84	153,087	1,030,339,274.37
FIXED DEPOSITS	3,403	663,205,222.35	3,472	753,991,369.95
BUSINESS SAVINGS	18,156	731,239,478.00	18,725	712,993,478.61
MOBILE SAVINGS	10,529	42,351,632.08	10,693	41,127,427.73
JIJENGE SAVINGS	3,756	25,784,269.52	3,914	28,097,455.47
CHURCH SAVINGS	751	13,915,031.93	771	14,261,105.78
CHILDREN SAVINGS	1,485	15,584,718.09	1,550	15,980,981.82
STAFF SAVINGS	502	3,981,273.79	551	3,721,489.89
PREMIUM SAVINGS	429	2,546,183.04	425	2,644,413.64
CONSOLIDATED TOTAL	187,125	2,521,048,262.64	193,188	2,603,156,997.26

Table 25: Savings Products and Respective Charges and Conditions

Savings products	Ordinary	Business	Jijenge	Super junior	Call and fixed deposits	Church
Interest rates (p.a.)	2.5%	2.5%	2.5% - 4.37% depending on the number of years	2.5%	Negotiated depending on Treasury bills (0.8% - 1.0%)	2.5%
Per transaction fee (Kshs)	Kshs.40	30	40	40		Free
Withdrawal below minimum balance (Kshs)	100	200	-	100	-	Free
Remittance charge (Kshs) per month	100	100	Not for remittances	-	-	-
Account closure (Kshs)	300	500	Premature withdrawal 1% on one month notice while 3% for no notice	300	-	Free
Account statement	Half-yearly and free	Half-yearly and free	Half-yearly and free	Half-yearly and free	Half-yearly and free	Half-yearly and free
Photo card	Free	Free	Free	Free	Free	Free
In-house check book (Kshs)	200	200	-	200	-	Free
Up-country check clearing	0.4%	0.4%	0.4%	0.4%	0.4%	Free
Local clearing for a minimum of (Kshs)	250	250	250	250	250	Free
Minimum opening balance	Nil	Nil	Nil	Nil	Nil	Nil
Minimum operating	400	1,000	500	400	20,000	400

balance		5,000 for corporate				
Mobile fees (Kshs) per transaction	50	50	-	50	-	Free
Stop payment for in-house checks (Kshs) per check	500	500	-	500	500	500

Table 26: Equity Building Society: CBK Deposit Slabs

EQUITY BUILDING SOCIETY: CBK DEPOSITS SLABS 31ST AUGUST 2003

SLAB	TYPE OF DEPOSIT	NO. OF ACCOUNTS	AMOUNT KSHS
Less than 50,000	Demand Accounts		
	Savings	182722	574,373,348.42
	Call	0	0
	Fixed	2559	12,595,069.80
50,000 to100,000	Demand Accounts		
	Savings	3710	257,942,990.22
	Call	0	0
	Fixed	344	27,355,366.01
100,001 to 500,000	Demand Accounts		
	Savings	2993	559,322,256.73
	Call	0	0
	Fixed	403	92,085,791.05
500,001 to 1,000,000	Demand Accounts		
	Savings	197	130,255,852.52
	Call	0	0
	Fixed	73	56,922,624.14
Over 1,000,000	Demand Accounts		
	Savings	94	327,271,179.42
	Call	0	0
	Fixed	93	565,032,518.95
	TOTAL	193188	2,603,156,997.26

PART 4 – POLICY IMPACT AND REPLICATION

1.0 Introduction and Research Objective

The policy and replication assessment seeks to measure outcomes of and impact against the potential policy and replication impact areas outlined in the UNCDF Strategy for Policy Impact and Replication.[4] This sub-report assesses the extent to which the UNCDF-supported pilot operations *exert a wider influence and leverage on policy* and provides a tested *model for replication and adoption of best practice* by national government, other development agencies or private entities.

The microfinance goal of the UNCDF, as stated in the organisation's Strategic Results Framework (sub-goal 2), is:

"To increase access of the poor, especially women, to financial services on a sustainable basis through strengthened microfinance institutions and an enabling environment."

UNCDF realised that supporting microfinance initiatives on the scale needed worldwide would require a broader look at the policy, regulatory and institutional support environment for each country that it works in. At one level, this amounts to little more than a macroeconomic framework that minimises inflation and avoids policies such as rigorously enforced interest rate controls, or large directed, subsidized credit programmes that compete with MFIs. However, at another level, it also reflects the need to ensure that outdated practices and policies, such as legislation which limits the organisational forms which can enter the market and gender obstacles in terms of property rights, inheritance laws and other discriminatory practices, are suitably updated. UNCDF advocates an enabling environment, which removes potential roadblocks for microfinance institutions and, where appropriate, offers incentives to the industry.

In recognition of its limited funding base, piloting with a view to replication by other donors, government or private sector is central to the UNCDF approach that emerged in the 1990s.

After a brief overview of the methodology employed in Section Two, the policy and replication impact assessment is structured as follows: Section Three provides an overview of some of the key players in the Kenyan microfinance industry. Section Four uses an analysis of UNCDF's Illustrative Policy Issues Matrix to discuss each of the four levels of policy influence as per the Terms of Reference – Broad Policy Directions (3.1), Legal and Statutory Framework (3.2), Regulatory Framework (3.3) and Norms (3.4), with special reference to the microfinance sector. It explores the *policy changes in the country attributable to UNCDF-supported microfinance interventions.*

[4] Policy changes are identified according to the typology used in the 2002 UNCDF Strategy for Policy Impact and Replication. see: http://www.uncdf.org/english/about_uncdf/corporate_policy_papers/index.html

Section Four explores evidence of replication as identified based upon UNCDF's Replication Matrix and elaborates on: Expanding a programme through Co-financing (4.1), Upscaling a programme Sequentially and Private Sector Replication (4.2), and Ad-hoc Influence and Inspiration (4.3). Here, we seek to explore *what evidence of acceptability/replication of the MFI and its products exists in the market.*

2.0 Methodology

Enterprising Solutions employed the following methodology to assess UNCDF's achievements in influencing policy and promoting replication and microfinance best practices.

Through the systematic identification of changes in the policy environment over the period under review, and super-imposing them against UNCDF instruments employed in the same time period, the evaluation team attempted to isolate the causes and sources of the change through analysis, and to establish the extent to which UNCDF has had an impact on the policy environment.

The methodology considered that it would not always be possible to establish a direct correlation between policy changes and UNCDF instruments but, to the extent possible, the assessment team sought to determine whether changes could be attributed to UNCDF and/or whether or not they can be attributed to the effective partnerships in which UNCDF is engaged.

In order to assess the replication impact of the UNCDF in the microfinance sector, the team undertook a similar process using the UNCDF's Replication Matrix Replication where it was assessed according to the benefits that the programmes have brought to the market, such as the extent to which:

- MFIs have become valued and accepted by the financial sector;
- MFIs have successfully developed new products and services that can reach a different market and be replicated by others; and
- The practical experience of supported MFIs has contributed to sector development.

Tools included an analysis of secondary data on policy initiatives and changes in a desk review prior to the mission as well as through document collection during the mission, and primary data collection through semi-structured interviews with key players in the microfinance sector.

It should be noted that the terms "policy impact" and "replication" are taken from the Information, Training and Agricultural Development (ITAD) recommendation wherein "policy impact" implies actions by national authorities imitating UNCDF procedures nation-wide and "replication" refers to UNCDF influences on donor strategy, MFIs, the private sector and the wider microfinance community.[5]

[5] UNCDF Strategy for Policy Impact and Replication in Local Governance and Microfinance p.7.

3.0 Background: Mayor Players in Microfinance

The Kenyan Microfinance industry is one of the oldest and most established in Africa. Two of the current six to ten big players in the MFI market in Kenya started operating as early as the 1980s: the Kenyan Rural Enterprise Program (K-Rep) and Kenya Women's Finance Trust (KWFT). K-Rep initially focused on lending funds provided by USAID and other donors to smaller organisations such as the National Council of Churches in Kenya (NCCK), KWFT, and Tototo among others. K-Rep transformed into a bank serving nearly 40,000 active clients and, by the end of 2002, had a portfolio of US$15 million. The Kenya Women Finance Trust (KWFT) was incorporated as a non-profit trust in 1982 and has grown into a leading MFI serving over 50,0000 active clients with a portfolio of over US$6 million at the end of 2002.

By the early 1990's, interest in and knowledge of the microfinance industry had grown substantially and the "minimalist" group-based Grameen lending approach was adopted by many MFIs. Despite this relatively long history, until the early 2000s, outreach was extremely limited. Banks in Kenya did not pay much attention to the poor with the exception of the Kenya Post Office Savings Bank, and the Cooperative Bank. NGOs have made efforts to act as intermediaries but until recently their outreach has not been impressive. Part of the limited outreach, compared to MFIs in Asia for example, is due to geographic and demographic challenges as well as several other factors (see the section on key changes in the sector in the sub-report on positioning for further details).

The latest available microfinance sector overview counted 86 organisations providing financial services.[6] Though some initiatives were halted and some programmes merged, it is likely that the number has grown to over 100 MFIs, excluding SACCOs. The most prominent institutions that emerged besides K-Rep and KWFT are FAULU (with Food for the Hungry International as majority shareholder), SMEP (Small and microenterprise Programme – formerly NCCK) and WEDCO (with CARE as majority shareholder) and more recently EBS (Equity Building Society) and Jamii Bora.[7] Table 1 provides a snapshot of key indicators of some of the major MFIs.

Table 1: Key Indicators of Selected Major MFIs (in US$ as of 31/12/2002)

	Clients	Outstanding Loan Balance	Voluntary Savings Balance	Operational Self-Sufficiency
K-Rep Bank	38,739	15 million	10.9 million	133%
KWFT*	50,000	6 million	N.A.	>100%
Faulu	19,000	9.5 million	N.A.	124%
SMEP**	13,911	2.5 million	N.A	74%
EBS	155,883	15.5 million	27.9 million	129%
Jamii Bora	13,500**	1.8 million	N.A.	>100%

* As of June 2002. KWFT posted a net profit ($16,000) for the first time ever in the first quarter of 2002 (MicroRate, September 2002). ** As of December 2001; Jamii Bora has grown fast and had about 40,000 clients at the t ime of the mission in August 2003

[6] Dondo, A. The Status of Microfinance in Kenya, K-Rep Occasional paper no.35, Nairobi, 1999.
[7] In addition, there are a number of smaller MFIs, such as ECLOF, KADET (formerly World Vision), PRIDE Kenya, Microfinance Partners Ltd, BIMAS, WEEC, etc..

The Kenyan microfinance market was traditionally characterised by a similarity in lending methodology, with the majority of MFIs doing group based lending, often with a second tier guarantee group known as 'chikola' groups. This landscape is now changing with more diverse methodologies emerging every day as new MFIs enter the market.

The Kenyan Government

The Government of Kenya (GoK) has indirectly provided support to the microfinance sector since 1992. To counter the possible initial negative social impacts of the 1992-1994 Structural Adjustment Program and liberalisation process, the government identified areas and projects needing external donor support, including small-scale and micro enterprises. The lack of access to credit was considered a major bottleneck for entrepreneurial development. The international donor community responded generously and microfinance agencies became donor darlings. A conservative estimate is that the microfinance industry has received a total of US$ 80 million[8] (Hospes, Musinga Ongayo; 2002).

The Kenyan Government issued three important policy papers: the Sessional Paper No.1 of 1986, when the casual term informal sector had been given a new positive dimension, the Sessional Paper No 2 of 1992, which formed the base of all programs for the development of the sector, and the third one in 2003 (see also sub-report 4 on positioning).[9]

NGOs

At the end of the 1990s, the sector was dominated by NGO-MFIs, which still play a large role in terms of the number of institutions. Faulu and WEDCO, two of the major institutions have meanwhile changed institutional charter from international NGO into a microfinance company, registered in Kenya with limited liability under the Companies Act.

SACCOs

The SACCO system is a mutual membership organisation, which involves pooling of voluntary savings from members in the form of shares. These savings/shares form the basis for extending credit to members. Credit is usually based on three times the level of savings/shares. The SACCOs are primarily organised as workplace or cash crop based savings and credit associations, whereby people with a common bond (e.g. by working together in the same company or institution) save regularly, thus building enough deposits for lending within the group. Today, there are over 4,000 such SACCOs with over 1 million members. The market segment is growing fast and now control KSh80 billion (nearly US$1 billion).

Commercial Banks

The number of banking institutions actively involved in the provision of microfinance is increasing. These include the Post Bank, K-Rep Bank, the Kenya Commercial Bank (KCB), the Co-operative Bank of Kenya, Equity Building Society

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[8] A large part of these donor grants has been invested in two, now leading, micro-finance agencies: Kenya Rural Enterprise Programme (K-REP) and Kenya Women Finance Trust (KWFT). K-REP reports to have received USD 23 million or more in its life-time (see Annex J) whereas KWFT reports that it has received Ksh 411 million (or about USD 6 million) in the period 1995-2001.

[9] Micro and Small Enterprises in Kenya – agenda for improving the policy environment, Mullei, Bokea, 1999.

(EBS) and Family Finance Building Society. These institutions have, in the past, channelled funds from organisations such as USAID, the OPEC Fund, the IFC and DANIDA to the microfinance and small enterprise sector.

In terms of savings mobilisation, the Kenya Post Office Savings Bank has provided deposit services to micro-savers since 1910, and the K-Rep Bank was the first NGO to become a bank in Africa.

In 1991, the KCB used its own funds to begin microfinance lending, as did Barclays Bank. However, commercial bank top management was not particularly interested in serving this sector. In general, microfinance was not seen as profitable, and banks wanted to support government programs. Microfinance was seen as donor induced. However, management is now changing the way it views microfinance, seeing instead its profit potential. The advantage of commercial banks is the ability to use their branch structure to achieve greater outreach.

The Co-operative Bank of Kenya is an indigenously owned bank, which was created for the sole purpose of providing financial services to co-operative societies which otherwise would not have been able to access such services from traditional commercial banks. It was incorporated in 1965 and licensed to operate as a bank in 1968.

International Investors

There are a number of private investors who have entered this market in recent times as illustrated below. *AfriCap* has become the largest shareholder in EBS.
The *Agence Francaise de Developpement* is going to issue a credit enhanced, five-year bond to raise KSH 1 billion. The *FMO* invests in K-Rep. *Oikocredit* provides medium- to long-term hard currency loans at 10% on US$ loans, local currency variable interest rate loans, guarantees, and equity investments. Oikocredit makes finance available to groups of people active in agriculture and livestock, manufacturing, tourism and to credit and savings cooperatives and other microfinance institutions. *Shore Bank* invests in K-Rep.

Donors

In 1999, there were twelve main donors funding microfinance programs in Kenya.[10] Donors have supported some institutions and have helped the government to acknowledge the sector's importance. Donors that have supported the microfinance sector include DFID, UNDP, USAID, DANIDA, FINNIDA, GTZ, the EU, Dutch NGOs, the Gatsby Trust, and the Ford Foundation. The major ones are discussed below.

DFID's £12 million Financial Sector Deepening program in Kenya supports pro-poor development of the financial sector through a series of strategically focused interventions. For instance, the programme provides support to the Cooperative Bank. In addition, DFID is a major donor to both MicroSave and the Equity Building Society. Other programs include the British Partnership for

[10] Dondo, A. The Status of Microfinance in Kenya, K-Rep Occasional paper no.35, Nairobi, 1999.

Enterprise Development (BPED) programme (£20.9 million over five years), which aims to enable more people, especially women, to access and use financial and business development services. DFID works in partnership with a number of MFIs such as the Kenya Women Finance Trust, K-Rep and FAULU, as well as business service NGOs such as the ApproTEC.

The *European Union (EU),* through its Micro-Enterprise Support Programme (MESP) has supported a number of MFI activities in Kenya since 1999. The EU is taking on a role in supporting the second tier level, following in the footsteps of the Dutch Government in a revamped Jitigemee Trust. The EU also supported EBS with institutional capacity building and capital needs to support outreach.

The *Ford Foundation* has been providing support to the microfinance sector for some time. It currently provides long-term loan finance (for example, a 10-year loan of US$2 million at 1% per year to KWFT, with a seven year grace period).

USAID has a programme to increase rural household incomes in Kenya by supporting both agriculture and micro-enterprise activities. In addition, USAID supports microfinance institutions (MFIs) and will start an intensive support programme to the microfinance network organization (see below). The USAID programme targets approximately 3.5 million small-scale farmers, the majority of whom are engaged in the dairy, horticulture and maize sub-sectors, as well as some 1.3 million MSEs.

UNDP supported a MicroStart programme which was completed in 2003 and also provided support to the network organisation, the Association of Microfinance Institutions (AMFI).

International Networks
There are many international networks in Kenya including: Women's World Banking, Catholic Relief Services (CRS), CARE, INAFI, etc.

Notably, in collaboration with the Women's World Banking (WWB), Citigroup, through the Citigroup Foundation, donated US$400,000 to the WWB to host a Regional Management Development Workshop that will provide training to enhance financial management skills among leaders of African microfinance organizations.

CARE has created the MFI WEDCO, which has spun off from the CARE program into an independent legal entity.

Domestic Networks
A domestic network, the Association of Microfinance Institutions (AMFI), whose objective is to address issues and challenges affecting the sector, was formed in March 1999 (see also the sub-report on policy and replication). It was hosted within one of the MFIs (KWFT) but since 2003 secured its own premises and permanent staff. The AMFI funding comes primarily from grants and membership fees. Its funding partners are: the Ford Foundation, the World Bank, DFID and the Central Bank of Kenya, USAID, WWB/UNDP who provide seed funding for networks, Jitigemee Trust, and the Dutch embassy. AMFI has been working as part of the team that drafted the Microfinance Bill. The network holds promise to raise the

industry profile so that the government can talk to the sector and is poised to play an important role, now that it has resources at its disposal.

Second-Tier Organisations

Jitigemee Trust
The Jitigemee Trust is a Kenyan financial wholesaler offering loans to MFIs. Interest rates are 8-10% per year and loan tenure is up to four years.

Development Finance Institutions
Development Finance Institutions such as the Kenyan Industrial Estates and the Industrial Development Bank could become important. They are state owned and registered as commercial banks although they have never mobilized deposits and have had limited funds since state funding dried up.

In addition to these formal second-tier institutions, donors such as the Ford Foundation, Kenya Gatsby Charitable Trust and the EU have also provide loan finance (see above).

Part 5 on UNCDF's strategic positioning will build on this overview and discuss key changes and gaps.

4.0 Policy Issues Findings

A comparative analysis of the policy environment was undertaken in the year 2000 – when the UNCDF initiated its involvement in Kenya – and again in 2003 to track changes that had occurred during the period under review.

4.1 Broad Policy Direction

This depth of policy impact assessment has to do with the broad political options and directions being taken by national political authorities in regards to microfinance. Often, this is tied to the wider debate (if one can say that there is debate) within the political fora, as well as to pressure from opposition parties, civil society, advocacy groups, the media, and to some extent, from donors. The sum of the positions taken determines the national political stance and, consequently, determines the overall enabling context in which microfinance will develop. The overall Policy quality at this level varies. At times, it is consistent, well-articulated and documented (in Cabinet papers, White papers, Presidential statements, party resolutions or manifestos, etc.). Sometimes this is not the case and different national authorities may also hold different views.

An analysis of top-performing microfinance institutions found that, among the broad policy directions that matter, the only macroeconomic conditions which were prohibitive for microfinance were hyperinflation and rigorously enforced interest rate controls (Christen, Rhyne and Vogel). *Broad policy direction or macro policy of key importance to microfinance are thus financial sector policies, such as inflationary controls, interest rate policies, monetary policy and financial sector reforms.* This analysis will single out these key areas for analysis.

It should be noted that the Kenyan political and economic situation changed for the worse at the beginning of the project and continued in this manner until the elections in December 2002, which marked a watershed period in the political situation in Kenya.

Financial Sector Reform

Although Kenya has been implementing a financial sector reform program since 1991, it has not resulted in unequivocal beneficial results. Kenya's financial liberalisation has been associated with the substitution of financial taxation with rising public debt, particularly domestic debt. The ensuing fiscal pressure and lack of banking competition have spawned a high interest rate spread, depressing both saving and investment while economic potential in both the productive and financial sectors has been reduced.

Sessional Paper No.3 highlights two critical issues the Government envisions itself addressing with regards to the maintenance of a sound banking system, something which also is of importance to the flourishing of MFIs. First, it will be important to take very firm measures to deal with liquidity and banks' asset quality. Second, it will push for the refinancing of the illiquid banks and develop a solution to address the issue of the banks' non-performing assets. Measures will also be taken to enhance competition in financial services, promote asset-based finance such as leasing and remove constraints on the ability of some financial institutions to take deposits.

Fiscal and Monetary Responsibility: A Broad Orientation

The government deficit remains high, 57bn shillings ($740m), due to lower-than-expected tax collections and revenue from privatisation, heavy borrowing on the local money markets to cover spending, and the introduction of a free primary school program. The government intends to constitute a Monetary Policy Committee composed of people with an impeccable record in the society and who are considered expertise in monetary matters. This Committee will provide recommendations on issues such as reducing the government's appetite for credit, and has the specific task of targeting an inflation rate of no more than 4% and reducing interest rates to a single digit. The reduction in domestic financing of the budget deficit is expected to ease pressure on domestic interest rates and free resources to support production in the private sector.

Inflation and Exchange Rate Policies

Controlling the inflation rate is high on the government's agenda, and inflation remained subdued and well under control over the past year, largely due to the sustained implementation of a prudent monetary policy (see above) and a judicious approach towards stabilizing the shilling exchange rate.

Interest Rate Ceilings

In 2000, Kenya proposed to reverse the period of financial liberalisation that has been in place since 1991 by reintroducing regulated interest rates through the use of a Treasury Bill benchmark on lending rates, deposit rates and other supporting measures. The initiative, known as the Central Bank of Kenya (Amendment) Act 2000, is popularly called the Donde Act, after the legislator who introduced it in the Kenyan Parliament.

The Donde Act, which intends to introduce an interest rate ceiling, was passed in Parliament last year. However, the Kenya Bankers Association is protesting the Act's interest rate cap that fixes interest rates at an annual rate of 3% above T-bills (currently T-bills are around 1%). Other fees and charges have not been capped. The Court has enjoined the CBK from applying the Act during a repeal attempt by the KBA. Institutions have further tightened their lending requirements focusing on only the most "creditworthy" (read: wealthy) borrowers.

The GoK Sessional Paper No.3 on Micro and Small Enterprise Development for Employment Creation and Poverty Reduction, states that the government will seek to lower and maintain low lending rates through market reforms, which will address both operating costs, including the costs of intermediation, together with the banks' asset quality.

Financial Repression (Directed Credit)

Since the 1990s, the Government of Kenya's small enterprise policies have repeatedly stated the importance of the creation of an enabling environment. Kenya therefore does not suffer from large scale, subsidised government directed credit programs.

In summary, the financial sector policies and, as a result, the broad policy direction could not have made a change in a worse direction. The passing of the Donde Act is an anomoly in modern day Kenya. The country seems to have only narrowly escaped a great set-back now that the Act has been repealed by the KBA. It would have been a particular big blow to the microfinance sector

In terms of the other key elements of broad policy direction, the situation was bad during the project years in the area of fiscal policy, or general macroeconomic management, and only started to improve in 2003 with the arrival of the new government. UNCDF did not in any way play a role on any of these improvements, as the nature of the issues in the area of general macroeconomic policy is such that they are almost always beyond the scope of UNCDF activities.

4.2 The Statutory and Legal Framework

Financial Sector Statutory Framework

There are four main alternatives for legal status as a financial institution in Kenya:

- Commercial bank;
- Non-bank financial institution (NBFI);
- Housing/Mortgage finance company/Building society; and
- Savings and Credit Cooperative Society (SACCO).

In addition, there is the Post Office Savings Bank.

Commercial banks and NBFIs are regulated and supervised by the Central Bank of Kenya (CBK). Prior to the amendment of the Banking Act in 1996, NBFIs and commercial banks differed in the following respects: NBFIs had lower minimum share capital requirements and liquidity ratios, provided a narrower range of loans

and services, and had less extensive reporting requirements than banks. In fact, K-Rep Bank – the first NGO MFI to transform into a bank in Africa – had initially intended to register as an NBFI because of the lower capital and less extensive reporting requirements. The amendment raised the minimum capital requirements and liquidity ratios to levels similar to those of commercial banks.

Box 1: Capital Requirements

Minimum paid-in capital requirement for each of the following financial institutions are:

- Commercial banks: KSh 75 million (local), KSh 200 (intl)
- Non-banking Finance institutions: as above
- Housing/Mortgage finance company/Building society: KSh 150m
- When MFI Bill is passed: MFIs KSh 100 million

The restrictions contained in the Banking Act and the Building Society Act profoundly limit the institutions from serving the housing finance needs of the poor. These Acts require that mortgage finance companies and building societies only lend against "real" guarantees, that is, mortgaged properties. Establishing a mortgage requires the borrower to have clear and legal land title to a house that is up to code. Obtaining titles in Kenya is difficult and almost impossible for poor households. In addition, the building codes are inappropriate for the kinds of structures that poor households can afford to build or finance. Similarly, these Acts explicitly prohibit mortgage finance companies and building societies from financing the purchase of a plot of land without a structure. These regulations effectively prevent institutions from financing the progressive home construction likely to be undertaken by poor families.[11]

SACCOs are neither licensed nor regulated by the Central Bank, but are subject to restrictive regulatory oversight from the Commissioner of Cooperatives. A recent reform of the cooperative law has created a new legal framework for the SACCOs, which partly explains their recent rapid growth. The provisions of this law include: i) the possibility of creating SACCOs outside the traditional "common bond" framework, which implies ii) the opening up of SACCOs to new types of members and the creation of new types of SACCOs (such as trader SACCOs) and iii) the possibility of increasing interest rates, which would allow certain SACCOs to approach banks for the complementary resources they need to meet the significant demand for credit; and iv) the withdrawal of the state from the supervision and regulation of the SACCOs, that are now required to ensure their own internal control and self-regulation.

Government savings services were initiated in 1910 by the colonial government and entrusted to the then postal service provider on an agency basis. In January 1978, the Kenya Post Office Savings Bank (KPOSB or POSB) was incorporated through an Act of Parliament, CAP 493B of the laws of Kenya. The Post Bank is prohibited by the Post Bank Act from getting involved in lending to the public. Discussions have been going on regarding the possibility of amending the Act to allow for the provision of credit.

Microfinance Statutory Framework

Microfinance institutions are registered under a number of different acts: They are either registered under the Banking Act (e.g. K-Rep), the Societies Act (KSTES), the

[11] Cities Alliance Shelter Finance for the Poor Series, 2002.

Trust Act (Kenya Gatsby, KWFT), the NGO Act (BIMAS) or as company limited by guarantee (SMEP, ECLOF, etc), or company limited by shares under the Companies Act (FAULU, WEDCO). The Kenya Post Office Savings Bank (KPOSB) has the largest branch network and requires a low minimum balance to open and operate the account. Grassroots operations are registered as self-help groups.

Table 2: Registration of MFIs

MFI	Registered Under:
K-Rep Bank	Banking Act
Kenya Post Office Savings Bank	Kenya Post Office Savings Bank Act
Jamii Bora	Trustees Act
KSTES	Societies Act
Cooperative Bank	Cooperative Societies Act
BIMAs	NGO Coordination Act 1990
ECLOF	Company Limited by guarantee
Faulu Kenya, WEDCO	Companies Act

Source: from Dondo; 1999

Legal Framework

The existing financial services legislation in Kenya, albeit intended to ensure financial discipline, imposes an unnecessarily strict system, specifying which institutions can provide which types of products to which types of customers. For instance, in the housing finance market segment, commercial banks are permitted to lend to developers over a two to three year period to allow them to get through the construction phase while mortgage companies and building societies are permitted to provide long-term mortgage loans to individuals to purchase units from developers, or less commonly, to build their own complete units.

As for the microfinance sector, there is currently no specific prudential regulation or oversight in place. A number of unscrupulous operators have taken advantage of the situation by taking deposits then shutting down and running away with the money. A major issue at the policy level is a long debated Microfinance Bill that should come up for a vote late 2003 or early 2004. The CBK has also set up a microfinance department. The impact of this awareness is that MFIs are restructuring to fit into the legal framework and are aware of the need to be more accountable, including producing financial statements. Constraints to operating as a CBK-regulated financial institution will be the high minimal capital requirements and the ownership limitation of 25% maximum ownership of any one party (see below).[12]

The Kenyan Association for Microfinance Institutions (AMFI), which is comprised of 11 of the largest MFIs of different sizes and legal structures, in collaboration with the Central Bank of Kenya, drafted the above mentioned proposed MFI bill first in 1999/2000. The draft bill has been prepared and discussed by the stakeholders and is currently awaiting final touches by the Minister of Finance. The Bill proposes to confer authority to the Central Bank to license, regulate and supervise the

[12] Though the opinions on this differ, one of the bankers interviewed thought it to be too low.

microfinance providers, more specifically those authorised to take deposits from the public. Non-deposit taking MFIs have a choice of either self regulation under an umbrella organisation or to stay out of any direct regulation. It will, however, be necessary to recognise and provide limited non-prudential regulations for institutions which, although not taking deposits, still hold money from their clients as security. The Central Bank will develop the appropriate MFI performance criteria and regulations to suit the operating circumstances.

Other statutory or legal framework matters of relevance to microfinance to note are the following measures the government intends to undertake:

- Laws affecting bank collateral will be reviewed to ensure that lenders can actually foreclose, when need be;
- Amendments to the Co-operative Act will be brought forward to allow co-operatives to operate in a more commercial way;
- One of the areas spelled out as an area of attention in achieving the MDGs is working towards securing women 's rights to land; and
- The new constitution is bound to do away with problematic provisions of the current constitution in which women's right to own, inherit and control property are violated.

4.3 Regulatory Framework

The Central Bank is the statutory regulatory agency for banks and NBFIs in Kenya. The Kenyan financial system has undergone significant reforms since 1990 as part of the transition from a planned to a market economy. In that process, the Central Bank has become politically independent from the government and the regulatory and supervisory frameworks for bank and non-bank financial institutions were revised to reflect international banking standards. The CBK's profile has also become more prominent since 1993. With the shift to market-based regulatory instruments, the Central Bank relies on open market operations to influence monetary conditions. During specific periods, the Central Bank has done a commendable job and has discharged its statutory mandate reasonably well given some of its constraints.

Although the Central Bank of Kenya is regulating the conduct of banks and NBFIs in the country, it does not have the power to license them, which is the responsibility of the Directorate of Fiscal and Monetary Affairs following approval by the Minister of Finance. With the recent amendments to the Banking Act, the Central Bank is now required to "vet" individuals applying for a banking license. A critical dimension in Kenya, therefore, is the licensing of banks and NBFls. The presumption is that the licensing authority will have requisite skills and information to prevent undesirable characters from entering the banking industry either directly or by proxy.

In Kenya, more and more microfinance institutions are increasing their scale of operations and starting to incorporate as NBFIs or banks, hence the need for banking and finance authorities to learn more about them. In order to develop appropriate norms and regulations, policy makers must understand how microfinance differs from conventional banking and, in order to supervise

microfinance effectively, bank supervisors need specialised training on assessing the performance of microfinance institutions (MFIs).

In the time period under consideration, 2000-2002, there have been a number of informal consultations organised by microfinance practitioners on legal and regulatory matters in Kenya. Notably, MicroStart Kenya and the SUM managed UNDP Africa Regional programme funded a conference and training course on the regulation and supervision of microfinance in Southern and Eastern Africa in Nairobi, Kenya in August 2002. It included intensive training for bank supervisors in the use of the ACCION CAMEL evaluation instrument for assessing MFIs.

A discussion on the legal and regulatory framework for microfinance in Kenya is not complete without a look at the K-Rep experience when it transformed from an NGO to a bank. This experience helped the CBK become more familiar with MFIs and made it more aware of the similarities and differences between conventional financial institutions. A number of issues arose. At first, the CBK was reluctant to accept an NGO as an owner. In addition, as Kenyan law requires that no single investor owns more than 25% of a bank, it was necessary to approach a large group of investors who could take the long-term view needed for the project. This led to the entrance of a valuable group of the investors including: IFC, the Shorebank Corporation, FMO, and the African Development Bank, all of whom brought their specific expertise to the table. K-Rep and the CBK had to negotiate mutually agreeable solutions to several routine bank regulatory and supervisory issues, which affect MFIs differently than they would a standard bank. For instance, the CBK normally approves all new branches for commercial banks based on economic viability and community need, and it is cautious about locating branches in the lower income ('dangerous') neighborhoods – the target markets of MFIs. Another issue was the value of the collateral underlying group loans in relation to risk-weighted value of assets. The CBK eventually accepted current uncollateralised (group guaranteed) loans of up to KSh 300,000.

Another informative example is the Equity Building Society (EBS), which was registered in 1984 under the Building Societies Act. From its inception, Equity has pushed the limits of this legislation by accepting deposits and offering loans unrelated to mortgage banking. In fact, it was a micro-lender years before management formally used the term. It has always acted with the implied consent of the Central Bank of Kenya (CBK) and, over time, the Act has been amended to bring it more in line with the types of practices carried out by Equity. As a building society, Equity is prevented from offering certain services including chequing, current accounts, international transactions and offering a broader product range. However, EBS successfully lobbied the authorities to allow it to offer loan products despite its status as a Building Society. This change galvanised the traditional microfinance institutions to move towards creating the necessary regulations that would enable them to mobilise deposits from the public and thereby compete fairly against EBS, who was fast emerging as a market leader.

At the broader level, commercial banks will be expected to develop an appropriate risk classification system governing loan collateral, documentation and inspection programs to manage risks for the micro- and small enterprise sector.

4.4 Norms, Prescribed Systems, Procedures, Guidelines and Practices

Though one of the oldest microfinance sectors in Africa, the Kenyan microfinance industry is still lacking a number of main building blocks characteristic of a microfinance sector. It has few officially endorsed or accepted performance or reporting systems for MFIs. Typically, in cases where there is no government regulatory authority or supervisory body governing the MFI industry, standards are developed by the MFIs themselves, and the process of developing these is often facilitated by MFI networks and/or donor agencies and second-tier institutions. In the case of Kenya, there are a range of lenders that wholesale to MFIs. These range from purely dedicated microfinance lenders such as Jitigemee Trust (Kenya) and Africap (regional fund), to social investors such as Oikocredit and the Acacia Fund that finance the microfinance sector, in addition to other sectors, to a number of donors that have been extending loans to MFIs on an ad-hoc basis. Up until now, these wholesaling institutions as a group have not yet been playing a determining role in setting the norms, either because of internal problems and restructuring (Jitigemee) or because microfinance was just one of the many sectors invested in.

The forces that are likely to have the most impact on influencing industry standards in Kenya in the future are: AMFI, the new Microfinance Act, and the performance of market leaders such as EBS, K-Rep Bank, Faulu, and Cooperative Bank, and MicroSave support programme.

There is currently no support agency like the capacity building facility AFCAP, which came to an end in 2002, resulting in a sort of vacuum in terms of a local capacity building. MicroPed, a USAID project that worked in this area, also terminated their work in 2000. MicroSave is addressing some of the capacity building needs in the specific area of market research and product development, and K-Rep Advisory services can tailor courses upon request. Various private outfits also provide training and the Kenya Management Training Institute has also provided training to the sector. However, there is no entity that regularly offers courses in key areas such as delinquency management, financial management, liquidity management, etc..

MicroStart had between $150,000-$200,000 budgeted for items that could have further stimulated development of norms, but these funds were not used, except for the workshop for regulators described above.

In the future, it is likely that the recently formed network organisation, the Association of Micro Finance Institutions (AMFI), will play an important role in the development of norms (systems, procedures, guidelines and practices). It managed to attract broad support and a broad funding base. It has among its objectives: 'The promotion of a self-regulatory mechanism for the industry'; and 'The promotion of performance standards, norms and ethics that encourage transparency and sound performance across the range of institutions engaged in the provision of microfinance services'

Among its programmes and outputs are: i) consensus building on common performance standards, norms and ethics for the microfinance industry; ii) performance reporting and monitoring systems; and iii) self-regulatory mechanism. MFIs have planned to start reporting to AMFI as a means of self-regulation.

4.5 Conclusion of UNCDF Policy Impact

Table 3 summarizes the key bottlenecks for MFIs in Kenya in the respective policy domains and the UNCDF/UNDP policy impact.

Table 3: Policy Impact Summary

Macro Policy	Legal Framework	Regulatory Framework and Microfinance policy	Norms: prescribed systems, procedures, practices, guidelines adopted nationally
Identification of Key Bottlenecks in the Various Areas of Policy Matrix for MFIs			
The most immediate threat to building sustainable institutions was caused by the threat of the Donde Bill, that would have introduced interest rate controls	Acts requiring finance against 'real' guarantees Legal land title needed for mortgage finance Inheritance laws that do not favor women	A determination of asset quality and provisioning regulations	The absence of common standards
UNCDF Policy Impact			
None	None	UNDP funded workshop on microfinance legal environment and regulation. MAB served as a forum for upstream activities.	Systems KPI reporting UNDP funded AMFI

It shows that UNCDF's policy impact was non-existent at the broad policy and legal framework level and provides evidence that there has been some impact at the regulatory and microfinance policy framework level, and significant policy changes can be attributed to the UNCDF/UNDP in the area of norms – systems, procedures guidelines and practices. [13] The fact that there is no impact at the broad policy level is not a surprising finding, as it should be pointed out that the nature of issues in the area of general macroeconomic policy are generally beyond the scope of UNCDF's activities, and impacting the legal and regulatory environment is also something that is appropriate only in specific contexts. Moreover, the UNCDF/SUM's activities in Kenya have been primarily focused on "downstream activities", given that the microfinance industry was still relatively undeveloped at the outset of the project, lacking strong institutions with a capacity to deliver microfinance services at scale and also not a very well developed sector support structure.

Through its "downstream activitiess" MicroStart actually had some policy impact. First, the support impacted the development of a comprehensive and reliable management information system for a major MFI, EBS. Furthermore, MicrosStart supported, albeit not in a formal way nor through complete nation-wide adoption, the development of best practice standards for microfinance and UNDP also supported this through its support to the network organisation.

[13] Banks and financial institutions as a group had an impact in the repeal of the act; hence this included institutions such as EBS, which was support by MicroStart. Nevertheless, the weight of MFI lobbying was less than the actions of the banks.

The MicroStart Advisory Board (MAB) has served as a forum for upstream activities in a limited way. Despite its interesting composition, it does not appear to have played a major role in policy development issues in Kenya. The limited effectiveness may have been due to the administrative issues and financing issues that have apparently dominated the MAB meetings. Long delays were encountered throughout the project's life, not only in timely implemetation but also in disbursement of funds

The importance of the various policy domains differs per country. Kenya and Haiti were the more mature microfinance industries among the four PIA case study countries. In Nigeria, for instance, where microfinance operations lack institutional strength, it would have been premature to prioritise the discussion of legislative issues. In Kenya, on the other hand, the time was right to discuss the legislative and regulatory issues. The UNCDF/SUM did not need to lend its support, however, as the process was practitioner-driven, the desired option. A combination of factors made policy actions by the microfinance industry as a whole possible on all four fronts appropriate: norms, regulatory, legal framework and even broad policy direction (the plans to introduce the Donde Act capping interest rates triggered all financial institutions, including microfinance, to protest against it forcefully).

5.0 Replication Findings

As a small-scale investor, UNCDF's impact at the country level will emanate from its ability to provide stakeholders with concrete operational results on a pilot basis, paving the way for larger-scale replication and policy impact. To capitalise on the experience gained from successful pilots, UNCDF attaches a great deal of importance to documenting and analyzing lessons learned, and for successful pilots with policy implications, to appropriate dissemination.

Although the replication of programs and activities often takes years to carry out and usually needs to be preceded by several years of demonstrated success, we were able to identify a number of financial and non-financial replication effects of UNDP/UNCDF's MicroStart program in Kenya, just three years after it commenced under the auspices of the 1999 Policy shift. In addition, the MicroSave programme attracted a lot of other donors that are also moving the initiative forward.

5.1 Expanding a Programme through Co-financing

The MicroStart program was funded exclusively by UNDP. MicroSave was a joint initiative between UNDP ($880,000) and DFID ($148,000). UNDP continued funding Phase II ($550,000) and DFID also provided another major capital injection ($1.6 million). CGAP joined the initiative for Phase II ($1.4 million) that was completed at the end of 2003. Other donors that joined for Phase II are the Austrian government ($350,000), the Ford Foundation and IDS ($370,000), and the EU ($27,000).

5.2 Upscaling a Programme Sequentially and Private Sector Replication

MicroStart's support to EBS was followed by other donors such as DFID and social investors like AfriCap. The MIS has been key to EBS's ability to scale up. It is hard to claim that without the MicroStart's investment, eventually another donor would

not have done the same. However, because MicroStart was designed to take risks with promising MFIs, it was pre-dispositioned to take on this type of project. What is clear is that the combination of donor efforts and system and product development helped position EBS as a market leader that could interest more commercial investors such as AfriCap. UNDP/UNCDF support to EBS was followed by investments to the tune of US$3 million and, though it is difficult to make a strong case of direct attribution, it is an indicative figure.

Moreover, UNDP/UNCDF's support to MicroSave will continue along with the support of other donors, with Phase Three to start in January 2004 at a US$6 million budget (US$2.5 million from DFID, US$1.5 million from CGAP, US$1.5 million from NORAD and US$0.5 million from Austria). As noted earlier, UNCDF/SUM's managed investment for UNDP Africa over the three phases of MicroSave and managed to leverage significant other donor funds. UNCDF/SUM has also mobilized US$0.45m in complementary resources through UNDP/RBA for a sister programme in West Africa. One could say the CGAP and other Phase II new donors can be partly attributed to UNDP/UNCDF's and partly to DFID investments.

Private sector replication of best practice microfinance took place on a limited scale. The KCB and the Cooperative Bank continue to increase their microfinance activities. The Cooperative Bank is one of EBS's closest competitors so performance of one clearly affects the other.

5.3 Ad Hoc Influence and Inspiration

MicroStart's investment in EBS has had significant ripple effect and ad-hoc influence. After EBS's procurement of an MIS, a number of other MFIs also started to change their MISes, after years of operating under mostly manual systems. Yet, it is difficult to fully attribute this to the EBS, however, some influence is not unlikely. In addition, the efficiency gains that were made posed a competitive threat to its competitors, who tried to catch up. Thirdly, the EBS was developed products that were better tailored to the demand of its clients while also offering a wider product range.

The improvements in EBS product development has led to fundamental changes in how the organisation does business. In particular, a recent focus on strategic marketing is proving extremely useful in increasing its market share, enhancing operational efficiency and maximising the return on its assets.

The combination of product development and MIS has made EBS an extremely popular institution. For clients this entailed:

- A wider variety and greater flexibility of products;
- Clear product terms; and
- Improved access

It is said that about 100 accounts are opened each day in the Nairobi area.

MicroSave also had considerable ad-hoc influence.

5.4 Replication in the Wider Development Community

The investment in the EBS is a case in point for the wider, global development community, as it shows more clearly than any case hitherto, the dramatic impact a proper MIS can have on an MFI and, therefore, the people it serves. As a cautionary note, it should be mentioned that the research team is not promoting MIS alone as a panacea for good microfinance. EBS had other critical building blocks in place, such as clear ownership, a sound governance structure and a demand-driven orientation, making for a sustainable organisation.

Donors

Donor resources dwindled in Kenya toward the end of the 1990s for microfinance as well in other sectors. The numbers of donors and available funds for Kenya as a whole are, however, likely to increase again after the change in government in December 2002, after decades of rule by President Arap Moi.

In terms of non-financial replication, the MicroStart Advisory Board consisted of a number of key donors in the microfinance sector in Kenya such as Ford and the EU (MESP program), the FAO, and UNOPS/IFAD.

To a large extent, the policy and approach of such major players as the DFID and USAID, was also to promote microfinance best practice principles. In general, they operated at the institutional level, although none of them had an explicit vision of creating a critical mass of viable MFIs.

The MicroSave project, to which UNDP Africa and DFID were the founding co-donors, whereby UNCDF is in charge of managing the investment on behalf of UNDP, is widely known. However, the MicroStart program was less known with other donors. Therefore, it may benefit from enhancing its promotional activities as well as disseminating its lessons learned and good practises, as this could help to raise the program's profile within the donor community and, in doing so, increase the possibility of obtaining additional funding.

Networks of Practitioners

UNCDF/UNDP did not play a direct role in getting the network of practitioners up to speed on microfinance best practice or other pertinent matters, although UNDP is now funding the network. It should be noted the World Bank has been trying to stimulate the establishment in the early 1990s but, interestingly, it only took off when two of the MFIs took the initiative in 1998.

MicroStart is not known for microfinance industry standard setting in Kenya as there were already a number of mature MFIs that have been active for a decade and are well plugged into best practice knowledge centres and mainstream key performance indicators.

UNDP can, however, be credited with funding the network organisation, AMFI, at an important time. This is an important contribution, given the network's potential role.

Research, Training and Advocacy Institutions

The rationale of impacting research, training and advocacy institutions stems from UNCDF's limited resources and the need to enhance the impact of its policies through strategic alliances, not only with other donors, but also within the civil society and academic world. UNCDF did not have influence on the research community besides MicroSave's broader influence. The local research community in Kenya is fairly strong and selected institutions and individuals have been involved in microfinance, such as the International Center for Economic Growth (ICEG). As early as the mid 1990s, the government stimulated the establishment of the College of Banking and Finance and its cooperation with the Cranfield School of Management to expose commercial bank staff to the specifics of small and micro-enterprise lending. The Kenya School of Monetary Studies also has some courses covering micro and small entrepreneurs. Moreover, the K-Rep NGO is undertaking a range of cutting-edge research projects.

Under MicroSave, a number of local individual researchers are being trained. Moreover, in terms of the impact beyond East and Southern Africa, to date MicroSave has certified 79 specialists as Certified Service Providers.

MicroStart did not fund any research initiatives, although it did have some funds for this. It could be that this is due to the administrative issues and financing problems MicroStart has been faced with, which limited the group's attention to the actual start of the core activities of selection and assistance to the partner MFIs.

Donors that assisted and impacted the research community were USAID (through its USAID/ICEG MicroPED program in 1999-2000), DFID (funded studies in the mid-1990s and since 2000 has co-funded the MicroSave initiative), and UNDP/UNCDF (through MicroSave).

5.5 Conclusion on the Replication of UNCDF Programme

Table 4 provides an overview of UNCDF's impact in terms of its program replication and microfinance program approach. It demonstrates that both UNDP and UNCDF have been effective in co-financing for the MicroSave programme. Its key partner, DFID, provided US$148,000 in Phase I and US$1.6 million in Phase II. Moreover, US$3.7 million was contributed by other donors during Phase II. The table also demonstrates the impact in so-called sequential scale-up in the form of a Phase III to the initiative. In sum, UNDP Africa/UNCDF contributed a small amount, as the initial, main donor of a new initiative that eventually led to a multidonor initiative which will soon be in its third phase.

The results of the investment into EBS were followed by investments to the tune of US$3 million. The MIS, which is the item funded under the MicroStart seed capital, helped to foster the immense growth that has taken place and continues to this day, together with EBS client orientation and improved products.

In terms of non-financial replication, in Kenya's case, the influence of both UNDP and UNCDF was significant. MicroSave is having a lasting effect on the global microfinance industry by adding an overlooked dimension in best practice microfinance (i.e. a market-led and client centered approach.) EBS is also a case in point for the wider, global development community, as it shows more clearly than

any case hitherto, the dramatic impact a proper MIS can have on an MFI and therefore the people it serves. Furthermore, the combination of the factors of MIS and the product development research tools available through MicroSave, enabled EBS to offer a wide range of products, some of which were greatly appreciated by the clients, which was instrumental in the organisation's extremely rapid growth.

Table 4: Summary Replication (exchange rate: US$1=KSh 78)

Co-financing	Sequential scale-up	Influence
Direct:: UNDP US$0.88 million for MicroSave Phase I UNDP US$0.55 million for MicroSave Phase II, US$0.45 million for MicroSave West Africa initiative Indirect:: US$1.4 million CGAP MicroSave Phase II US$0.74 million other MicroSave Phase II donors Total: US$ 4 million	Indirect:: Swiss contact US$150,000 for EBS product development 2001 AFRICAP US$1,600,000 majority shareholder 2002 and $800,000 technical assistance DFID EBS investment US$470,000 US$1.5 million CGAP funds for MicroSave Phase III US$1.5 million Norway MicroSave III funds US$0.5 million Austria MicroSave III funds US$ 5 – 6.5 million*	Other MFIs installing MIS Other financial institutions lengthening opening hours through increased efficiency Product diversification Local research capacity greatly strengthened through MicroSave local researchers

* Roughly US$6.5 million of all replication from Phase III is attributed to UNDP/UNCDF, and about US$5 million if part of the replication can be attributed to DFID.

PART 5 – UNCDF STRATEGIC POSITIONING

1.0 Introduction and Research Objective

This assessment will analyse whether the UNCDF's choice of intervention(s) strategically positions the organisation in accordance with its comparative advantage vis-à-vis other players in the microfinance sector in Kenya.

UNCDF plays a unique role within the international development financing architecture as a small-scale multilateral investment organisation in support of LDCs. Recognising that it will never be a large donor, UNCDF has strategically emphasised its comparative advantage as a piloting organisation, using resources as seed money to help programme countries launch new initiatives. Activities are geared towards mobilising additional financial resources. UNCDF seeks to maximise its comparative advantage through strengthened and expanded strategic partnerships.

More specifically, the review will assess whether UNCDF's interventions and programme objectives in Kenya, as a case study, were relevant, significant and in line with the country's strategic priorities for the sector, national needs, stated UNCDF microfinance goals and the broader UN framework.

The past positioning is assessed against UNCDF's policy reorientations in 1999. A major element of the policy reorientation was to move away from guarantee and refinancing schemes to building partnerships with MFIs with the potential to help demonstrate the feasibility of sustainable microfinance.

The recommendations for future positioning will take into account the 2003 policy that is just starting to be implemented. This includes a coordinated, strategic approach to building microfinance as an integral part of the formal financial sector as the most effective route to reducing poverty and ensuring aid effectiveness. Therefore, UNCDF seeks to maximize its comparative advantage through strengthened and expanded strategic partnerships.

2.0 Methodology

The analysis sought to identify first, whether the programmes assessed were in line with the 1999 policy shift. Second, if they were, what the evidence reveals about how this type of intervention has enabled UNCDF to intervene strategically and optimally position itself in the microfinance sector (taking into account sector demands, relevance of intervention to organisational goals, country priorities, MDGs, Programme of Action for the LDCs, etc., and the ability to be flexible and responsive to evolving sector contexts). Third, the assessment makes recommendations on how UNCDF could (re)position itself in the future to achieve a high impact in the sector, both independently and through its partnership with other agencies in light of SUM's shift towards a sector approach.

A standard positioning exercise was undertaken. Research methods employed included an analysis of secondary data; semi-structured interviews with key sector players including: MFI practitioners; bankers; officials at the Central Bank and

government; the local microfinance network organizations; socially responsible investors; the research community; academics and sector analysts.

The following sections outline the following steps to analyse UNCDF's positioning:

- Industry analysis (including the supply and demand for microfinance, key changes that have taken place and remaining gaps in the sector);
- A reflection on the UNCDF's main customer needs and goals (UNCDF seeks to serve the needs of the people and governments of developing countries, UNDP country offices, and other UN partner organizations), capability analysis of UNCDF and assessment of comparative advantage as donor/investor in Kenya; and
- Based on the above review of sector and country needs and stated UN goals, UNCDF's capability and activities in Kenya and comparative advantage, an assessment of the relevance of the evaluated program.

3.0 Industry Analysis Findings

3.1 Demand and Supply Estimation

Demand

Kenya possesses, in principle, the primary conditions necessary for a fertile microfinance sector: a liberalised economy during the Structural Adjustment Program of 1992-1994; a large domestic market (31 million inhabitants), a high population density of about 288 persons per square kilometer; over 70% of the population live in poverty (defined as less than $1/day (see Appendix 4 comparative sector overview); and a high national unemployment rate. When all these figures are analysed together the result is a high potential demand for microfinance services.

It is generally said that the bulk of the poor, most of whom live in the rural areas, have no access to formal financial services. As in many countires, most formal financial agencies do not exist in rural Kenya because of high transaction costs and perceived risks. As a result, people in the rural areas cannot afford the time and money for a journey to a bank located in the major towns.

However, in spite of Kenya's relatively large financial service sector, it is hard to find reliable, more or less comprehensive and analytical reports on the financial landscape (Hospes, Musinga Ong'ayo; 2002). There is an official estimate on the market for enterprise finance from 1999, which counts 1.3 million micro and small enterprises.[14] Key informants put the number for the current microfinance clients higher, at 1.5 million and some practioners even estimate the market to be more in the order of 3 million. In terms of capitalisation, in 2001, the demand for micro-credit was estimated to be in excess of KSh 4.3 billion per year and in 1995 the total for microfinance and smallholder farmers was estimated at KSh 23 billion.[15]

[14] National Micro and Small Enterprise Baseline Survey, CBS/ICEG. 1999.
[15] The chapter on Kenya in 'How to regulate and supervise microfinance – key issues in an international perspective', by Kitili, J. in Eds. Hanning, A., Katimbo-Mugwanya, E., 2000 and Kiiru, W. 'A review of institutional lending to the Jua Kali and small enterprises sector in Kenya. 1995..

Supply

Determining the supply is also not an easy matter. On the whole, it is clear that the banking sector has, to date, not seriously penetrated the microfinance sector. As a group, banking institutions have only a small proportion of their activities focused in microfinance. Data suggest that banks, if at all interested in microfinance, tend to be more active in the mobilisation of small-scale savings than in the extension of microloans. As of the end of May 2001, the five banking institutions involved in microfinance had a total loan portfolio of Kshs 1 billion and 28,288 microfinance borrowers. The table below gives some insight into the outreach of the larger financial sector players with an interest in the microfinance market segment and shows the outreach had already tripled by the end of 2002. It demonstrates that the branch network offered by KPOSB's has the fullest geographic coverage of any financial institution in Kenya.

Table 1: Geographic Outreach of Banking Institutions involved in Microfinance (December 2000)

Basis for Comparison	KCB	KPOSB	Cooperative Bank	EBS	K-Rep Bank
Total branches	95	494	12	30	22
No. of branches in cities and major towns	25	57	2	11	1
Total number of loans 2002	1088*	N/a	912*	41,503	38,739

Source: Hospes, 2002 updated with primary data collection
* 2000 year's end.

At the time of the mission in mid-2003, the total number of borrowers was generally estimated at 350,000-400,000 (figures are excluding SACCOs).

It should be mentioned that savings play a relatively important role in Kenya. Kenya has the largest credit union system in Sub-Saharan Africa and serves over 1 million members. The Post Office Savings Bank (POSB) serves over 2 million clients. Hence the POSB and SACCOs already reach over 4 million depositors. EBS, Cooperative Bank, K-Rep and Jamii Bora alone reach over 300,000 microfinance clients with savings services. All in all, a rough estimate of provision of savings services would be 4.5 million.

Moreover, a geographical analysis of the distribution of MFI operations reveals that they are usually focused on the more developed regions and peri-urban towns and main cities where levels of poverty are less intensive. For example, in Kenya the major MFIs are five times more likely to be operating in the 15 least poor districts than in the 15 poorest districts.[16] More specifically, the majority of the microfinance programmes are concentrated in Nairobi, the Mount Kenya region and the Western region. The financial sector, given the problems that it currently faces, is becoming less deep in rural areas with many commercial bank branches closing their branches.

Market Penetration

In 1999, at best 3.5% of the country's poor are estimated to have access to microfinance services.[17] According to the 1999 National Baseline Survey, only 10.4% of the 1.3 million existing MSEs had accessed credit from any source. The current penetration rate of the microfinance enterprise market segment is higher, but

[16] Hulme, D., 'Client Drop-outs From East African Micro-Finance Institutions', MicroSave, 1999.
[17] Ibid.

no reliable indicative figures can be calculated until a study on the microfinance sector, including a formal estimation of total supply and demand estimation for the whole microfinance sector has been done. For loans it could range between 11% to 27%.[18] When one takes into account the enterprise and non-enterprise microfinance market segments, including savings services, that reach 4.5 million, the penetration rate is higher.

3.2 Key Changes in the Microfinance Sector

The stalemate in the sector's development came to an end in the early 2000s. The outreach is still extremely limited, but there finally seems to be movement within the sector and MFIs which had been stagnating suddenly started to see growth. New commercial entrants such as consumer lenders and commercial banks are changing the microfinance industry in Kenya, as is seen in maturer microfinance markets.

Below is a brief overview of the critical events and key changes in the sector since 2000 in terms of the general enabling environment, MFIs and the broader microfinance infrastructure.

A critical event was the Donde Bill in 2002, intending to cap interest rates, but which has not been enacted as it has been contested by the KBA and suspended as mentioned in the policy impact assessment .

Key changes in the microfinance sector are:

- An eventual take-off of the microfinance sector;
- Product diversification with the help of MicroSave;
- Commercialisation (MFIs accessing banks for lines of credit, NGOs changing institutional charter and new entrants, including the K-Rep MFI becoming the first Microfinance Bank in Kenya, a start in merging of programmes such as the CRS Group);
- The AFCAP capacity building program was abolished;
- The AMFI gets its own premises and staff and broad funding base; and
- The Central Bank of Kenya instituting an MF department

The stalemate was a result of a combination of factors. Explanations and comments from key informants range from the donor-driven nature of the sector development and key actors being NGOs, to the lending methodology and limited product range (see below) to organisations being afraid of a crack-down by the authoritarian regime of Moi which felt threatened by organisations that were sizeable and were potentially in a position to influence public opinion, to banks being mainly interested in serving the government. Nevertheless, since the early 2000s, the sector has grown from an estimated 135,000[19] clients in mid 1999 to 350,000-400,000 in 2003 (figures are excluding SACCO's and Post Office Savings Bank account holders).

Aleke Dondo, in what is probably the best overview report of the microfinance sector status in 1999, "The Status of Microfinance in Kenya", states that, despite the

[18] Low estimate: 11% (if one takes 350,000 borrowers and as effective demand the estimate of 3 million, assuming 90% are in need of finance). High estimate: 27% (if one takes 400,000 borrowers and as effective demand the lowest estimate of 1.3 million of the 1999 baseline survey).

[19] "The Status of Microfinance in Kenya", K-Rep Occasional paper no 35, 1999

numerous donors investing in microfinance, it is clear that existing products and methodologies do not allow the sector to have as extensive a reach as required for the services in demand.

A more outward-oriented approach, combined with the emerging capacity to develop products which respond better to client needs through the tools developed by MicroSave, is a key change that has taken place in Kenya over the last couple of years (see Table 2). In addition, K-Rep NGO is broadening the horizon through the piloting of highly innovative and risky products. EBS led the way in product development and is now offering five savings products and seven loan products.

Table 2: Summary Table Kenya

	1999		2002	
	Method	Products	Method	Products
K-Rep Bank	Group	1	Group + Individual	4
KWFT	Group	2	Group + Individual	3
Faulu	Solidarity Groups	4	Solidarity Group	4
SMEP	Solidarity Groups	1	Solidarity Groups	6
ECLOF	Solidarity Groups	1	Solidarity Groups	1

Source: compiled by assessment team

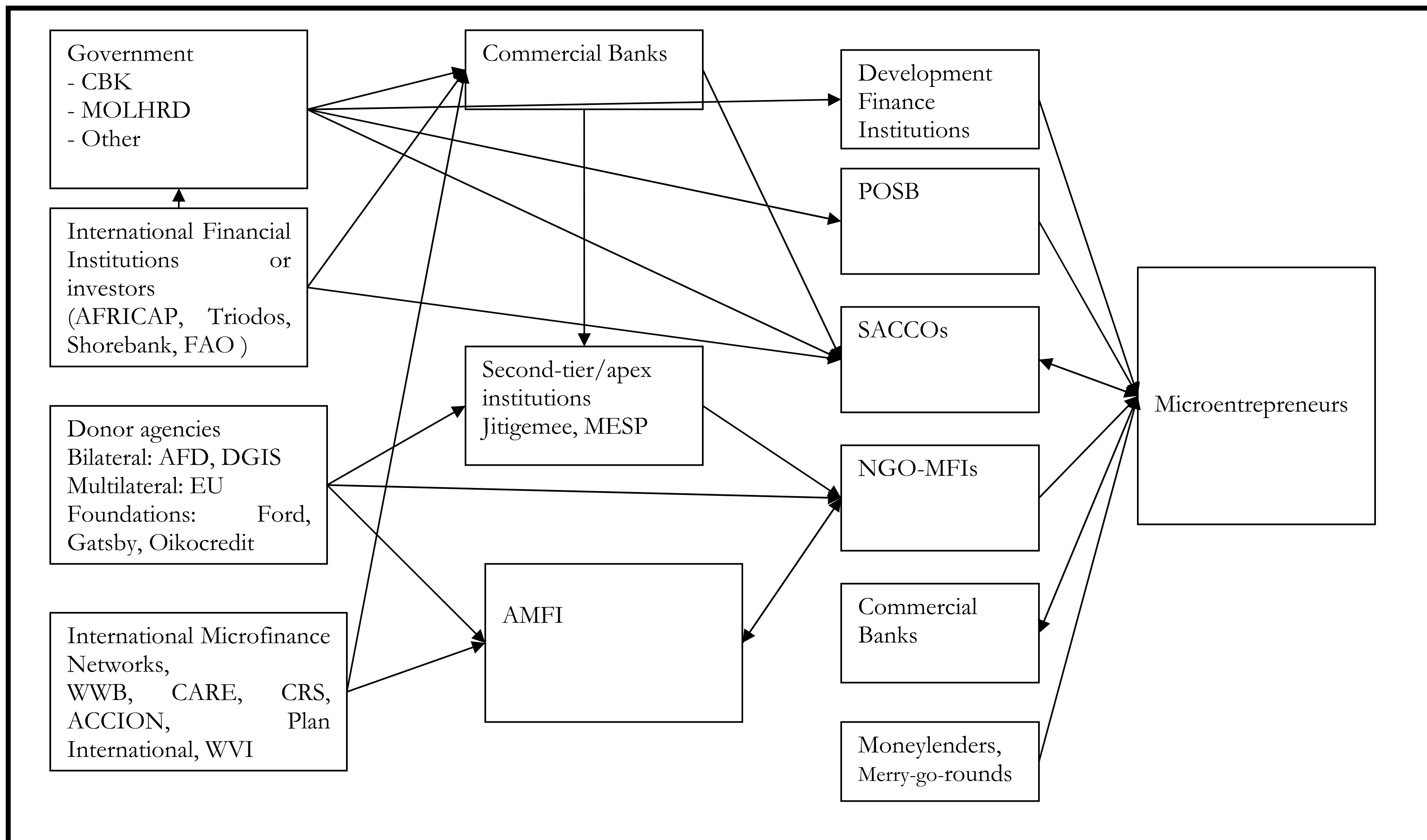
Faulu and Jamii Bora and KWFT are examples of MFIs that have access to bank finance having borrowed from Barclays Bank. One would expect to see mergers and consolidations in the near future, although some MFIs may not be interested in expanding that way because of the attitude "if we are the best, why buy worse?". CRS managed to merge three of their four microfinance programs into a new company.

The firmer establishment of AMFI is a significant step forward towards providing a framework for the development of a solid, professional and reliable microfinance sector in Kenya.

Considering these key changes that took place over the past three years in the microfinance sector in Kenya, the MicroStart support can be said to have had significant impact, as it contributed directly to one of the prime movers of the industry, EBS, which contributed greatly to the eventual take-off of the industry.

Figure 1 is a schematic overview of the Kenyan microfinance sector and synopsis of the discussion on mayor players in Part 4.

Figure 1: Overview of the Key Players in the Kenyan Microfinance Industry



3.3 Remaining Gaps in the Microfinance Sector

The attempt to map and analyse the sector indicates the following as the likeliest gaps and areas to be developed:

- As MFIs grow and some of them become part of the regulated financial system, banking authorities are facing the need to learn more about this important financial activity. In order to develop appropriate norms and regulations, policy makers must understand how microfinance differs from conventional banking and, in order to supervise microfinance effectively, bank supervisors need specialised training on assessing the performance of microfinance institutions (MFIs). The Microfinance Bill will soon be passed but beyond that a lot of work needs to be done in the regulatory arena.

- There is a geographical constraint which needs to be overcome, especially in rural areas. The physical infrastructure in the rural areas is perhaps the most critical support structure currently lacking. Groundwork has been done by some MFIs to think through what the main enabling factors are, one of them being enhancement of the payment systems in rural areas.[20]

- Access to capital is a major gap. The Central Bank does not recognise the loan book as collateral. Commercialisation moved the industry but brought with it its own problems (e.g., donor credit programs that were localised and are in some ways on their own with few grants available and without capital to grow). Most MFIs will be unable to raise the KSH100 million minimum capital requirement to become a deposit taking institution under the new Microfinance Bill and it will not be easy to meet supervision standards. Donors could help develop the local capital market for microfinance, including linking MFIs to banks so that they are not all dependent on deposits for capital.

- Commercialisation has led not only to problems of capital, but also to problems of ownership and governance.

- The lack of adequate MIS and sector data. Most MFIs have just gone through or are going through an exercise of improving their MIS systems, some with more hiccups than others. AMFI intends to undertake initiatives to fill the void of the lack of information on the sector, including basic demand and supply estimation.

- Credit referencing would strengthen the sector and is definitively needed. Survey findings indicate that almost all microfinance clients have loans from other MFIs as well. Although this happens in some other markets, the prevalence and scale is particularly high in Kenya.

[20] Key informants also suggested trying to link up the small village based FSAs with larger MFIs, though this might not be in line with the MicroStart's emphasis on breakthrough MFIs.

- A supportive judicial system and the effective administration of property rights, especially with respect to specific courts for small claims and at the local government level. In addition, it will be necessary to help municipalities develop policies and capacities to assist microlenders access premises to carry and legitimise their businesses, especially for women who face the additional constraints of a lack of financial resources and a lack of land rights.

4.0 Customer, Capability, and Comparative Advantage Findings

The next section describes the overarching goals of UNCDF and its primary customers, notably the government and UNDP. This analysis is followed by a reflection on UNCDF's capability, and its comparative advantage.

4.1 National Priorities, UN Kenya Cooperation Frameworks and UNDP Programme

UNCDF serves people and governments of LDCs, UNDP country offices, and other UN partner organisations, where appropriate. As such, it is important to know what the main UNCDF customers value and how well UNCDF manages to meet their expectations and needs. Furthermore, it is desirable to consider what else might be needed and to anticipate the type of support the UNCDF could provide in the future. Considering that there are a range of actors in the Kenyan microfinance sector, it is also important to understand, how microfinance is viewed and fits in with the stated priorities of the Kenyan government, the UN system in Kenya and UNCDF's own programme and institutional goals.

To meet this objective, we outline the goals of the government and the UN in Kenya as articulated in some of the key UN documents such as the United Nations Development Assistance Framework (UNDAF) Kenya. Furthermore, we identify and explore points of intersection in the plans of these agencies *vis-a-vis* microfinance and its role in development.

Millennium Development Goals (MDGs)

Kenya has committed itself to the MDGs for poverty reduction. The MDGs will build on and contribute to on-going national frameworks, initiatives and processes such as the Poverty Reduction Strategy Paper (PRSP), the new government's Economic Recovery Strategy for wealth and Employment Creation 2003-2007, the UN's Common Country Assessment (CCA) and the UN Development Assistance Framework (UNDAF). The UNDAF progress report for 2003 concludes that what is needed to accelerate progress towards the goals are: the allocation of sufficient funds to the social sector; establishing more girl-friendly schools; building more public water supply systems; securing women 's rights to land; investing in agricultural research; improving governance; and rooting out corruption.[21] Microfinance is not explicitly mentioned in the report, although some of these measures will contribute to the creation of an enabling environment for microfinance.

[21] Millennium Development Goals Progress Report for Kenya – 2003

Government National Priorities – PRSP

The government planning framework at the beginning of the MicroStart programme was the Eighth National Development Plan, which spanned form 1997-2001. The Economic Recovery Strategy for wealth and Employment Creation 2003-2007 – formulated around growth, governance, infrastructure, and investing in poor people – was formulated by the new government. It is seeking to reconcile this policy with the pre-existing Poverty Reduction Strategy Paper.

Microfinance, or support to small and medium enterprise development, is addressed in a number of policy papers, notably current policy documents. Microfinance is included in the government's Poverty Reduction Strategy Paper (PRSP) and the National Rainbow Coalition (NARC) Manifesto. There is also the Microfinance Bill that should be voted on later in 2003 or early 2004, etc..

In the past, the government had tried to assist the sector but few of the proposed polices were implemented. In the 2000/2001 and 2001/2002 National Budget Address, the Minister of Finance pledged that the government would support the MFI sector; little was carried through. The Kenyan Government issued three important policy papers: the Sessional Paper No.1 of 1986, when the casual term informal sector, jua kali, was given a new positive dimension, the Sessional Paper No 2 of 1992, which formed the base of all programmes for the development of the sector, and the third policy paper of 2003.

Kenya has adopted the goals of the major international conferences, including the Beijing Platform for Action, and the World Summit on Sustainable Development, and has a new gender and development policy.

Goals of the UN System in Kenya – CCA and UNDAF

In 1998, the combined direct and indirect benefits of the UN agencies to Kenya amounted to more than US$350 million, or more than 19% of exports, second only to tea as a source of foreign exchange, and equivalent to 3% of the GNP (UNDAF 2004-2008). The UNDAF programme objectives are good governance, emergency preparedness systems, reduced incidence and socio-economic impact of AIDS, malaria and TB, and sustainable livelihoods.

Table 3: The UNDAF Program 2004-2008
Goal: To promote sustainable human development through action to combat poverty and social exclusion, the strengthening of the rule of law, and the protection, observance and achievements of human rights.
Objectives
Promote and contribute to good governance and the realization of rights.
Strengthen national and local systems for emergency preparedness, prevention, response and mitigation.
Reduce the incidence and socio-economic impact of HIV/AIDS, Malaria & TB.
Promote sustainable livelihoods and protect the environment.
Cooperation Strategies
Promoting advocacy and policy dialogue.
Decentralised planning.
Capacity development.
Joint, parallel, or collaborative programming.
Mainstreaming cross-cutting issues.
Targeting vulnerable groups and regions.
Monitoring the MDGs (Millennium Development Goals).

Source: UNDAF Kenya

UNDP Country Cooperation Framework 1999 – 2003

The overall objective is to promote sustainable human development through action to combat poverty and social exclusion, the strengthening of the rule of law, and the protection, observance and achievements of human rights. The four axes of the First Country Cooperation framework for Kenya (1999-2002) are: governance, employment and sustainable livelihoods, gender mainstreaming and empowerment of women, and environment and natural resource management. MicroStart fell under the Employment and Sustainable Livelihoods Programme, and within the focus area of provision of support to micro, small and medium enterprises.

It is evident that UNCDF/SUM's programme was generally compatible with the broad strategies of the Government of Kenya and the UN system towards using microfinance as a tool for poverty alleviation. The support contributed to some of the key changes described in section 3.2, which took place in the microfinance sector in Kenya over the past three years.

Regarding the future, Kenya is a pilot country under the global United Nations harmonisation and simplification process. In collaboration with the Government, UNDP will promote a country-based country programming within the framework of the Rome Declaration and link this to the MDGs campaign strategy. In this new approach much of the work will be subcontracted out directly by UNDP Kenya to partners in the civil society, the private sector or the United Nations system. This will leave project units free to concentrate on good planning, partnership and implementation. Microfinance is not a key area of concentration in the 2004-2008 results framework. The outputs referring to the broader area of small enterprise development include the following:

- Backward and forward linkages between the formal and the informal sectors developed and implemented; and
- Access to financial services by SMEs accomplished through an expanded capital market and Kenya being awarded an international credit rating.

In view of the above, the MicroStart Programme has not been extended.

4.2 UNCDF's Capabilities

Institutional Capabilities

The UNCDF's mission is to "undertake innovative institutional development projects within private microfinance organisations or public local organisations, with a view to influencing national policies and/or having approaches to institutional development replicated." The agency's mission is driven by the primary goal of "poverty reduction through local development programs and microfinance operations." In line with the organisation's overall goal of poverty reduction, the MDGs and the objectives of the Brussels Programme for Action for the LDCs are expected to constitute the framework for the UNCDF action in the coming years.

Following the 1999 evaluation of its programmes, the UNCDF identified a niche for itself within the UN system as a competence centre for microfinance,

decentralisation, and local governance. The 1999 Evaluation recommended that the UNCDF "adopt clearer goals of excellence in project design and project results."[22] In view of this recommendation, the Executive Board decided to focus broadly on two areas: microfinance and local governance.

In 2002, UNDP/UNCDF was evaluated as part of the Donor Peer Reviews initiated by the DFID to assess the effectiveness of aid. The strengths and weaknesses in the capabilities of this agency, as identified by the Peer Review, are summarised in the following table:

Table 4: Strengths and Weaknesses of UNCDF – A Select List

Strengths	Weaknesses
SUM's financial instruments of grants and loans and TA for the microfinance sector are flexible and meet the needs of a target market that has low absorptive capacity but great potential	Though the evaluation capacity is well institutionalised, monitoring of investments could be enhanced. The current reduction of the number of investments is a timely measure in this regard.
UNCDF is part of the UNDP group, which provides a worldwide operational infrastructure, with close contact with government ministries	Incentive structure of field staff (RR and DRR) is not conducive to observing sound technical advice
Ten highly competent microfinance professionals at UNCDF/SUM who can be accessed by the global network of UN organisations.	In some cases being part of the UNDP group undermined UNCDF's promotion of best practice microfinance
Trusted and neutral development partner of governments in many countries in the world	UNCDF operates within an uncertain budgetary environment
Not linked to one ministry, but in principle has access to all line ministries	No clear articulation as of yet as to how microfinance relates to MDGs
Capacity to pilot and innovate with a view to pulling in other, larger donors or investors who have a lower risk aversion.	Emphasis on policy impact and partnerships can lead to a neglect of results and development impact.

Source: Based on CGAP Peer Review of UNDP and UNCDF/SUM, October 2002

Within the broader and more complete analysis of the capabilities, its strengths and weaknesses of the UNCDF/UNDP/SUM, the 1999 Peer Review team made a number of recommendations for future strategic direction of the UNCDF/SUM. A select few are presented below:

- The UNCDF and UNDP should achieve a shared understanding of microfinance, its contributions to poverty reduction and the achievement of MDGs, and how to best support sustainable financial services for the poor;
- The SUM should spend the bulk of its time providing services to UNDP Country Offices and SUM staff should keep an operational edge by maintaining some strategic direct investments;
- UNDP should develop constructive partnerships with other donors to share technical staff in country, jointly develop microfinance support strategies for countries, and to exchange lessons learned from various experiences. Other donors should not be seen only as a potential source of funds; and

[22] *A Conceptual Framework for the UNCDF Impact Assessment*, United Nations Capital Development Fund Evaluation Unit, February 2003 p.2.

- By moving from isolated projects to a more systemic policy approach, UNDP has no clear comparative advantage in working at the policy level in the financial sector.[23]

Partnerships, Synergy and Alignment of a Support with Other Initiatives

During the period under analysis (1999-2002), the major other donors engaged in building retail capacity of the microfinance sector were the DFID, EU, Ford and USAID, as well as CARE, Dutch bilateral aid and a number of Dutch NGOs and the Dutch Embassy. Swiss Contact, the CRS, and Plan International are other key donor agencies that have been involved in capacity-building for microfinance in Kenya.

Although there have been attempts at donor coordination and coordination committees, one can not call the Kenyan microfinance sector a particularly well coordinated one. However, UNCDF, together with UNDP, was critical at the important launch and initial stages of what has become an initiative of major importance in Kenya (i.e., MicroSave).

In its decision 99/22, the Executive Board stressed the importance of strengthening the UNCDF's partnership with UNDP. In the same Executive Board decision, the UNCDF was encouraged to strengthen strategic alliances with other parties including governments, civil society, bilateral donors, and other international financial institutions. The partnership between MicroStart and the government seems to have evolved in a relatively strong manner. Partnerships were also forged with local researchers under MicroSave.

Responsiveness

Responsiveness can be looked at from three different angles: project, sector changes and opportunities, and in terms of responsiveness to the UNCDF shift in policy orientations.

The type of technical assistance offered by the TSP, although appropriate for the majority of the MicroStart MFIs, was not well-tuned to all types of institutions, as in the case of EBS. Although the minutes of the Advisory Board meetings note at more than one meeting the decision to allow EBS to seek technical assistance elsewhere, this never materialised. Moreover, UNCDF/SUM repeatedly encouraged the Country Office to make use of UNDP's ability to make a second grant to EBS so that EBS could use it for its priorities for growth. This was never done. On the other hand, UNCDF and UNDP must be credited for being responsive at the outset of the project as the MIS was particular appropriate for the needs of the EBS at the time.

At the sector level, the UNCDF was responsive to acute needs of a non-traditional partner, with relatively high portfolio at risk and the inability to track and monitor performance and, thereby incurred a fair amount of risks. It paid off by leading to additional and more substantial investments in the same MFI and gave a push to the

[23] If one reads this as 'UNDP on its own', the strengthened partnership with UNCDF in this regard with the new focus on sector level support is responsive to an immediate need.

sector's development. It is an example of how, by promoting innovation with some risk tolerance, the UNCDF niche can pay off.

Regarding UNCDF responsiveness to the policy reorientations in 1999, and the mid-term MicroStart evaluation findings, the programme has been responsive and in compliance.[24] The emphasis on financial sustainability and an accurate and reliable MIS has evidently enabled UNCDF to make a difference in the microfinance sector in Kenya through its sponsorship of a true 'breakthrough' MFI.

4.3 UNCDF Comparative Advantage

A major UNCDF initiative in 1995, the preparation of a new policy paper which revised the organisation's orientations, established microfinance as a "niche." The microfinance thrust was detailed further in the 'UNCDF Working Paper on Microfinance' of March 1999. Instead of supporting wholesale finance linking local financial intermediaries with the wider financial system, the vision was for UNCDF to directly support reputable MFIs that are confronting the challenge of bringing sustainable microfinance services to rural areas. The choice of interventions was also to be guided by the interest of reputable MFI partners in consolidating or extending their activities in such areas.

UNCDF investments are in the range of US$500,000 to US$5,000,000 and target capital-investment projects that are below the lending threshold of international development banks but beyond the financial means of most NGOs and local administrations. UNCDF is an agency that is risk-taking in support of innovative mechanisms that can later be adopted and advocated by larger agencies such as the World Bank, IFAD/FAO and the African Development Bank.

In Kenya, as in in many other countries, USAID has a comparative advantage in the agriculture sector. Kenya's Strategic Objective no. 7 aims to increase rural household incomes through four intermediate results or strategic components; increased agricultural productivity; increased agricultural trade and improved market efficiencies; increased capacity of small-holder business organisations to represent their farmer-members' business interests; and increased access to financial and non-financial services by microentrepreneurs. Through 2005, USAID will give over US$ 7 million in development funds to the GoK and to other non-governmental and private institutions to help them to achieve these strategic objective. The programme will increase micro and small enterprises' access to financial and business services and will address the key policy issues that constrain MSE development.

DFID is heavily involved in addressing the MFI capital constraint issue. It is involved in partnerships with the formal banking sector, including Barclays and the Co-operative Bank, to encourage the sector to lend to small enterprises, as well as a new £12 million Financial Sector Deepening Project to help strengthen the financial sector to meet the needs of poor people and micro/small enterprise. The EU is also taking on a larger role in supporting the second-tier institutions, following in the footsteps of the Dutch Government in a revamped Jitigemee Trust.

[24] In parallel to UNCDF policy reorientation, a MicroStart mid-term evaluation took place in 1998 that urged UNDP/UNCDF to select potential 'breakthrough' MFIs and be wary of financing multiple small organisations that would have less of an impact on the sector at large.

Reflecting on UNCDF's competitive advantage compared to these main donors, unlike many bilateral funders who fund MFIs and other financial institutions directly, UNCDF has access to different government ministries and government institutions that deal with micro and small businesses directly through UNDP network. In Kenya, for example, the ministry of research, science and technology, the ministry of cooperatives and many others have collaborated with UNDP through various programmes focusing on micro and small businesses. UNCDF is seen as a non-biased institution with no political or ideological affiliation as compared to other major international funders. UNCDF and UNDP have a neutral mandate and rapport with national governments. At the same time UNCDF/SUM has a track record in the delivery of downstream capacity building support in Kenya and the intricacies of operating in remote areas.

If the UNCDF manages to align a bilateral or multilateral agency, there would be a window of opportunity to push the frontier, through a pilot project, that could be taken on by one of them later on.

5.0 Conclusions on Strategic Positioning

5.1 Positioning in the Past

After completing the above key steps in the UNCDF positioning exercise – industry analysis, reflection of its client needs, capability analysis and highlighting of comparative advantage – this section draws conclusions on whether UNCDF managed to intervene strategically and optimally position itself in the microfinance arena in Kenya.

UNDP/UNCDF supported MicroStart and MicroSave programmes were relevant and significant. As such, UNCDF helped bring about change in the microfinance sector. Microfinance is a powerful tool that has the potential to contribute to the MDGs despite the fact that, in Kenya, outreach in terms of loans had been a major hurdle in the 1990s. UNDP/UNCDF support helped the sector take off and thereby unleashed its power to contribute to national goals, notably poverty alleviation.

The demonstration effect of profitable microfinance, combined with market forces is creating the conditions for rapid expansion in a number of liberalised financial markets, which is starting to happen in Kenya.

More specifically, some of the major accomplishments of the UNCDF/SUM in Kenya are:

- The creation of a much needed market-driven orientation through its support to MicroSave;
- The demonstration of customer-oriented product development and its critical importance in increasing market penetration and service delivery;
- Significantly increasing outreach, primarily through EBS;
- Building capacity of other select promising retail-MFIs through the MicroStart program, equipping them with international best-practice tools;

- Demonstrating the importance of MIS by supporting an MFI which has perhaps most dramatically shown what is possible once a proper MIS is installed;
- Through its support to a building society, UNCDF/SUM stimulated a diversity of organisational forms to develop in the emerging microfinance sector.; and
- The establishment of a forum for donor coordination through the MicroStart Advisory Board (MAB) and policy influence on government policy makers.

In light of the above, one can conclude that during the period 1999-2002, UNCDF's activities in Kenya were focused on downstream activities, in an effort to develop a market leader. As the microfinance sector was fairly young and there were relatively few restrictive laws for microfinance, the focus of UNCDF/SUM seemed justified.

At the time, UNDP was in dire need of assistance in the area of microfinance. As such, UNCDF has been responsive in its assistance of one its principal allies and succeeded in adding value through its focused technical expertise within the broader UN assistance framework. The government has been supportive of small enterprise development and microfinance and has appreciated the technical expertise from UNCDF.

As a small multilateral agency, with a focused approach in microfinance and local governance, UNCDF has become a well-respected centre of excellence on microfinance. This is an expertise that is seemingly appropriate for a UNDP group investment agency. As such, the choice of investments, provision of downstream support, including the capital support for a key ingredient of an MFI such as an MIS systems – under MicroStart – and launching new timely initiatives such as MicroSave, are niche support areas that have proven valuable and in line with UNCDF's competitive advantage. One could argue that perhaps it did not act upon another sector gap, the geographical imbalance, where it could have contributed, although maybe it was too early for that and a push to sector development with the support to EBS would have been hard to parallel.

In both its support to MicroStart as well as its support to MicroSave, UNCDF seems to have been able to leverage its resources and UNDP/UNCDF group has greatly contributed to the development of microfinance in Kenya. It is imperative that some of the results and lessons learned are spread globally to the benefit of other MFIs and other microfinance sectors that are on the path to maturity.

5.2 The Way Forward

In terms of the future for UNCDF in Kenya, UNDP's plans are of ultimate importance as it has been a key finding partner in numerouse initiatives. UNDP, however, seems to be moving away from its support to microfinance. Nevertheless, below we will outline what emerged as optimal positioning in the future, if Kenya becomes a country whereUNCDF may not invest its core resources.

The supply-demand discussion earlier in the report underscores that the supply of microfinance falls short of demand and that the gap is particularly large in rural

areas. Other key gaps are: a lack of sector data, general lack of capital and capacity, and microfinance specific knowledge of the central bank and at the policy maker level.

UNCDF has realised that to mainstream microfinance initiatives on the kind of scale that is needed worldwide, will require a broader look at the kind of policy, regulatory and institutional support environment that is most appropriate for the target country. Kenya is beginning to have a critical mass of strong MFIs and is also starting to have an increasingly more enabling microfinance environment, notably with the change in regime, which unleashed energy at all levels of society and helped advance the mainstreaming of microfinance.

In a sector which has reached this stage of development, and through its long standing relationship with the government and reputation as an honest broker, combined with its on-the-ground experience with retail MFIs in Kenya and technical microfinance expertise, UNCDF, together with UNDP, are well-positioned to assist the various public agencies to develop adequate prudential norms and enforceable guidelines and it UNDP Kenya has a strong interest in this.

For the same reason UNCDF could be investigating public-private partnerships for advancing outreach to rural areas, through the development of payment systems, so as to deepen outreach in underserved areas. There are not many other agencies that have the institutional experience to pilot innovative, risky undertakings like expanding microfinance into remote areas in Kenya.

As the sector moves on the path towards commercialisation, support is also needed in the field of local capital market development and second-tier financing vehicles, though DFID and Agence Française de Développement (AFD) programs are already venturing in this area.

In addition to these rather strategic areas, UNCDF could, in principle, also fund an in-depth study on the microfinance sector, technical assistance and training, and assistance in the establishment of a credit bureau (see Box 2 for full overview).

Box 2: Possible Future Areas of Intervention

- Undertake an in-depth study on the microfinance sector, including a formal estimation of total supply and demand estimation for the whole microfinance sector (enterprise and non-enterprise);
- Assist the various public agencies involved to develop adequate prudential norms and enforceable guidelines as well as reporting procedures and help them liaise with MFIs.
- Together with the USAID or DFID, UNCDF could help confront the challenge of overcoming the geographical imbalance;
- Fund technical assistance and training; and
- Assist in the establishment of a credit bureau or credit referencing function

It should be noted though that the chances are minimal that UNCDF could continue its support. Kenya is not an LDC, so a full -fledged UNCDF program would not be justified unless they can secure non-core financing from other donors.

APPENDIX 1: TERMS OF REFERENCE

Independent Programme
Impact Assessment (PIA)
of UNCDF-Supported Microfinance Operations

Terms of Reference for the Impact Assessment of:

Kenya: MicroStart Kenya

Nigeria: MicroStart Nigeria

Nicaragua: FNI Nicaragua

Malawi: Pride Malawi

December 2003

Background and Objectives of the UNCDF Independent Impact Assessment (IIA)
The Executive Board of UNCDF, in its decision 99/22, requested an independent evaluation of the impact of UNCDF programmes and projects and that its findings be reported to the Board in 2004. The Conceptual Framework for the UNCDF Impact Assessment provides the full background to this exercise[25].

Objectives: In serving the need for organizational accountability both to the Executive Board and to stakeholders for results, the main objective of the IIA is to assess whether UNCDF has effectively implemented the recommendations of the 1999 independent ITAD evaluation of UNCDF[26] and whether, as a result, its local governance and microfinance programmes have had the intended impact in terms of their effect on individuals, households, communities, institutions, policy and replication. The Impact Assessment will also generate useful lessons and recommendations for UNCDF and partner institutions on programming, strategic positioning and organisational effectiveness at the country, regional and corporate levels.

The overall IIA of UNCDF will be based on two sets of externally conducted exercises to be carried out in 2003, the findings of which will appear in a Synthesis Report:

i) **Programme Impact Assessments (PIAs)**, which will take selected countries as "case studies" and assess the outcomes and indications of impact of UNCDF-supported local governance and microfinance operations at the programme/field level—analysing evidence and the potential of the approaches adopted to achieve the intended impact.

ii) An **Organisational Performance Assessment (OPA),** which will assess UNCDF's organisational performance and effectiveness in formulating and managing its local governance programmes and microfinance programmes at both the HQ and in the field.

This TOR concerns itself only with the PIAs of UNCDF's microfinance operations.

Scope of the Microfinance PIAs
The purpose of the PIAs is to test the programme theory of UNCDF Microfinance Operations, to establish whether in fact the programmes show evidence of, or potential for the intended impact. The scope of the PIAs therefore, following the above programme logic, and with reference to the three impact areas identified for assessment in the Impact Assessment Concept Paper, and to the complementary intended microfinance programme results expressed in the UNCDF Strategic Results Framework[27], will involve an assessment, in each of the selected countries, of:

(i) the achievements of UNCDF-supported MFIs with respect to **poverty reduction**;
(ii) the viability and **sustainability** of UNCDF-supported MFIs; and
(iii) UNCDF's achievements in **influencing policy and promoting replication** and microfinance best practices.

In addition to these "programme-centred" assessments, the PIA will make a "development-centred" assessment of the **strategic positioning and comparative advantage of UNCDF** in its areas of intervention in the broader microfinance context in the country and vis-à-vis other players in the microfinance arena. The **relevance and significance** of UNCDF investments and TA to UNDP-funded MicroStart programmes will also be assessed from this perspective.

The findings and analysis of the PIAs for all four country studies shall be presented in a single main report, with explicit sections covering all of the components in the following table for each of the four countries. Supporting data for the analysis shall be presented in a separate report, clearly cross-referenced in the main report.

Main evaluation questions to be answered:
IMPACT AREA 1: Poverty Reduction

- Is there increased access to financial services by the poor (in particular poor women) as a result of UNCDF-supported microfinance interventions?
- What are the nature and magnitude of changes in people's lives (women's in particular), and in communities served by microfinance services, in respect of, *inter alia*, poverty reduction and empowerment, as a result of their increased access to the financial services supported by UNCDF?
- Has increased access to financial services supported the development of clients' productive enterprises and generated employment?
- Are poor current and exited clients satisfied with the level of access to, type, quality, and consequence of microfinance services provided by UNCDF-supported MFIs? What improvements are suggested?

[25] UNCDF (Feb 2004) A Conceptual Framework for the UNCDF Impact Assessment
[26] ITAD (1999) Evaluation of UNCDF Synthesis Report, p65
[27] See http://www.uncdf.org/english/about_uncdf/corporate_policy_papers/index.html

IMPACT AREA 2: Sustainability (institutional and capacity development)

- Is there increased access to financial services by the poor (in particular poor women) as a result of UNCDF-supported microfinance interventions?
- What are the nature and magnitude of changes in people's lives (women's in particular), and in communities served by microfinance services, in respect of, *inter alia,* poverty reduction and empowerment, as a result of their increased access to the financial services supported by UNCDF?
- Has increased access to financial services supported the development of clients' productive enterprises and generated employment?
- Are poor current and exited clients satisfied with the level of access to, type, quality, and consequence of microfinance services provided by UNCDF-supported MFIs? What improvements are suggested?

IMPACT AREA 3: Policy Impact and Replication

- What policy changes (in terms of norms, legal and regulatory frameworks, macro and micro policy) in the country are attributable to UNCDF-supported microfinance interventions?
- Is there evidence of acceptability and/or replication of the MFI and its products in the market?

ASSESSMENT OF UNCDF STRATEGIC POSITIONING

In addition to assessing the programmes themselves and related outcomes/impact according to the above criteria, the PIAs will also make an assessment of the strategic positioning of UNCDF in terms of:

- The *relevance and significance* of UNCDF-supported interventions, programme objectives and actual activities/outputs/outcomes to i) the development of microfinance in the country; ii) government priorities and national needs; iii) the UN System goals as expressed in the UNDAF; and iv) the Millennium Development Goals[28] and Programme of Action for the LDCs[29]
- How *responsive* UNCDF has been to significant changes in the country's microfinance context
- The *comparative advantage* of UNCDF in providing support to microfinance services in the country, vis-à-vis other private sector entities or donors.
- The effectiveness of *partnerships* made by UNCDF in pursuit of its objectives and *synergy and alignment* of UNCDF support with other initiatives and partners.
- How UNCDF could, in future, best (re)position itself to provide added value.

Organization, composition, duration and costs of the mission

The PIAs shall be carried out and reports finalised between April and October 2003, earlier if possible.
Team leaders for poverty assessments and CGAP appraisal: an international consultant with microfinance and impact assessment expertise and specific applied experience in using AIMS and MicroSave Africa assessment tools, and extensive experience in conducting microfinance assessments, and an international consultant with specific applied experience in using CGAP Institutional Appraisal tools respectively. Familiarity with Malawi, Kenya, Nicaragua and Nigeria would be an advantage. In addition, the team leaders shall have excellent team-management and writing skills, and will be responsible for preparing the analysis of findings and research data to feed into the main report and companion report.

Team members: will consist of international and local consultants who shall possess applied experience with LFA (Logical Framework Analysis), be familiar with the AIMS/MicroSave Africa assessment tools and/or have applied experience in participatory qualitative and quantitative research techniques and knowledge of the local microfinance context and CGAP institutional assessment tools.

Summary of deliverables

One bound copy and an electronic version each of the main report and the companion report shall be submitted to UNCDF HQ. In summary, the outputs required of the evaluator are:

1. Detailed workplan
2. Detailed methodology plan
3. Summaries of Key Findings (prepared for each in-country debriefing)
4. Minutes of all PIA Wrap-up Meetings
5. Interim Report
6. Draft main report
7. Draft companion report
8. Final main report
9. Final companion report

[28] See http://www.undp.org/mdg/ for Millennium Development Goals and indicators.
[29] See http://www.uncdf.org/english/news_and_statements/current/lauzon-statement_06Aug-02eng.html for Statement of Executive Secretary referring to the Programme of Action for the LDCs 2001-2010

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APPENDIX 3: PEOPLE INTERVIEWED

MFIs
Gerard Macharia, Executive Director, Faulu Kenya
Ingrid Munro, Jamii Bora
Costa Malai, Microfinance Partners
Omondi Okoyo, CRS
Mwai Mbuthia, Partner, Mungai and Associates, CPA
Kimanthi Mutua, MD K-Rep Bank
Betty Sabana, AMFI

Government and Donors
Fortunatus Okwiri, Ministry of Labour and Human Resources, GOK
Winnie Karingithy, Ministry of Labour and Human Resources, GOK
Francesco Rispoli, UNCDF
Graham Wright, MicroSave
David Ferrand, Financial Sector Specialist, DFID
Zach Ratemo, USAID

Financial sector
Timothy Biwott, Head of Microcredit Unit, Cooperative Bank
Lynette Dawa, Manager Special Loans, Kenya Commercial Bank
JM Kitili, Deputy Director – Supervision, Central Bank of Kenya
George Omino , Microfinance Manager, Central Bank of Kenya
Aleke Dondo, K-Rep NGO
John Kashangaki, KAS
Ben Mbai, Managing Consultant Jitegemee Trust

Equity Building Society
Joseph Geita, R&D
Winnie Imaniara, HR/Marketing Manager
MK Kafuro, Uthayi Branch Manager
Jeremiah Kamau, Thika Branch Manager
Njunge Kamau, Finance Manager
Simon Minyoike, Corporate Branch Manager
Peter Munga, Chairman of the Board
John Mwangi, Chief Executive Officer, Board Member
James Mwangi, Finance Director, Board Member
Alan Mwangi, Internal Audit Manager
Ambrose Ngari, Credit Manager
Dennis Njau, Marketing/research
John Staley, Chief Operating Officer
Samuel Tiras, Tom Mboya Branch Manager
Gerard Warui, Chief Accountant/Operations Manager

APPENDIX 4: COMPARATIVE OVERVIEW ofCASE STUDY COUNTRIES 12/2003

Table 1 A Comparative Overview of Case Study Countries
All financial figures are in US$, unless otherwise stated
MM = Millions

	Kenya	Malawi	Nigeria	Haiti
1. Macro-economy				
Population (2002)	31.3 million	10.7 million	133 million	8.3 million
Population Density (sq. km)	53	93	144	288
GNI / Capita (Atlas Method)	$350	$160	$290	$480
GDP / Capita (current dollars)	$364	$151	$365	$460
GDP / Capita (PPP US$, 1999).	$1,022	$586	$836	$1,464
Gini co-efficient	.44	.41	.51	.50
% Below Poverty	50%	65%	60% (40% in absolute poverty)	80% of rural poor (70% of total population)
Currency Exchange Rate	1 US$ (USD) = 73.75 Kenyan Shilling (KES) 100 KES = 1.36 USD	1 US$ (USD) = 89.36 Malawi Kwacha (MWK) 100 MWK = 1.12 USD	1 US$ (USD) = 126.8 Naira (NGN) 10,000 NGN = 78.87 USD	1 US$ (USD) = 41 Gourde (HTG) 100 HTG = 2.44 USD
Inflation Rate(2002)	6%	27% 15% (1/2003)	18%	16%
Interbank Lending Rates	9% (12/ 2002) 1.6% (6/2003)	Range: 30-40% (1/2003)	15% (2003)	12.5% (2002)
Commercial Bank Lending Rates	14.7 (1/2003) 19.6% (2001)	40-46% (2003)	Capped at 19% (2003)	26% (2002)
91 day Treasury Bill rate (8/2003)	3.9%	44%	15.7%	14.5%
M2/GDP (1999)	42%	13%	13%	30%
Credit to private sector (US$ MM)	$203,443	$5,391	$582,606	$1,250
Credit to Private Sector (% of GDP, 2001)	24.6	6.8	17.8	15
Savings Ratio (Private sector savings/credit to private sector)	12%	4%	25%	10%
Manufacturing Sector (1995 prices) MM	$814	$201.5	$1,631	$850
Size Manufacturing Sector as % of GDP	12.5%	12.9%	4.2%	24%
General enabling environment	Improving after elections 12/2003.	Declining with continuing parastatal subsidized lending and	Diversity between north and south.	Per capita income declined 5% a year in last 20 years. Civil unrest is high

	Economic conditions had been falling in Kenya for more than a decade.	upcoming elections. One of 7 African countries in drought. Largely rural population	Political and religious friction.	and safety is low. Country uses International Development Association, (IDA), World Bank's concession lending window.
Gross Exports	$2,981	$455.5	$19,798	$327
Main exports	Tea, Coffee, Corn, Horticultural Products, Fish	Tobacco (50% of Exports), Tea, Sugar	Oil (20% of GDP), Coal, Vegetable Oils	Coffee, Sugarcane, Mangoes, Rice, Labour
Debt as % of GDP	4%	15%	8%	33%
Gross Domestic Savings (% of GDP, 2002)	5.5% (2001)	-1%	26%	10%
Exchange Rate Nominal Real	 153 120	 472 118	 501 284	 51
Foreign Direct Investment (FDI) US$ MM	5.3	58.4	1101.4	2.9
Aid per Capita (current US $, 2001)	14.7	38.1	1.4	20.4

Sources:
Population, Population Density: World Bank, World Development Indicators
GNP: World Bank
Gini: World Bank, Human Development Network, Development Data Group
Gini Haiti: Pederson, Lockwood, "Determination of a poverty line for Haiti," 2001
% Below Poverty: UNDP
GNI: World Bank data
GDP, PPP: World Bank, Human Development Indicators
Currency: UNIDO
Inflation: African Development Bank, World Bank (Haiti)
Commercial Bank Lending Rates: World Bank, Standard Bank Research Reports
Interbank Lending Rates: Respective Country Central Bank Website
T-Bill Rates: Liquid Africa.com, World Bank
Credit to Private Sector: African Development Bank, World Bank (Haiti)
Credit to Private Sector (%): World Development Indicators 2003
Savings ratio: African Development Bank, World Bank (Haiti)
Manufacturing Sector: African Development Bank, World Bank (Haiti – 1991)
General Enabling Environment: Various
Gross Exports: African Development Bank, World Bank (Haiti)
Main Exports: CIA Factbook
Debt as % of GDP: African Development Bank, World Bank (Haiti)
Gross Domestic Savings (as % of GDP): African Development Bank, World Bank (Haiti)
Exchange Rate, nominal, real: African Development Bank
Aid per capita: World Bank

APPENDIX 5: MAP