Cardiff School of
Planning and Geography

Inclusive Growth: Improving Microfinance Regulation to Support Growth and Innovation in Micro-enterprise

The Republic of Kenya Background Country Report

Dr. Alastair Michael Smith

Informal Economic Observatory

Contents

Disclaimer

The current document should be considered work in progress, and only aims to provide the most accurate and complete account at the time of writing. The profile should not be considered exhaustive and has not been reviewed by country experts or peer reviewed. If you notice a gap or error in any of the profiles, we would very much appreciate your comments for improvement. All financial data stated in this report are nominal values, and therefore, the impact of inflation should be taken into account of corrected for.

Acronyms

Acronym	**Meaning**
AMFI	Association of Microfinance Institutions
ASCAs	Accumulating Savings and Credit Associations
ATM(s)	Automated Teller Machine(s)
CBK	Central Bank of Kenya
COSALO	Community Savings and Loans
CRB	Credit Reference Bureau
DT-MFI(s)	Deposit Taking Microfinance Institution(s)
DTS	Deposit Taking SACCOS
ICDC	Industrial and Commercial Development Corporation
KIE	Kenya Industrial Estates
KShs	Kenyan Shillings
KTDC	Kenya Tourist Development Corporation
MFI	Micro-Finance Institution
NA	Not Applicable
NBFI(s)	Non-Bank Financial Institution(s)
NDT-S	Non-Deposit Taking SACCOS
ROSCAs	Rotating Savings and Credit Associations
PAR 30	Portfolio At Risk over 30 days
SACCOS	Savings and Credit Co-operative Societies
UA	(Data) Unavailable
VAT	Value Added Tax
VSLA	Village Savings and Loans Associations

Exchange Rates

Kenya Shillings (KSh)	United States Dollars (USD)
100	1.11

Introduction

Although the development of small scale and informal enterprises in the Kenyan economy is constrained by a myriad of factors, the availability of credit does offer an important input where it is available on appropriate terms (Kariuki 1995).

According to the Central Bank of Kenya, "Microfinance is the provision of a wide range of financial services and products ranging from savings credit facilities, money transfer and micro insurance to the economically active poor, low-income households and Small and Micro Scale Enterprises (SMEs) in both rural and urban areas, using innovative delivery methodologies and channels" (Central Bank of Kenya 2007, p. 17). SMEs are particularly identified as important given that the "best estimates peg the MSME market [in Kenya] at approximately 7.5 million enterprises. They contribute approximately 44% to the Kenyan GDP (in 2008, up from estimates of 13.8% in 1993), 80% of the country's total employment and 92% of all new jobs" (FSD Kenya 2010a, p. 1). While this report will discuss microfinance as a broad sector throughout, the focus is on understanding microcredit.

This Background Country Report first summarises the contemporary macroeconomic context of Kenya; discusses the drivers for the emergence of microcredit in the country; then provides an overview of the sector, including specific discussion of the regulatory history and framework for microcredit. The role of technology and particularly mobile phones in contemporary microcredit provision is addressed.

Current Macro Economic Context of Kenya

Population (in millions) 43.2	Corruption Perception Index country rank 139
Population % urban 24	Account at a formal financial institution (% age 15+) 42
Gross domestic product per capita 865 (current US$)	Bank branches/100,000 people 5.2
Human Development Index ranking 145	ATMs/100,000 people 9.5
Adult literacy rate (%) 87 (2010)	SIM penetration (%)70

Table 1: Overview of Economic and Financial Indicators for Kenya (Zimmerman et al. 2014, p. 2)

According to the Central Bank of Kenya (2013, p. 24), the country's economy grew by 4.7 percent in 2013, compared with 4.6 percent in 2012 and 4.4 percent in 2011. Growth was mainly driven by the energy, financial services and trade sectors; and individual contributions can be seen in Table 2.

Sector	**Contribution**	**Sector**	**Contribution**
Agriculture and Forestry	20.6 percent	Wholesale and Retail Trade	11.5 percent
Transport and Communication	12.6 percent	Manufacturing	9.5 percent

Table 2: Sectoral Contribution of Kenyan GDP 2013

Inflation rose in 2013 from 3.67 percent in January to 7.15 percent in December 2013 but remained within the CBK target range of 2.5% - 7.5%. This acceleration was largely attributed to price rises in food, increased from 2.40 percent to 10.41 percent on account of adverse weather conditions in the last quarter of 2013, and implementation of Value Added Tax (VAT) in September 2013. The non-food, non-fuel inflation (NFNF) registered marginal increase from 4.53 percent in January 2013 to 4.71 percent in December 2013 (Central Bank of Kenya 2013, p. 24).

Historically, the Kenyan domestic economy has been tied to international markets for the export of coffee and import of oil, upon which it is reliant for domestic fuel consumption (Mosley 1986). In the late 1970s, price drops in the former and rises in the latter forced the country to turn to international financial institutions and donors for support. This resulted in a process of liberalisation across the economy.

Despite inflation, overall interest rates in Kenya have recently declined[1]

Rate	**2012**	**2013**
The Central Bank Rate (CBR)	11.0 percent (December)	8.5 percent (May)
Interbank rate	13.64 (average)	8.41 (average)
Repo-rate	12.61 percent (average)	8.07 percent (average)
Commercial banks' lending	18.13 percent (Jan 2013)	16.99 percent (December 2013)
Bank deposits	6.51 percent (Jan 2013)	6.65 percent (December 2013)
Interest rate spread	11.62 percent (Jan 2013)	10.34 percent (December 2013)

Table 3: Key Interest Rates (Central Bank of Kenya 2013, p. 24 & 26).

[1] It is relevant to note that the central bank does not record and publish interest rates of microfinance institutions. Other third party organisations have stated to make this data available however, offering a summary of reported interest rates by institutions from countries across the globe (MF Transparency 2015).

Overview of Contemporary Banking Sector in Kenya

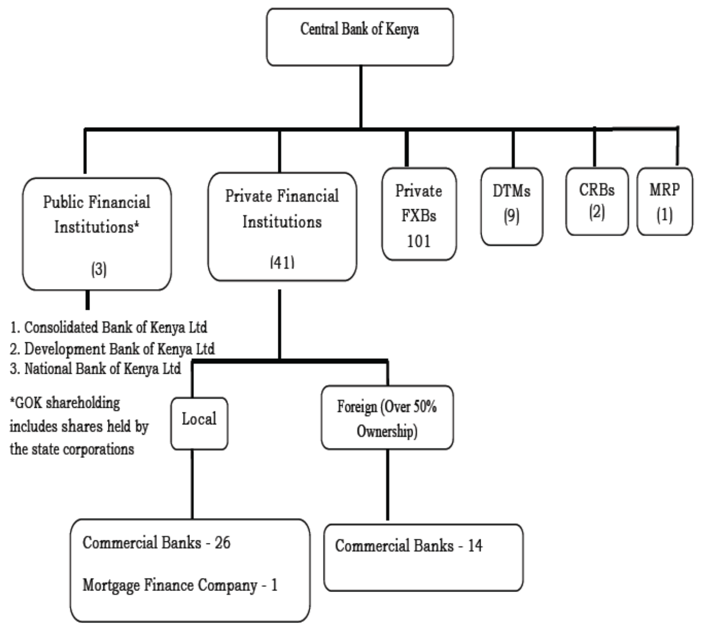


Image 1: Structure of Banking Sector (Central Bank of Kenya 2013, p. 1)

As can be seen in Image 1, at the end of 2013, the banking sector in Kenya was composed of the Central Bank of Kenya (as the regulatory authority), overseeing 44 banking institutions. Out of these, 30 were locally owned banks, 3 had publically held shares (Consolidated Bank of Kenya 77.8%, Development Bank of Kenya 100% and National Bank of Kenya 70.6%) and 27 were privately owned. 14 banks were foreign owned. There was also one locally owned mortgage finance company - MFC). In addition to full commercial banks, there were nine registered Microfinance Banks (MFBs) or Deposit Taking Microfinance Institutions (DT-MFIs), 2 Credit Reference Bureaus (CRBs) and 101 forex bureaus. The 9 MFBs, 2 CRBs and 101 forex bureaus were privately owned. The foreign owned financial institutions comprised 10 locally incorporated foreign banks and 4 branches of foreign incorporated banks (Central Bank of Kenya 2013, p. 1). Nationally there were 2,487 bank branches (Central Bank of Kenya 2013, p. 6 & 8).

Structural Drivers for Microfinance in Kenya

The need for microfinance in Kenya has been driven by a series of interrelated constraints on the development of a banking and finance sector. These key constraints have been: the structure and composition of the Kenyan banking and finance sector; a lack of the appropriate regulation and governance required for quality improvements in banking and finance; general macro-economic conditions; and the conservative commercial business practices of profit focused banking institutions.

Before independence (1963 with the republic declared in 1964), Kenya had a banking sector established as part of the wider economic colonisation of the country, and therefore, not geared to provided credit to the majority of Kenyans. At the end of colonial rule there were four British owned banks and three Non-Banking Financial Institution (NBFI), two of which were subsidiaries of the formal banks (Central Bank of Kenya 1998, p. 13). These banks were subject to the Summary of Banking Arrangements, which eliminated competition in lending rates and charges (Leys 1975, p.

134). Prior to the establishment of the Central Bank of Kenya in 1966, matters relating to monetary management were handled by the East African Currency Board which also served Uganda and Tanzania (Kinyua 2000). Following independence, the Kenya government bought controlling shares in all national banking institutions under a nationalistic policy to expand the availability of credit to African Kenyans; although they insisted that they expected them to operate on a commercial basis (Leys 1975, pp. 133-135). The sector also began to expand and two new domestic banks were established in 1964 under the Banking Act of the same year: the Cooperative Bank of Kenya, which was opened to provide banking services to members of the cooperative moment[2], and the wholly government owned National Bank of Kenya both opened in 1968. One commercial bank separated into two in 1971 and the Commercial Bank of Kenya was nationalised (Leys 1975, p. 157). There was also growth of Non-Banking Financial Institutions: existing NBFI operations were newly licenced and others emerged to leave seven by the end of 1977, and 35 by 1983 (Central Bank of Kenya 1998, p. 13).

Despite this initial growth in the banking and finance sector, the political interest in expanding credit was not matched with prudent regulation to maintain quality. The newly nationalised Commercial Bank of Kenya expanded lending by 225% between January and September 1971 (Leys 1975, p. 157). Between September 1970 and January 1971, commercial banks as a whole increased credit availability to domestic traders by £6.5 million and to households by £6.3 million (Leys 1975, p. 157). Overall, credit to the private sector rose by 36.5 percent in 1970 (Kinyua 2000). Unfortunately, in the absence of appropriate governance, large non-performing loans were made to Directors and their associates which greatly weakened asset quality (Central Bank of Kenya 1998, pp. 14-15). As a result, a good number of bank, and non-bank-financial-intuition failed in the 1980s, and Central Bank of Kenya was required to step in to restructure institutions in order prevent their collapse (Central Bank of Kenya 1998, p. 13).

In response to the problems of the banking sector a two part strategy was implemented—to some degree influenced by external conditionality. As for many African countries in the early 1970, the sharp rise in the global oil prices were compounded by wider recession that reduced markets for exports. As a result of this situation, the Kenyan Government were forced to seek support from international financial institutions (Mosley 1986). The conditions attached to this support required the application of market governance to the financial sector via liberalisation, and increased and improved direct regulation (See section on Regulation below). Liberalisation of interest rates is considered to increase the availability of credit as it allows banks to charge rates necessary to service high cost of provision and offset risks associated with providing credit to wider interests (Kariuki 1995, p. 15). However, in the early years of reform, governance frameworks often lacked coherence. Initially, regulation of NBFI was less stringent, as for example these were not subject to interest rate controls. Therefore, while the number of banks remained limited, there was a proliferation of NBFI which continued to operate outside appropriate governance frameworks.

Year	**Banks**	**Other Non-**	**Mortgage or**	**Total**	**Licenced**	**Number of**

[2] Given the bank was unable to comply with capital requirements specified under the Banking Act, it was given special dispensation and a grace period to meet these obligations. The Bank registered as a finance company – the Co-operative Finance Limited – in 1977 to conduct the business of a financial institution, and opened to the public in 1993. Only in 1994 did the Co-operative Bank become a full commercial bank (Co-Operative Bank 2014).

		bank financial institutions (NBFIs)	Building Societies	Institutions	Deposit Taking MFI	Branches
1964	3	3	No stats	6	Na	No stats
1968	5	3	No stats	7	Na	No stats
1977	6	7	No stats	13	Na	No stats
1983	6	35	No stats	41	Na	No stats
1994	33	52	No stats	85	Na	489
1995	No Data	No Data	No Data	No Data	Na	568
1996	50	21	Not stated	71	Na	588
1997	53	17	6	74	Na	670
1998	53	14	6	73	Na	692
1999	53	8	6	67	Na	530
2000	49	5	6	60	Na	465
2001	46	3	6	55	Na	494
2002	45	3	6	54	Na	486
2003	45	3	6	52	Na	512
2004	44	2	5	51	Na	532
2005	49	1	3	53	Na	No Stats
2006	41	1	3	45	Na	575
2007	42	1	2	45	Na	740
2008	43	0	2	45	Na	887
2009	44	0	2	46	1	996
2010	43	0	1	44	5	1,063
2011	43	0	1	44	6	1,161
2012	43	0	1	44	8	1,272
2013	43	0	1	44	9	1,342
2014	43	0	0	44	UA	UA

Table 4: Numbers of Banking Institutions (Compiled by author from various sources: Central Bank of Kenya 1995, 1997, 1998, 1999, 2000, 2001, 2002, 2003, 2004, 2005, 2006, 2007, 2008, 2009, 2010, 2013, 2014b; FSD Kenya 2012)

During the 1960s and 1970s the Kenyan Government's monetary policy remained characterised by strong state intervention, as it administered interest rates through a regime of fixing minimum savings rates for all deposit-accepting institutions and minimum lending rates for commercial banks, non-bank financial institutions (NBFIs) and building societies (Kariuki 1995; Ngugi 2001, p. 296). The intention was to ensure low interest rates to encourage investment and protect small borrowers. Consequently, real interest rates were negative during the 1970s (Kariuki 1995, p. 15). However, the CBK struggled to open up credit supply for domestic private sector given the constraints of money management, a fixed exchange rate and expansionist government fiscal policies (Kinyua 2000). "By 1985 it had become clear to the Kenya government that the economic difficulties the country faced were more structural in nature and, as such, in addition to the stabilization measures, it called for far-reaching structural reforms in the economy" (Kinyua 2000). As a result, interest rates were fully liberalised in July 1991 (Ngugi 2001, p. 297). The intention was to expand credit availability so that biases against lending to small business were eliminated (Kariuki 1995, p. 16). Rates immediately and significantly increased although inflation continued to rise. Despite high rates, some evidence suggests that more small and medium businesses borrowed money in the early 1990s than they did in the 1970s (Kariuki 1995). However, higher interest rates also had the effect of increasing non-performing assets and triggered bank failures: with 17 more failing banks requiring liquidated between 1993 and 1994, (Central Bank of Kenya 1998, p. 13).

Another reason for the failure of monetary policy was reliance on domestic credit guidelines as a way of containing monetary expansion. However, these did not apply to the non-bank financial institutions (NBFIs) that therefore proliferated in the late 1970s and early1980s. As a means to counter this, NBFIs were encouraged to become banks through mergers, acquisitions and sole conversions (Central Bank of Kenya 1998, p. 13). Amendments to the Banking Act (1994) finally ensured NBFI also complied with monetary policies issues by the Central Bank. There was a moratorium on the licencing of new banking institutions in POSSIBLY BEFORE UNTIL 1997 (Central Bank of Kenya 1998, p. 4). This situation, led to a significant change in the banking and finance structure, with a rise in the number of banks and a corresponding fall in the number of NBFIs. Despite the restructuring, some of the NBFIs were ill prepared for commercial banking; many were insufficiently capitalised and therefore collapsed. To address this issue, the Banking Act was amended in 1997 and 1999 to require banks to raise their paid-up capital from KShs 75 million to KShs 200 million and then KShs 500 million for banks and KShs 375 million for NBFls by end of 2005. This policy was expected to incentivise many of the small and medium size banks to merge and become more competitive; and in 1999, eight institutions were approved for merger into four (Central Bank of Kenya 1999, p. 7). Following liberalisation, The Cooperative Bank of Kenya moved away from only working with members of the cooperative movement, to become a universal commercial bank (Bell et al. 2002).

Period	**Nominal Lending Rates**	**Interest Rate Spread**	**Real Interest Rates**
1971	9	5.5	20.07
1972	9	5.5	7.7
1973	9	5.5	-1.09
1974	9.5	5.19	-5.64
1975	10	4.87	-1.64
1976	10	4.87	-7.49
1977	10	4.87	-5.9
1978	10	4.87	6.71
1979	10	4.87	4.13
1980	10.58	4.83	0.94
1981	12.42	3.57	1.41
1982	14.5	2.3	2.61
1983	15.83	2.56	3.57
1984	14.42	2.65	3.84
1985	14	2.75	5.26
1986	14	2.75	4.86
1987	14	3.69	8.16
1988	15	4.67	8.03
1989	17.25	5.25	6.82
1990	18.75	5.08	7.33
1991	19	UA	5.75
1992	21.07	UA	1.83
1993	29.99	UA	3.41
1994	36.24	UA	16.43
1995	28.8	15.2	15.8
1996	33.79	16.2	-5.78

1997	30.25	13.52	16.88
1998	29.49	11.09	21.1
1999	22.38	12.83	17.45
2000	22.34	14.24	15.33
2001	19.67	13.03	17.81
2002	18.45	12.97	17.36
2003	16.57	12.44	9.77
2004	12.53	10.1	5.05
2005	12.88	7.8	7.61
2006	13.64	8.5	5.43
2007	13.34	8.18	7.31
2008	14.02	8.71	0.71
2009	14.8	8.84	4.62
2010	14.37	9.81	11.86
2011	15.05	9.42	1.33
2012	19.72	8.15	12.08
2013	17.31	UA	10.06

Table 5: Selected Indicative Interest Rates in Kenya (Datastream Service)

Interest rates remained high into the 1990s (peaking in 1996) and were noted as posing a problem to the long term sustainability of the Kenyan banking sector given the likelihood of loan defaults and restriction on credit supply (Central Bank of Kenya 1995, p. 3). One measure taken by the Central Bank was to launch an educational program focusing on the appropriate management of loans and encouraged commercial banks to assist in the campaign. However, non-performing loans increased from the early 1990s until 2001. Research among bank managers of key institutions concluded that these stakeholders attributed the rise to three factors: the national economic downturn (external factor), customer failure to disclose vital information during the loan application process (customer factor) and lack of more aggressive debt collection (bank factor) (Waweru and Kalani 2009).

In terms of physical coverage of Kenya by the banking system, despite slow growth in the number of branches, the commercial orientation of banks has restricted development. For example, in 1999, rationalisation measures by banks led to a decrease in the number of branches of banking institutions with four big banks accounting for majority of the branch closures (Central Bank of Kenya 1999, p. 5). In 2003 it was noted that rural customers were particularly hard hit by these measures.

The lack of competition and appropriate regulation has also reduced the quality of credit provision in Kenya. For example, it is noted by the Central Bank that many institutions have used loan interest calculations other than the reducing balance method and have failed to ensure customers understand rates of interest prior to taking out loans (Central Bank of Kenya 1998, p. 15). In terms of savings, banks applied high minimum balance requirements in the early 1990s, reportedly applied to “rid themselves of small depositors” not considered to be sufficiently profitable (Central Bank of Kenya 1998, p. 15). This saw many middle and low income persons unable to operate bank accounts (SASRA 2010, p. 9). While the consumer experience did improve, complaints returned in 1999 as banks sought to maintain profits, which eroded 1994-1998, by reducing operating costs and again increased minimum balance requirements (Central Bank of Kenya 1999).

Historical Development of Microcredit in Kenya

This section discusses the historical growth of microcredit availability by developing the tripartite categorisation suggested by Dondo (No Date): which breaks the sector into Informal/Quasi-formal initiatives, Formal subsidised initiatives and Formal non-subsidised initiatives. Despite the usefulness of this categorisation for understanding the credit availability in Kenya however, it is important to bear in mind that informal and formal credit networks often interact (Alila 1992).

1. The Informal Financial Sub-system

This sector is further categorised as coming in three forms:

a. **Financial arrangement among relatives and friends**. The exact magnitude of these transactions is impossible to estimate. Although research, by Financial Sector Deepening (FSD) Kenya (2014b), indicates that this is general practice and a wide-spread phenomenon among friends and relatives in Kamba Mathira, Kitui and Nyamira. This form of lending in highly embedded in culture. Credit terms are popular as many of these loans are interest free or charge very low interest and do not require collateral; this is especially when they are for education, health, or to manage other shocks. Repayment arrangements tend to be open-ended, and are based on reciprocity. If a borrower fears they will not be able to repay on the agreed date, “the best way to avoid the lender’s disappointment and a negative spin-off on the relationship is by explaining the cause of non-payment before the agreed date. This enables the borrower and the lender to agree on an extension or a different arrangement. Adverse personal circumstances of the borrower may lead to leniency on the part of the lender” (FSD Kenya 2014b, p. 3). Other studies show that credit from friends and relatives constitutes an important source of start-up capital for many micro enterprises in urban areas and for smallholder farmers in rural areas. However, where fund are lent for business or a productive purpose “the borrower may return them with *‘something on top’,* which is literally explained as an appreciation or *‘giving back thanks’,* however, this is not necessarily small in relation to the amount lent and can depend on the scale of the gain and the gratitude of the borrower” (FSD Kenya 2014c, p. iv). The introduction of mobile money has allowed the expansion of inter-personal lending, in addition to uni-directional remittance payments (FSD Kenya 2014c).

b. **Traditional moneylenders / “shylocks”.** Money lenders are used by individuals and groups to obtain credit, usually at high rates of interest. There is some evidence of formally registered small and medium enterprises using these as a source of working credit (Kariuki 1995).

c. **Shopkeepers.** Many small scale shopkeeper or street sellers provide informal credit to clients allowing good to be taken in exchange for payment at a later date.

2. The Quasi-Formal Financial Subsystem

Community Savings and Loans Groups. Kenya has thousands of Community Savings and Loans Groups which are a source of credit to millions of low-income people: and this form of financial services is growing strongly across the continent. These are found in both rural and urban areas, either as registered social welfare groups or as unregistered groups of friends and family members. It is for this reason they have been classified as quasi-formal organisations, as they might or might not be legally registered groups, although as will be discussed later, neither category are subject to financial regulation. NGOs have been instrumental in encouraging and supporting the development of such groups. For example in Marsabit, Financial Sector Deepening Kenya has funded CARE's establishment and expansion of 665 Community Savings And Loans (COSALO) groups, and local NGO BOMA fund has established a further 350 groups (FSD Kenya 2014a, p. 10). Other groups are set up autonomously or are now independent following initial NGO support. Although all savings groups follow similar modalities of operation, there are many specific individual methodologies, in many cases derived from the groups selection of options depending on their own needs (FSD Kenya 2014a, p. 10). A good summary is offered by FSD Kenya (2014a, p. 10):

"Groups usually comprise 15–30 members who are most often, but not exclusively, women. Group members are trained or facilitated to establish group by-laws which include agreeing the amount to be saved each month (or other period). They also set the procedures for and terms of any loans to be made, including repayment timeframes and interest rates. Most approaches encourage formal, written record keeping, however, given the high levels of illiteracy..., some groups keep verbal records. Some groups, most notably CARE's COSALOs, pay out all savings and interest earnings to members as a lump sum at the end of each financial year. This means the capital available for lending must be re-established at the beginning of each subsequent year".

Two general types of group can be distinguished (Aghion and Morduch 2005, p. 68):

A) Rotating Savings and Credit Associations (ROSCAs) / Merry-go-Rounds – where weekly savings are made available on a rotating basis as short term credit for one member at a time.
B) Accumulating Savings and Credit Associations (ASCAs) / Village Savings and Loans Associations (VSLA). Where weekly savings are made available as credit for the members on the basis of a needs assessment basis and allow more than one person to borrow at one time. In their most formalised form these organisations essentially operate as a credit cooperative or credit union).

Borrowing from Community Savings and Loans Groups tends to carry a high rate of interest. However, the interest stays within the community and boosts the loan capital. Traditionally, links between Community Savings and Loans Groups have been limited, although some microfinance institutions provide them with lending funds, usually as a group loan.

As might be expected, there is no accurate date for either informal or quasi-formal credit providing services, although Dondo (No Date, p. 6) offered the following estimates for the year 2000:

Informal Microfinance Organizations	**Estimated Numbers**
ROSCAs and ASCAs	More than 30,000
Moneylenders	More than 1000
Unregistered Family/Neighbour/Friends Groups	Various

Table 6: Estimated Number of Community Savings and Loans Groups

More contemporary evidence suggests that use of quasi formal credit-giving institutions is geographically and culturally varied. In survey locations in Turkana (where the population is largely semi-nomadic pastoralists), membership of savings groups was found to be negligible, whereas in Marsabit (settled town) approximately 25 per cent of women surveyed were in such groups (FSD Kenya 2014a, p. 10).

3. The Formal, Subsidised Credit System

Arguably, the first formal microcredit initiative in Kenya was the Joint Loan Board scheme introduced by the colonial government in the 1950s (Dondo, pp. 2-3), designed to support farmers undertake agricultural modernisation (Alila 1992, pp. 1-2), as well as Kenyan industrialists, artisans, and other businesses. Since then the Kenyan Government has established many targeted and subsidized credit programs to help the development process. The principal institutions that have provided microcredit are (Bwonya-Wakuloba 2008; Dondo No Date):

- Industrial and Commercial Development Corporation (ICDC);
- Kenya Industrial Estates (KIE), who provide start up, expansion and working capital (Kariuki 1995);
- District Joint Loan Boards (started 1951, updated 1963), Rural Enterprise Fund (1991) District Poverty Eradication Program (2002), and;
- Kenya Tourist Development Corporation (KTDC).

Overall, it has been noted that government credit schemes have performed poorly in terms of repayment speed and default rates (Bwonya-Wakuloba 2008). However, in 2004 it was estimated that there were still more than 20 Joint Loan Board Schemes and two government owned organisations that provide publically subsidised credit under various conditions (Dondo No Date, p. 6).

Alongside these programs NGOs began to offer administered credit programs for Micro and Small Enterprises (MSEs) using capital provided by foreign aid agencies (Dondo, p. 3; Wanyama 2009). These range from small charitable units operating in a limited geographical area to large institutions, covering vast areas and carrying out a variety of development and welfare activities. Increasingly, organizations have emerged with the primary objective to provide financial services to micro and small enterprises. For example CARE acquired Wedco Enterprise Development Limited to create WEDCO (2000), the National Council of Churches of Kenya (NCCK) established Small and Micro Enterprise Program (SMEP) (1999), Plan International created Business Initiatives and Management Assistance Services (BIMAS) (1997) and World Vision the Kenya Agency for the Development of Enterprise and Technology (KADET) (2000). Starting roughly in the 1980s innovations appeared as a number of NGOs have developed microfinance assistance models that do not require tangible collateral and are more cost-effective to in supporting clients with limited financial capacity. However, a significant limitation to subsidised credit initiatives is that they are limited by the extent of donor capital. Although such organisations have been formally registered under a variety of frameworks, their financial operations have until recently remained largely unregulated (Dondo No Date). In contemporary regulatory discourse these organisations are referred to as Non-Deposit Taking Microfinance Institutions (NDT-MFIs) or Credit Only Microfinance Institutions. It is however, also important to note that microcredit is also widely provided for purposes other than for business development, and some evidence suggests that where data is kept, misreporting might be an issue: as loans officially for investment are directed in part of in whole to consumption (Karlan and Zinman 2012).

Obtaining an historical or contemporary understanding of the size and characters of the formal microfinance sector in Kenya is problematic. Data is limited and fragmented; there is no institution which has committed to capture information from all formal institutions which might legitimately be considered to belong to the sector. For example, the Central Bank has only been able to report on those institutions which have registered under the newly developed Microfinance Act (2008). The Association of Microfinance Intuitions (AMFI) only produced reports from 2012 and was only been able to reply on a sample of their members, which themselves only represent a small number of microfinance providers in the country. For this reason "the exact number of practitioners undertaking credit-only microfinance business in Kenya is largely unknown" (Central Bank of Kenya 2009, p. 11).

4. The Formal, Non-Subsidised Credit System

In addition to formal banks, non-subsidised credit institutions also existed in the form of the Thrifts that emerged in the 1940s and 1950s (Alila 1990, p. 6). However, these organisations were very different from more recent organisations for the private administration of savings and credit. At the current time, non-public credit providers can be subdivided into two sub-categories of initiative: 1) Savings and Credit Co-operative Societies (SACCOs), 2) Formal Banks.

4.1. Savings and Credit Co-operative Societies (SACCOs)

Despite the existence of co-operatives in Kenya since the turn of the 20th century, it was following independence that cooperatives began to administer the provision of financial services to their members (Alila 1990, p. 8). One part of this initiative was the creation of Savings and Credit Co-operative Societies (SACCOs). It is reported that the first such financial service focused cooperatives was register in 1964 (Alila 1990, p. 12); in 1969 it was required that new registrations were formed of members with a common bond (Alila 1990, p. 13); and in 1986 were formally named as SACOS (Alila 1990, p. 12). Today these are registered under the Co-operative Societies Act and formed by members with common employment, geographical location or economic activity. See Table 7 for the details of SACCO expansion in Kenya, however, it should be noted that these figures are for legally registered SACCOs. While evidence suggests that as many as 30% of registered SACOs might not be active it is also the case that organisations operate without being registered (Wanyama 2009, p. 19). Therefore, statistics should be taken as indicative as opposed to truly representative.

SACCOs can further be divided into: 1) Non-Deposit Taking SACCOS (NDT-S), which provide a limited range of savings and credit products, are registered and supervised under the Cooperative Services Act, CAP 490; and 2) Deposit Taking SACCOS (DTS), are licensed and supervised under the SACCO Societies Act of, 2008, and in addition to basic savings and credit products, also provide basic 'banking' services including Front Office Savings Activities (FOSA) or demand deposits, payments services and ATMs (SASRA 2013, p. 13). As a general trend, SACCOS have started as NDT-S and then in many cases developed to take deposits in order to expand the range of financial services to members (SASRA 2013, p. 13).

Most SACCOs however, accept monthly payment, either from income from the sale of produce or monthly salaries, for shares (taken as savings), and from which members may then borrow up to two or three times the value, if they can get other members to guarantee them. Such loan are offered either for 1) investments, such as buying land, building houses, running business and farming activities; and 2) consumption, such as buying household furniture and meeting other family obligations (Wanyama 2009, p. 26). Although the number of rural SACCOs has for much of their history been outweighed by urban SACCOS, it is argued that these have played an important role in providing financial services to their members. This was particularly true from around 1997, when rural SACCOS were able to substitute for the formal banking sector, which was at that time closing many of its rural bank branches as a result of financial problems (Ministry of Finance, p. 7). Usually urban based SACCOs also offer loans in the form of cash salary advances that are popularly referred to as "instant loans" (Wanyama 2009). Under varying conditions, SACCOs approve and pay these advances within one day and often five minutes, in order to enable members respond to unexpected social costs. SACCOs do not clearly categorize loans, however, most are officially registered in the category of personal/household sector with large amounts utilized for school/college fees, general development and for emergency purposes (SASRA 2011, p. 28).

Year	Number of all Registered SACCOS	Members in Registered SACCOs	Savings and Share Capital of Registered SACCOs in Kenyan Shillings (KSh) (loans)	Number of Active SACCOs
1964	7	UA	UA	UA
1971	129	UA	8 million	UA
1972	101	36,000	16.2 million	UA
1975	230	101,000	118 million	UA
1978	520/630	387,500	375 million	UA
1980	731	UA	898 million	UA
1981	716	403,000	1.5 billion	UA
1982	900	500,000	1.6 billion	UA
1984	1022	600,000	2.7 billion	UA
1985	1350	694,000	3.3 billion	UA
1986	1462	930,000	3.5 billion	UA
1988	UA	982,287	7.9 billion	UA
1989	UA	UA	9 billion	UA
1990	2,144	UA	UA	UA
2003	4,200	3,500,000	UA	UA
2004	4,474	3,642,000	150 billion	UA
2005	4,678	4,602,000	UA	UA
2006	4,876	5,420,000	110 billion	3,300
2007	5,122	6,286,000	160 billion	3,500
2008	5,350	UA	UA	UA
2010	6,737	UA	UA	3,280
2011	UA	UA	UA	UA
2012	UA	UA	UA	1,989
2013	UA	UA	UA	1,995
2014	UA	UA	UA	UA

Table 7: The Expansion of SACCOs in Kenya (Compiled by the author from various sources: Alila 1990, p. 12; Central Bank of Kenya 2007, p. 18; 2008, p. 17; Dondo No Date, p. 4; Wanyama 2009, pp. 18-20)

A breakdown of the two categories of SACCOS can be seen in Table 8, while Table 9 shows the classification of Deposit Taking SACCOs by sector. The financial performance of all licenced and compliant SACCOS can be seen in Table 10, and the performance of DTS in Kenya can be seen in

Table 10 respectively. It is worth noting that in terms of their assets, some individual SACCOS (for example the Harambee, Posta and Mwalimu SACCOs) are larger than some of the small commercial banks. Their rapid growth backs claims that SACCOs are filling a need, which has not been met by other financial institutions. However, if and how SACCOs can remain competitive with the entry of new organisations into more accessible financial services, remains to be seen.

Year	Number of DTS (licenced)*	Total Assets of licenced DTS	Number of Non-DTS (compliant)**	Total Active SACCOs (compliant)
2006	214 (NA)	NA	UA	UA
2007	214 (NA)	NA	UA	UA
2008	214 (NA)	NA	UA	UA
2009	218 (Unknown)	UA	UA	UA
2010	215 (Unknown)	UA	3,065	3,280
2011	215 (110)*	UA	UA	UA
2012	215 (124)*	UA	UA	(1,989)
2013	215 (135)*	242 billion	Over 6000 (1,780)	(1,995)

Table 8: Numbers of DT & NDT SACCOs in Kenya (Compiled by author from a variety of sources: SASRA 2010, 2011, 2012, 2013)

* Licencing for DTS was introduced in 2008 under the SACCO Societies Act, 2008 (Act No.14) (Central Bank of Kenya 2008, p. 17). DTS have until June 17th 2014 to comply with licencing requirements or cease deposit taking SACCO business (SASRA 2013, p. 13).
** Compliant having submitted audited financial statement with the Commissioner for Cooperative Development as required by law.

Year*	Number of Deposit Taking SACCOs						
	Government (licenced)	Farmers (licenced)	Private institutions (licenced)	Community based** (licenced)	Teachers	Others***	TOTAL (licenced)
2010	44	74	26	NA	46	25	215
2011	87 (42)	74 (40)	24 (14)	30 (14)	NA	NA	215 (110)
2012	41 (22)	73 (42)	24(14)	32 (17)	45 (29)	NA	215 (124)
2013	(27)	(44)	(18)	(14)	(32)	NA	(135)

Table 9: DTS by Sector (Compiled by author from a variety of sources: SASRA 2010, 2011, 2012, 2013)

* As of end of December **. Traders, Transport and Housing ***. These include Traders based SACCOs, Transport based SACCOs and church based SACCOs.

Performance item	2006	2007	2008	2009	2010	2011		2012		2013	
						Total	Licenced	Total	Licenced	Total	Licenced
Total Assets (Billion KSh)	105	115	134	146	171	**196**	166	**223**	201	**503**	241
Loans /Advances (Billion KSh)	68	77	90	102	123	**147**	126	**167**	154	**381**	184
Deposits /savings (Billion KSh)	51	61	71	105	123	**140**	119	**160**	146	**358**	172
Share Capital (Billion KSh)	2	2.4	2.7	4.2	5.4	**UA**	UA	**UA**	7.6	**UA**	10.6
Turnover (Billion KSh)	12	13	15	17	22	**24**	20	**30**	28	**UA**	33
Members	0.98	0.95	1	1.5	1.5	**2**	1.4	**2.5**	2.3	**5.4**	2.6

Table 10: Performance of DTS in Kenya (Compiled by author from a variety of sources: SASRA 2010, 2011, 2012, 2013)[3]

[3] Please note, as stated at the beginning of this report, all financial values are nominal figures.

Although SACCOs are largely self-sufficient, a number of international development agencies have supported through various means. In addition to general capacity building, the European Investment Bank of the European Union has provided ongoing lines of credit to the Cooperative Bank of Kenya for on-lending to rural SACCOs (Wanyama 2009, p. 24). Domestically, the interests of SACCOs are collectively represented in the policy-making and legislative processes by The Kenya Union of Savings and Credit Cooperatives (KUSCCO); although this organisation also provides credit for SACCOs through the Central Finance Programme and a mortgage facility for through the KUSCCO Housing Fund (Wanyama 2009, p. 13). The Kenya Rural Savings and Credit Cooperative Societies Union (KERUSSU) is the umbrella national cooperative organization for rural SACCOs and other forms of savings and credit associations in Kenya (Wanyama 2009, p. 14). The organisation provides cooperative microfinance workshops to sensitize members on access to finance in rural areas (Wanyama 2009, p. 14).

4.2. Deposit Mobilizing Microfinance Providers

Deposit Mobilizing Microfinance Providers (DMMP) can be further subdivided into two categories: 1) Banks offering microfinance services; 2) Deposit Taking Microfinance Institutions (DT-MFIs).

4.2.1. **Formal banks,** registered and regulated under the Banking Act (see below), have also begun to provide microcredit. In some cases, this has occurred where longstanding commercial banks have down-scaled their products or set up subsidiary companies to specifically engage in microfinance business (Central Bank of Kenya 2010). Notable examples include, Kenya Post Office Savings Bank, the Co-operative Bank of Kenya[4], Equity Bank and Family Finance Building Society. In the case of the cooperative Bank it was decided in 1998 that its existing Small and Micro Credit Unit would continuing to wholesale funds to financial intermediaries such as cooperatives but also start its own direct lending on a pilot basis (Bell et al. 2002). DfID supported this by providing funding for technical assistance that it needed to develop new products and methodologies, and to make the necessary institutional changes (Bell et al. 2002). The microfinance programme was launched on a pilot basis in two branches during the first quarter of 1999 (Bell et al. 2002). In other cases, NGO initiatives have registered under the Banking Act following compliance with all stipulations including the minimum paid up capital of KShs: 0.5 billion (Dondo No Date, p. 7). The first to do this was K-Rep in In March, 1999 (Dondo No Date, p. 7).

4.2.2. **Deposit Taking Microfinance Institutions (DT-MFIs)** also accept demand deposits are use these as a means to generate capital for the extension of credit to customers. These organisations are registered under the Microfinance Act (2008). These are not fully registered banks but are subject to many of the same conditions under the prudential control of the Central Bank, given that they use customer deposits to raise capital for independent loans.

Based on what information is available, a survey reported by the Central Bank in the year (2000, p. 42) identified that an undisclosed number of major micro-finance institutions provided credit to 102,304 active clients with a loan portfolio of KShs 1.6 billion. Furthermore, there were 103,856 active savers (voluntary and forced) with the total value of KShs 812

[4] The Bank was registered as a cooperative in 1965. For a long time, the bank maintained cooperative ownership as 70 per cent of the bank's shares were held by cooperatives and individual coperators held 30 per cent (Wanyama 2009, p. 12). This might have changed with the 2008 share offer.

million. Dondo offers the following “estimates of the various types of microfinance institutions operating in Kenya” as of December 2004 (Dondo No Date, p. 6).

Type of Microfinance Organization	Number
Commercial Banks *	3
Microfinance NGOs	56
Societies	1
Companies Limited by Shares	12
Companies Limited by Guarantee	7
Post Office Savings Bank	1

Table 11: Estimates of Institutions offering Formal MF in 2004

In 2004, it was also estimated that the reach of microfinance in Kenya was around 1 million if SACCOs were excluded, and around 4 million (12% of the population) where SACCO credit, mainly as consumer loans, were included (Dondo No Date, p. 7). The outreach of commercial banks to the poor and rural communities is noted to be limited and has even been in decline between 1994 and 2004 (Dondo No Date, p. 8). However, these statistics did not differentiate between DT-MFIs and NDT-MFIs.

As discussed later in the report, 1999 saw the emergence of the Association of Microfinance Institutions in Kenya (AMFI-K). While the details of membership offer some idea of the growth of the sector, with a summary provided in Table 12, this information falls well short of a full account of the microfinance institutions in the country.

Year	Total AMFI Members	Banks	DT-MFIs	Retail MFIs	Outlets	Loan Portfolio (billion)	Borrowers (millions)	Deposits (billion)	Savers (millions)[5]
1999	5	UA	UA	UA	UA	UA	UA	UA	UA
2006	UA	UA	UA	UA	531	22.84	0.66	8.1	0.72
2007	34	UA	UA	21	648	33.56	0.95	11.8	1.1
2008	34	UA	UA	30	825	46.52	1.26	15.8	1.44
2009	41	UA	UA	UA	UA	UA	UA	UA	UA
2010	51	UA	UA	UA	UA	UA	UA	UA	UA
2011	UA	UA	UA	UA	UA	UA	UA	UA	UA
2012	59	UA	UA	UA	UA	UA	UA	UA	UA
2013	62	5	9	38	UA	UA	UA	UA	UA
2014	62	UA	UA	UA	UA	UA	UA	UA	UA

Table 12: AMFI (AMFI 2012, 2013a)

4.3. **Consumer Credit Providers.** Many formal retailers offer credit services provided by third parties other than Formal Banks of Microfinance Institutions. For example, Airtel offers credit for airtime through a partnership with a Consumer Credit provider.

[5] Excluding commercial banks.

4.4. **Wholesale Microcredit Organisations**. In order to address the reliance of many microfinance institutions on donor support, wholesale lending institutions emerged in Kenya: and by 2004 there were four such organisations, Jitegemee Trust Ltd, Micro Enterprise Support Project Trust (MESPT), Oiko Credit and Stromme Foundation (Dondo No Date, p. 11). In addition K-Rep Bank and Co-operative Bank had developed products for lending to SACCOs. AFD funding to Co-operative Bank, K-Rep Bank and Equity Bank for wholesaling to MFIs was also expected to increase lending to MFIs (Dondo No Date, p. 11).

4.5. **Other Stakeholders in the Kenyan Microfinance Sector.** Over the years a number of international private investors have provided equity to MFIs. IFC, AfDB, ShoreCap, Triodoes Doen, FMO have invested in K-Rep Bank while Africap have a 16% stake in Equity Bank (Dondo No Date, p. 11). Other international investors in the MFI sector have been Accion, Microvest, Unitas and catalyst Fund. In 2005, Faulu Kenya raised KShs. 500 million in Kenya by issuing a bond on the Nairobi Stock Exchange. The bond was fully subscribed by institutional investors – pension funds and commercial banks. The bond was made attractive by a 75% underwrite and an offer of a 0.5% above the Treasury Bill rate (Dondo No Date, p. 11).

Overall Structure of the Microfinance in Kenya (excluding SACCOS)

Although AMFI-K have published two annual reports in 2012 and 2013, their membership does not cover all the microfinance institutions in the country, and of the total membership of 32, only 29 institutions contributed to the survey (AMFI 2012, 2013a). For this reason, the reports are of limited use in understanding the coverage of the microfinance sector in Kenya, although they are considered by AMFI to be a representative sample of the characteristics within the sector. Another issue in the reporting of microfinance is that banks would need to separate statistics for microfinance from wider banking operations (AMFI 2013a). While some of those contributing to the report have already done so, this is according to their own definitions, and it is noted that a lack of common definition of microfinance hampers coherent reporting (AMFI 2013a). The following summary should therefore be read with these constrains in mind.

The total assets of the formal microfinance sector have expanded 2010-2012. Although DT-MFI grew the most in 2012 (32%), followed by Credit-only MFIs (26%) and Banks (20%), the overall makeup of the microfinance sector remained stable, with large domination by the banks, with Equity Bank alone comprising 72% of the sector's overall total assets (AMFI 2013b, p. 7). The growth of banks is however declining (36% growth 2010 viz 21% 2012) while the other institutions have increased the rate of expansion over the last three years (AMFI 2013b, p. 7). The largest DTM in Kenya has been Kenya Women's Finance Trust (KWFT). However, net assets shrunk for the first time in 2013, contracting from 61.5 per cent in 2012 to 53.19 per cent (Sh21.75 billion) (Central Bank of Kenya 2013).

Size of loans by Type of Lender

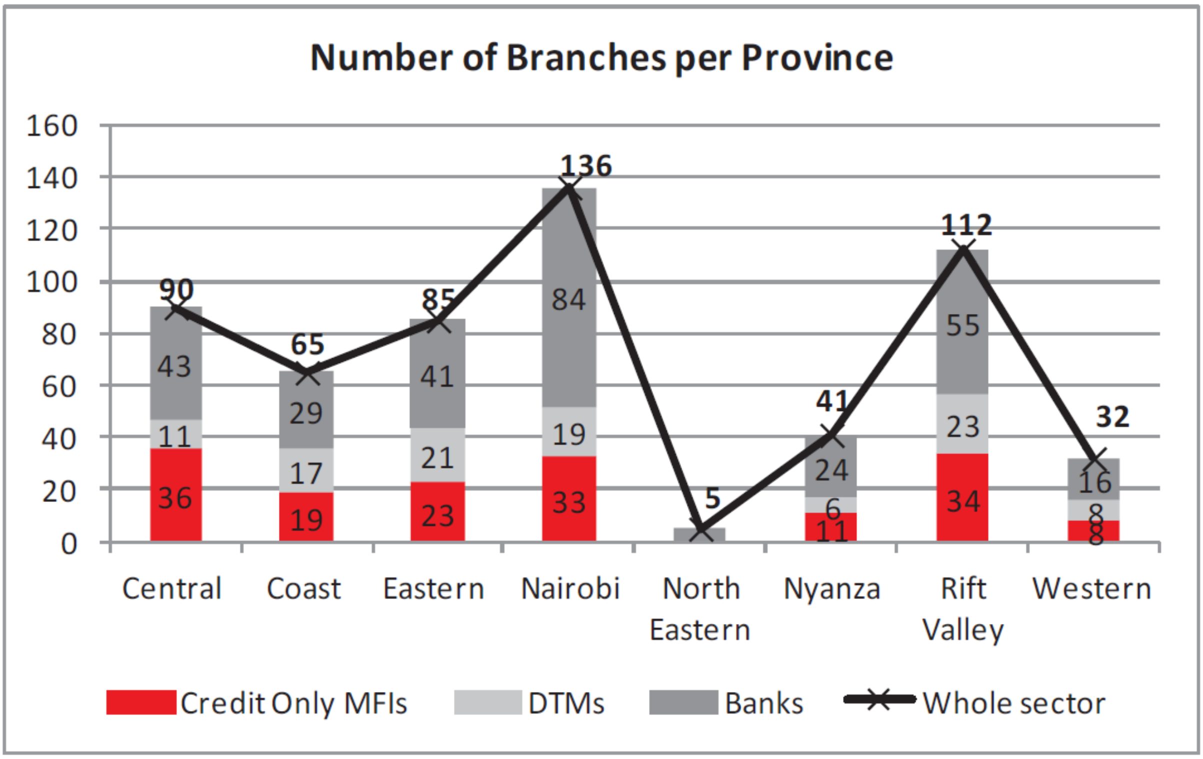
Between 2010 and 2012, the growth in number of microfinance active borrowers was much higher for Credit only MFIs (+21%) than for Banks (-3.4%) and DT-MFI (+0.5%). The average outstanding loan balance was the lowest for Credit only MFIs, followed by DT-MFI then Banks (AMFI 2013b, p. 8).

Gender Balance of Loan Access

Women represent a large majority of borrowers (65.6% of the entire sector and 70.9% of the sector without bank's active borrowers in 2012) but their share has been decreasing over the period of analysis: a pattern that might related to more individual borrowing by males over time. DT-MFI are the segment having the highest share of women borrowers, as KWFT (64% of total DT-MFI active borrowers) lends almost exclusively to women. This trend suggests that on average women tend to take out midsized loans, with more men accessing larger sums of credit.

Branches and Geographical Distribution

As of December 2012, microfinance services were provided by 292 Banks branches, 105 DT-MFI offices and 164 Credit-only MFI outlets (AMFI 2012, p. 9). The sample taken by AMFI suggests that there is a higher concentration of institutions in the southern parts of the country and a higher



density in the main towns and cities, particularly Nairobi.

Regressing the number of branches and active borrowers in each province (done by author), suggests that 78% of variation in the number of active borrowers can be explained by the number of branches available – with a significance F/P-value of 0.0035 and a predictor that for every additional branch opened, active borrowers will increase by over 1,000 individuals.

Financial Structure

The balance sheets for the sector as a whole, and the sector without banks, are very different: the whole sector mostly funds itself with clients deposits (62% of total assets in 2012) while the sector without banks mostly funds itself with borrowings (38% of total assets), followed by clients deposits (32%) (AMFI 2013b, p. 10). This has reportedly changed little over the last three years, although the sectors without banks experienced a reduction of the share of the debt funding and an increase of the share of clients' deposits. As would be expected credit-only MFIs borrow the largest percentage of their assets, 49% (AMFI 2013b, p. 10). This source of funding also grew by 44%, although banks increased borrowing by 78%, DT-MFI only by 5%. In 2012, DT-MFI experienced a stronger growth of the clients' deposits than banks (+54.3% against +13.4%). In response to the context of high inflation in Kenya in 2011, the cost of funding increased with most financial institutions adjusting their interest rates upwards.

Loan Use

A wide range of credit products is offered in the market financing specific sectors such as business, agriculture, the consumer segment including health and education etc.; asset finance, housing and green products. In 2010-2012, business loans represent the great majority of the portfolio, followed by consumption loans, Emergency loans and agriculture loans (AMFI 2013b, p. 15).

Lending Methodologies

DT-MFI and Credit-only MFIs concentrate in the core microcredit methodology involving a higher ration of operational costs to income than banks, which in turn results in a higher interest for clients (AMFI 2013b, p. 11). The DT-MFI' loan book is mostly concentrated in the group lending methodology (55% - with 44% individual lending) while the largest share of the Credit-Only MFIs' and Banks' portfolios consists mostly of individual lending: 57% and 62% respectively (AMFI 2013b, p. 15). The "vast majority of Credit Only MFIs charge flat interest rates" (AMFI 2013b, p. 11).

Loan Costs to Consumers

The main fees include the loan application fees and the loan insurance fees. There is a wide disparity in the interest rates as revealed by the gap between the minimum and maximum rates especially in the sector excluding banks. Here the majority of organisations apply flat interest rates as opposed to the declining balance method.

Training

Group trainings are the most widely offered non-financial services covering some basic aspects of group, loan and business management (9 Credit Only MFIs, 2 DT-MFI and 2 Banks). 4 Credit Only MFIs and 1 DTM report to offer business trainings.

Policy and Regulation for Microfinance in Kenya

Under Vision 2030 – the Kenyan Government's current long term planning strategy (Government of the Republic of Kenya 2007) – it is expected that a significant share of population currently using informal to quasi-formal finance (about 35% of the overall population) will migrate to formal services. It is anticipated that this will be achieved by increasing the percentage of the population served by MFIs and SACCOs. The reform of regulation has been expected to play a significant role in this process.

Overall, the Central Bank of Kenya (CBK), which falls under the Minister of Finance, formulates and implements monetary policy and banking regulation, in order to foster liquidity, solvency, and proper functioning of the financial system. However, the prudential banking sector is also regulated by the Capital Markets Authority (CMA), Insurance Regulatory Authority (IRA), Retirement Benefit Authority (RBA) and SACCO Societies Regulatory Authority (SASRA) (Central Bank of Kenya 2013, p. 14). Non-prudential institutions are subject to non-prudential oversight by regulatory agencies or government departments/ministries with focused legislations.

The significance of the microfinance sector was first recognised by the CBK as early as 1994, when it was observed that:

"Though the formal sector is relatively developed, it is apparent that the financial needs of the informal sector have not been well addressed. In view of the importance of this sector, it is important that strategies of ensuring its orderly development be devised. Therefore, the Central Bank will liaise with the various stakeholders associated with microfinance to evaluate how the sector can be assisted in terms of registration, regulation and integration into the formal banking sector" (Central Bank of Kenya 1997, p. 3).

Regulation of Microfinance Institutions

Despite the identified importance of regulation for microfinance in Kenya, little can be found in official bank publications until 1998 when it was identified that regulation would be necessary. It was only in 1999 that the Central Bank established a division to handle microfinance and in the same year the Association of Micro Finance Institutions of Kenya (AMFI) was formed under the societies Act by the leading Microfinance Institutions in Kenya. A history of some of the key financial regulation can be found in Table 13. The objective of the membership organisation is to build the capacity of the microfinance sector through the functions of: lobbying government for favourable policies; sharing information and experiences and linking up and network with both local and international actors. AMFI and the CBK began to work together in 1999 to create a strategy for regulation of the microfinance sector (Central Bank of Kenya 1998, p. 4). The Central Bank set up a Microfinance Division within the Bank Supervision Department (now Financial Institutions Department) in 2000 (Wanyama 2009, p. 7). In 2004, the Central Bank established a Rural Finance Department to address various policy issues concerning rural finance, including microfinance (Wanyama 2009, p. 7).

Year	Legislation	Overview
1966	Central Bank of Kenya Act of 1966	
1968	Banking Act (1968)	
1994	Amendments to the Banking Act (1994)	
1996	Central Bank (Amendment) Act of 1996	
1997	Amendments to the Central Bank of Kenya Act	Greater monetary autonomy for CBK; technically independent of the government
2006	Microfinance Act 2006	
2008	Microfinance Act (2008) The Microfinance (DT-MFI) Regulations 2008	Regulate the establishment, business and operations of Deposit Taking Microfinance Institutions under CBK to mobilise savings from the general public to provide credit for clients.
	SACCO Societies Act of 2008	Licensing, regulation, supervision and promotion of savings and credit cooperatives by the SACCO Societies Regulatory Authority. Establishes relevance of Deposit Guarantee Fund
	The Banking (Credit Reference Bureau) Regulations (2008)	Allowed CBK to license and supervise Credit Reference Bureaus (CRBs)

	The Finance Act (2008)	Raised the minimum core capital for banks (KShs 250m to KShs 1 billion by end of 2012) Islamic banking practices required to pay return
2010	Constitution of Kenya 2010 Finance Act (2010) inc amendments to Banking Act, Central Bank of Kenya Act	Deposit Taking Microfinance Institutions (DT-MFI) were allowed to contract third parties to carry out business on their behalf
2011	The National Payment System Act (2011)	
2012	Kenya Deposit Insurance Act 2012 Consumer Protection Act (2012)	Contains some specific requirements and limitations of lenders: Disclosure statements, restricts on recovery costs etc
2014	Banking Act (2014) Central Bank of Kenya Act (2014)	

Table 13: Development of Banking and Financial Regulation

Regulatory reform has advanced under the premise that previous governance has restricted the development of micro finance initiatives. Specifically, and despite shrinking donor support, such institutions have been unable to mobilise deposits, unless licensed under the Banking Act and therefore subject to the myriad of requirements (Central Bank of Kenya 2000, p. 42). Other regulatory problems were that institutions involved in providing microcredit were registered under as many as eight different Acts of Parliament (outlined in Table 14) and therefore different legal structures. Some of these Acts did not address the issues of ownership structure, governance, and accountability. This organic regulation was therefore understood to have “contributed to a large extent to the poor performance and eventual demise of many MFIs because of a lack of appropriate regulatory oversight” (Wanyama 2009, p. 5).

The Non-governmental Organizations Co-ordination Act	The Kenya Post Office Savings Bank (KPOSB) Act
The Building Societies Act	The Companies Act
The Trustee Act	The Banking Act
The Societies Act	The Co-operative Societies Act

Table 14: Acts Regulating Microfinance Institutions prior to reform

Finally, regulations have been motivated by a need to safeguard the interests of various stakeholders’ savers/depositors, borrowers, investors (Dondo No Date, p. 10). Indeed, Donde (No Date, p. 10) reports that “The need for regulation has been reinforced by the emergence of bogus microfinance institutions that have fleeced the public of money. Since June 2005 the Central Bank has closed three such organizations: Kenya Akiba Microfinance Ltd, Mayford Co-op, and Capital Microfinance Ltd. All were registered as Limited Liability Companies”. It was partly this situation that prompted the development of a draft Micro-finance Policy.

In 2001 it was recognised that what was needed was a “wider policy framework of dealing with second tier institutions including microfinance, savings and credit cooperative societies and other unregulated financial intermediaries” (Central Bank of Kenya 2001, p. 1). However, it was also clear that larger financial institutions, such as the Co-operative Bank of Kenya, Equity Building Society and K- REP were moving into microfinance with individual lending products. With such diversity, regulators began to consider a three tier system:

- **First tier: Informally constituted MFIs** like rotating savings and credit associations (ROSCAs), club pools, financial services associations should not be regulated by an external agency. Donors, commercial banks and government agencies from which they obtain funds or that support them should carry out due diligence and make informed decisions about them.
- **Second tier: Formally constituted micro finance organizations** that do not accept deposits from the general public but accept cash collateral tied to loan contracts could be regulated and supervised by a self-regulatory (umbrella) body like Association of Micro finance Institutions (AMFI). The proposed legislation could empower AMFI to enforce compliance with its laid down regulations.
- **Third tier: Formally Constituted Deposit-taking MFIs** could be licensed, regulated and supervised by the Central Bank.

In the words of Omino, different treatment of these institutions should be understood as justified and necessary as “Deposit taking involves a potential risk of loss depending on how the deposits are employed. As such, MFIs intending to take deposits must be regulated and supervised by an external authority to ensure that deposits are prudently employed and cushioned by adequate capitalization” (Wanyama 2009, p. 5).

There was also discussions on effective supervision of other financial intermediaries including SACCOs and the Kenya Post Office Savings Bank (POSTBANK) (Central Bank of Kenya 2001, p. 51). Interestingly, microfinance does not make an appearance in the 2002 Central Bank Supervision Report. However, the focus returned in 2003 when the Minister for Finance reiterated the increasing role of the microfinance for micro and small enterprises and low income households (Central Bank of Kenya 2003, p. 35). During this year, a Task Force was formed to co-ordinate the development of an appropriate regulatory framework for microfinance, and following consultation with stakeholders, a draft Bill was forwarded to the Attorney General for publication and presentation to Parliament (Central Bank of Kenya 2003, p. 35). The draft Bill proposed the above tripartite categorisation and associated governance proposals for microfinance activities. 2004 saw refinement of the Microfinance Bill and also consultation that produced the draft SACCO Regulatory Bill: designed to establish an authority to regulate SACCO societies, and especially those with Front Office Services (FOSA) (Central Bank of Kenya 2004, pp. 28-29). The mention of microfinance is missing from the Central Banks supervision report in 2005 (Central Bank of Kenya 2005).

The following year the Microfinance Act (2006) and the Finance Act (2006) were enacted in December (Central Bank of Kenya 2006) and published in the Kenya Gazette Supplement No. 103 on 2nd January 2007 (Central Bank of Kenya 2007, p. 44). The Act envisaged two tiers of microfinance institution, i.e. nationwide microfinance institutions whose minimum core capital is prescribed at KShs 60m, and community microfinance institutions with a minimum core capital of KShs 20m (Central Bank of Kenya 2006, p. 33). The Microfinance Act and the associated Microfinance Regulations, outlined the legal, regulatory and supervisory framework for the microfinance industry in Kenya through licensing and supervision (Central Bank of Kenya 2014b). In 2007, it was anticipated that the KCB would begin licensing DT-MFIs the following year (Central Bank of Kenya 2007, p. 26). The Microfinance (Categorization of the Deposit-Taking Microfinance Institutions) Regulations, 2008, the Microfinance (Deposit-Taking Microfinance Institutions) Regulations, 2008 and the commencement date of 2nd May 2008 were gazetted through the special issue, Kenya Gazette Supplement No. 36 dated 16th May 2008 and published on 29th May 2008. The Central Bank commenced the implementation of the Microfinance Act from 2nd May 2008 (Central Bank of

Kenya 2008, p. 37). The Act applies to both DT-MFIs and NDT-MFIs (Central Bank of Kenya 2009, p. 10). Here it is identified that:

“Non-Deposit Taking Microfinance Institutions that accept cash collateral are expected to open clients’ accounts and hold such funds in trust without intermediating such funds or borrowing against the same at the institution’s risk. The accounts of clients of Non-Deposit Taking MFIs must at all times be separated from the operating account of the institution” (Central Bank of Kenya 2009, p. 11).

In 2008, the MOCD&M established a Task Force to work out modalities for the establishment of a new body, the SACCOS Societies Regulatory Authority, to license, regulate and supervise SACCOs; as well as develop regulations to be issued under the Act to operationalize it. This work was expected to be concluded in 2009 (Central Bank of Kenya 2008, p. 17).

By the end of 2008, nine applications had been received for registration as a DT-MFI. CBK licensed the first Deposit Taking Microfinance Institution, Faulu Kenya Deposit Taking Microfinance, in May 2009 (Central Bank of Kenya 2009, p. viii & 11), and applications and licencing has continued to grow (as can be seen in Table 15, while Table 16 lists all DT-MFIs and there registration dates).

Year	**Applications for Registration**	**Approved Applications**	**Licenced Institutions**	**Institution Operating**	**Branch Network**	**Deposits (accounts)**	**Loan Portfolio (accounts)**	**Asset Base (billion)**
2008	9	0	0	0	0	0	0	0
2009	UA	1	1	0	0	0	0	0
2010	9	4	5	2	37[6]	6.1[7] billion (1 million)	14.2 billion (0.6 million)	23.4
2011	3	1	6	6	60	10 billion	16	24.8
2012	UA	UA	UA	6	UA			
2013	Not available	1	9	9	UA	6.4 billion (1.9 million)	24 billion (0.4 million)	UA

Table 15: Number Applications and Licences as DT-MFIs (Central Bank of Kenya 2008, p. 37)

Institution	**Registration Date**
Faulu Kenya DTM	May 2009
Kenya Women Finance Trust DTM	April 2010
Uwezo DTM	November 2010
SMEP DTM	December 2010
Remu DTM Limited	December 2010
Rafiki Deposit Taking Microfinance (K) Limited	June 2011
Century Deposit Taking Microfinance Limited	September 2012
SUMAC DTM Limited	October 2012

[6] Although reported in 2011 as 34.

[7] Although reported in 2011 as 8 billion and 6.7

Table 16: Registered MFI in Kenya (as of July 2014)

An amendment to the Banking Act through the Finance Act 2009 permitted banks to use Third Agents to provide certain banking services on their behalf (FSD Kenya 2010a, p. 10). This included DT-MFIs which were then expected to increase their penetration in the rural areas and generally increase the number of the population using the services of banks (FSD Kenya 2010a, p. 28). The agent banking model was mainly designed to assist banks in providing cost effective banking and Agents were empowered to deal with:

1. Cash deposits
2. Cash withdrawals
3. Payment of bills
4. Account balance enquiry
5. Collection of account opening application forms.

In 2011, the CBK develop a 'Guideline on the Appointment and Operations of Third Party Agents by Deposit Taking Microfinance Institutions' to extend the agency model to DT-MFIs and allow them to engage third parties to offer specified deposit taking business on their behalf (FSD Kenya 2010b, p. 10). The Finance Act (2011) amended the Banking Act and Microfinance Act to allow institutions licensed under the Banking Act to share credit information on their customers with institutions licensed under the Microfinance Act. Other regulations disqualified individuals who were part of a management team in collapsed financial institutions from being directors or senior officers in DT-MFIs (FSD Kenya 2010b, p. 35).

In 2012, reforms allowed microfinance banks to offer their services in marketing offices and self-managed agencies (Central Bank of Kenya 2013, p. 15). AMFI successfully lobbied to change the name of Deposit Taking Microfinance Institutions to Microfinance Banks MFBs) (Central Bank of Kenya 2013, p. 39) – although they were to remain under the regulation of the Microfinance Act. Legislation also revised Prudential Guidelines under the Banking Act and the Microfinance Act 2006 through the Microfinance (Amendment) Bill 2013 to increase the range of financial services that MFBs can offer (Central Bank of Kenya 2013, p. 12). This legislation also responded to the challenges faced by institutions licensed under the Microfinance Act in identifying, selecting and acquiring agents (Central Bank of Kenya 2013, p. 39).

Reforms amended 2006 legislation to allow the sub-contracting of banking agents to provide limited MFB services on behalf of institutions (Central Bank of Kenya 2013, p. 39). Changes also allow for the use of Agent Network Managers (ANM) or Agent Network Management Companies (ANMC), also known as aggregators, in overseeing the day-to-day operations of agents, in addition to providing strategic information to the respective financial institutions (Central Bank of Kenya 2013, p. 15). Banks and microfinance banks are also now empowered to enter into single contracts with ANM rather than multiple contracts with individual agents. This new intermediate tier of service provision was intended to ensure compliance, managing liquidity and training of agents (Central Bank of Kenya 2013, p. 15). This legislation had immediate impact. By December 2013, 6 out of the 9 licensed microfinance banks had established deposit-taking marketing offices: 5 of these came in 2012 and another 42 in 2013 (Central Bank of Kenya 2013, p. 15). "The number of banks conducting agency banking increased to 13 as at December 2013 from 10 commercial banks in December 2012. In addition, the number of approved agents increased by 7,144 to 23,477 as at the end of December 2013. This represents a 44% increase in the number of licensed agents, albeit the concentration of 92% of the agents in 3 large banks. The number of transactions increased by 40% from 29,937,112 transactions recorded in 2012 to 42,055,854 transactions in 2013" (Central Bank of Kenya 2013, p. 16).

Finally, AMFI were successful in calling for an amendment to section 14(1) of the Microfinance Act to allow microfinance banks to issue third party cheques, open current accounts and engage in foreign trade operations. This will enable microfinance banks to participate in the National Payment System (NPS)[8].

While new governance has been essential it has been observed that "The regulatory requirements to make this transition and to maintain a license as a deposit-taking institution are very stringent and include continuous evaluation of the qualifications of management and the Board of Directors. As most participating MFIs began as non-profit organisations or non-profit programmes, this transformation represents a major shift from a relatively informal type of organisational structure, to a highly regulated institution and trustee of public deposits" (FSD Kenya 2010a, pp. 4-5). Interviews at the CBK confirmed that such restructuring was one of the biggest challenges for many MFIs.

Regulation of SACCOS

Regulation of the rapidly growing SACCOs sector could not be adequately addressed within the provisions of the Cooperatives Societies Act (CSA) CAP 490, despite numerous amendments (SASRA 2011, p. 32). The Ministry of Cooperative Development and Marketing (MoCDM) promulgated the SACCO Societies Act (SSA) in 2008 providing for the licensing, supervision and regulation of SACCO Societies (SASRA 2011, p. 32). The Act also establishes the Deposit Guarantee Fund (DGF) which provides protection to members' deposits up to KSh.100, 000 per member. The SSA commenced in 2009. The body responsible for the implementation of this regulatory framework is the SACCO Society Regulatory Authority (SASRA), a semi-autonomous government Agency under the Ministry of Industrialization and Enterprise Development (SASRA 2014), a creation of the SACCO Societies Act 2008, inaugurated in 2009, which started operations in June 2010 upon publication of the SACCO Societies (Deposit Taking SACCO Business) Regulations. The SSA defines requirements for SACCOs in the areas of capital adequacy, asset quality, liquidity, restrictions on non-core business activities (SASRA 2012, p. 15). Section 69 of the SSA (2008) provided one year from the date of publication of the Regulations (2010) for all the Deposit Taking (FOSA operating) SACCOs to apply for a license (SASRA 2012, p. 33). This period lapsed in June 2011 by which date 200 SACCO societies had submitted their applications for license with SASRA (SASRA 2012, p. 33). The balance of eighteen (18) SACCO societies discontinued or closed the Deposit Taking SACCO business as they did not satisfy the licensing requirements: reverted to the operations the Back Office Service Activity (BOSA) referred to in the Act as non-Deposit Taking SACCO (SASRA 2012, p. 33). Fifteen SACCOs applied to commence Deposit Taking operations during the year bringing the total license applications to 215 by the end of 2011 (SASRA 2012, p. 33). By the end of 2012, 124 were licenced (SASRA 2012, p. 33). A four years transitional period for DTS to become licensed and fully comply with the prudential requirements runs until June 2014 (SASRA 2012, p. 15).

Membership of SACCOs has risen because the SACCO Societies Act prohibits SACCOs from transacting with non-members in line with the principles of cooperatives and the cooperative law, and therefore, new customers are technically made members although with less rights (SASRA 2010, p. 15).

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[8] The NPS provides systems to clear payments (cheques, electronic payment and payment cards) between banks, but also encompasses the total payment process.

<table>
<tr><th colspan="2">Status</th><th>Microcredit Providers</th><th colspan="3">Registration</th><th>Regulation</th></tr>
<tr><td colspan="2" rowspan="3">Informal</td><td>Money Lenders</td><td colspan="3" rowspan="2">No registration of any type</td><td rowspan="4">No specific regulatory framework, reliant on general financial and contractual legal frameworks where recourse is made by either lenders of borrowers</td></tr>
<tr><td>Family and Friends</td></tr>
<tr><td>Shopkeepers</td><td colspan="3">Potentially registered, but most likely unregistered businesses</td></tr>
<tr><td colspan="2">Quasi-Formal</td><td>Rotating Savings and Credit Associations (ROSCAs) and Accumulating Savings and Credit Associations (ASCAs)</td><td colspan="3">Encouraged to be registered with Ministry of Social Security, but some might remain unregistered.</td></tr>
<tr><td rowspan="6">Formal</td><td>Subsidised</td><td>Non Deposit Taking / Credit-Only Microfinance Institution</td><td colspan="3">Registered as a range of legal forms</td><td>Regulations for Non Deposit Taking Microfinance Institutions are yet to be put in place. The Ministry of Finance is in the process of discussing the best way forward for regulating the non-deposit taking microfinance businesses</td></tr>
<tr><td rowspan="5">Non-Subsidised microfinance</td><td>Commercial Banks</td><td colspan="3">Must be registered under the Banking Act (2014)</td><td>Banking Regulations and Prudential Guidelines
(off-site and on-site surveillance)</td></tr>
<tr><td>Deposit Taking Microfinance Institutions</td><td colspan="3">Must be registered under the Microfinance Act (2008)</td><td>Microfinance Regulations</td></tr>
<tr><td rowspan="2">SACCOS</td><td rowspan="2">Register under the Cooperative Societies Act (1997)</td><td>Deposit Taking SACCOs</td><td>Register under SACCO Societies Act of 2008</td><td>SACCO Societies Regulatory Authority (SASRA)</td></tr>
<tr><td colspan="2">Non-Deposit Taking SACCOs</td><td>Supervised by Commissioner for Co-operatives</td></tr>
<tr><td>Consumer Credit Providers</td><td colspan="3">Registered under the Corporations Act</td><td>Consumer Protection Act (2012)</td></tr>
</table>

Table 17: Current Regulatory Framework for Principle Microcredit Activities 2006

Performance of Microfinance in Kenya

Outreach

Unfortunately, due to a lack of publicly available statistical information specifically about microfinance, it is difficult to provide an accurate account of outreach. Replying on AMFI membership as an indicative sample, as of December 2012, members were reaching 832,794 active borrowers with a gross loan portfolio of KSHS 49.1bn, achieving a 15.7% annual growth (AMFI 2013b, p. 7). Thes growth of the microcredit sector contributes to the independent observation[9] that "Kenya's financial landscape has considerably changed over the period 2006-2013" (Central Bank of Kenya 2013, p. 13).

Looking at financial inclusion more broadly the Financial Access Survey of 2013 reports that:

- 32.7% of the adult population has access to formal financial services (15.0% in 2006 and 22.1% in 2009) and the proportion of the population using informal financial services declined to 7.8% in 2013 from 33.3% in 2006.
- Part of the reason for this was the population accessing Formal, non-prudential (e.g. mobile phone providers) prudentially regulated (Banks, DT-S and DT-MFIs) financial services increased significantly: from 15% and 4.3% respectively in 2006, to 22.1% and 15% in 2009 and 32.7% and 33.2% by 2013.

However despite the increases in the percentages of the population accessing services likely to be made available through microfinance providers, 25.4% of the adult population has remained financially excluded (39.3% in 2006, 33% in 2009). Furthermore, in 2013 it was reported that 25% of the population surveyed "use only family, friends, neighbours and secret places to save or borrow" (FSD Kenya 2014b, p. 1).

[9] Financial inclusion in Kenya has been tracking through three nationally representative financial access surveys undertaken in 2006, 2009 and 2013 dubbed 'FinAccess'.

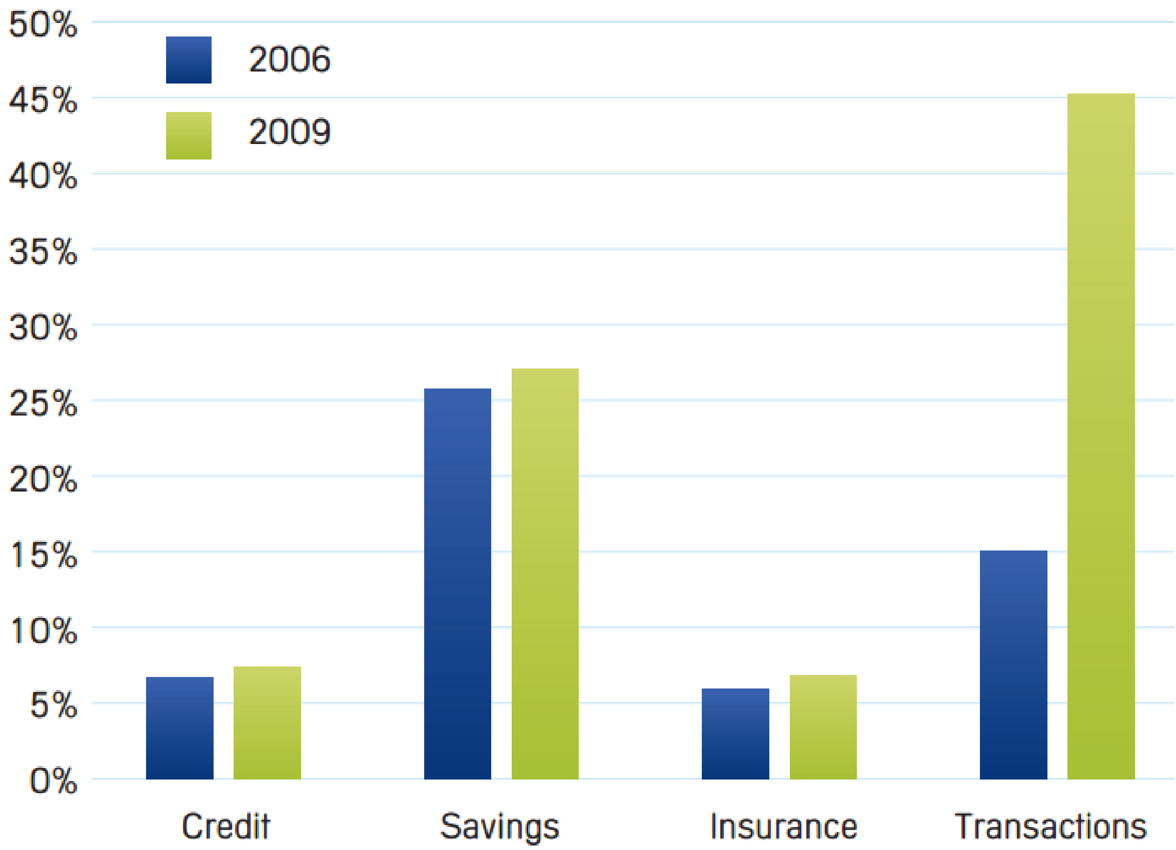


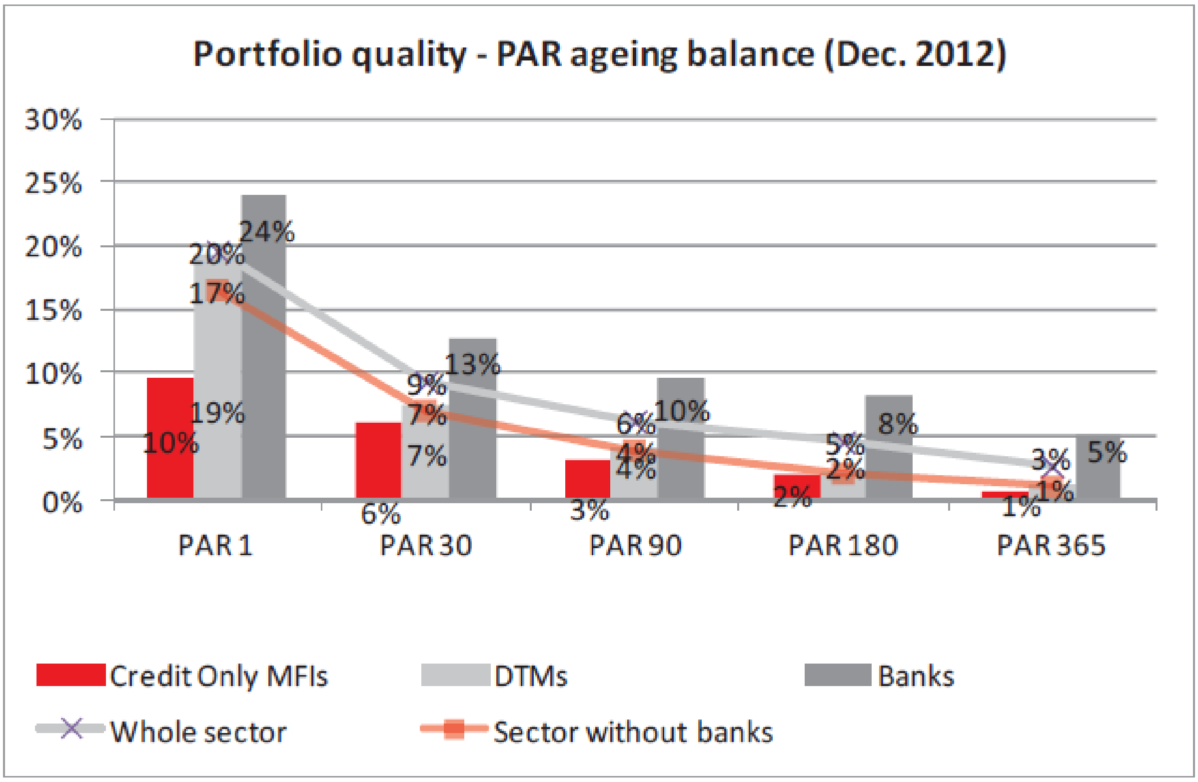
Figure 1: Changes in Access to Financial Services 2006-2009 (FSD Kenya No Date, p. 6).

Between 2006 and 2009, there was a modest expansion in overall usage of informal and quasi-formal credit, from 37.5% to 38.7% of the population (FSD Kenya No Date, p. 6). However there was a significant reduction in the proportion of people depending only on informal services (from 32.4% to 26.8%). To a great extent, this has been attributed to the introduction of M-PESA services in the country, which make credit available through mobile phones and therefore allow the expansion of services without investment in a physical presence by credit providers (see the section on Mobile Banking on page 39).

According to analysis in 2010, microfinance has not grown to the extent seen in many other countries for several reasons; although this is also true of east Africa in general. One of the challenges is the insufficient population density in many parts of the country, as MFIs are not incentivised to serve sparsely populated areas (FSD Kenya 2010a). Another issue was that while most MFI CEOs are effective operational managers, many lack the skills and training necessary to be strategic leaders (FSD Kenya 2010a, p. 4).

Sustainability of MF

As of December 2012, the portfolio quality held by AMFI members was described as “fair” (AMFI 2013a, p. 13). The Portfolio at Risk (PAR) over 30 days was 9% for the sector overall and 7% when



Graph 1: Portfolio at Risk Aging Profile (AMFI 2013a, p. 13)

banks are excluded. While the Banks’ performance is not as good as the average, Credit Only MFIs surprisingly show a portfolio quality better than average (AMFI 2013a, p. 13). Over time, while credit-only institutions have been slowly improving, banks and DTM improved 2010-2011 but then worsened slightly in 2011-2012. As can be seen in Graph 1, PAR declined overtime for all institutions in 2012, although it remain highest for banks who remain with 5% PAR even after a year. Write off ratio remained below 1% for the sector without banks over the period of analysis and for the whole sector in 2010 and 2012 (AMFI 2013a, p. 13).

Portfolio quality among all AMFI members was weakest for Emergency loans; while Portfolio At Risk over 30 days (PAR 30) in the sector, without banks, was concentrated around credit made available for Asset Finance Loans (AMFI 2013a, p. 14). Group lending methodology reports a better portfolio quality than individual lending (AMFI 2013a, p. 14). PAR 30 is highest in Nairobi and Coast province considering the whole sector and the sector without banks respectively. Portfolio quality is the best in Central, North Eastern, Nyanza and Rift Valley provinces, both including and excluding banks. This suggests that, as is usually the case, microcredit repayment is more difficult to enforce in urbanised areas as compared to rural areas.

Although less detailed information is available, SACCOS have been reducing the number of non-performing loans on their books: as can be seen in Table 18.

Year	Value of Non-performing Loans	Percentage of Non-performing Loans
2010	Data UA	
2011	12,185,308,345	9.6%
2012	11,540,001,024	7.3%

2013	Report not available

Table 18: Non-Performing Loans by Licenced SACCOs (SASRA 2012)

Issues with Microfinance Identified by the Existing Literature

Microcredit is not enough

The poor need other support in addition to the credit that is required to facilitate livelihood investments. Within the sphere of business development , it is necessary to facilitate exposure to 1) successful role models and 2) ideas and technologies (FSD Kenya 2014a, p. 15). In some places, individuals or communities have little knowledge of the extent to which successful enterprise can change their standard of living. Particularly remote populations lack any knowledge that their livelihoods can change and believe that wealthy households have always been so. Given that communities often only have trading as an example of how money might be made, isolated communities often remain unaware of, or unexposed to, technology that might support alternative livelihood options (FSD Kenya 2014a, p. 15). Where entrepreneurial thinking does exist, business people need other financial services in addition to credit. However, much less work has been done to provide micro-insurance, micro-pensions and micro-leasing products and services (Dondo No Date, p. 9). It should be born in mind however, that providers of finance might not be the best institution through which wider enterprise skills should be built. Moreover, the sustainable livelihoods framework well identifies that finance is only one, and often the least important, element of sustainable livelihoods: with social, human, physical and environmental capital often being more relevant (Hussein and Nelson 1998).

Access to Microcredit is Geographically Concentrated

Although rural financial inclusion has improved, there has traditionally been a bias in the physical geography of microfinance and credit availability. In 2004 it was reported that "The majority of the MF programmes are concentrated in Nairobi, the Mt. Kenya region and Western region of the country. Generally, most of the programmes operate in urban areas with very few penetrating deep in rural areas. There are very few programs in the arid and semi-arid areas of the country, which comprise of two-thirds of Kenyan landmass" (Dondo No Date, p. 9). Unfortunately, it is difficult to ascertain to what extent this situation has changed by 2014. AMFI have provided the map of distribution show in

# MFIs, DTMs and Banks	0	1-5	6-10	11-15	16-20	>20

Figure 2, which highlights a continued concentration of services around the primary urban areas, although suggests some penetration across the whole country – even those areas not directly included in the map. It should be noted that this distribution relates closely to the population density of the country.

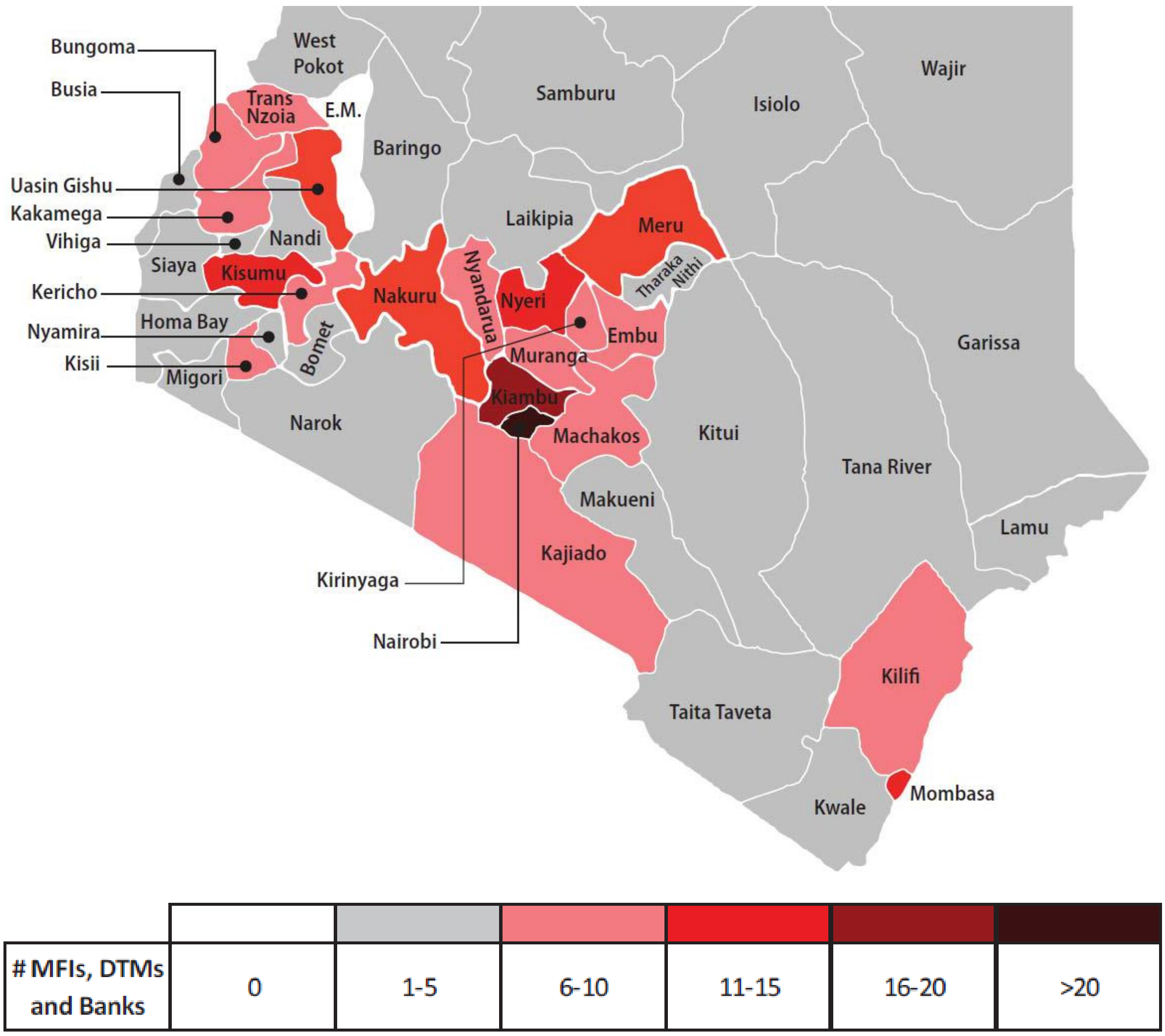


Figure 2: Map of Microfinance Distribution in Kenya (AMFI 2013a, p. 70)

Interest Rates Remain High

It has long been understood that the availability of credit is not sufficient to promote appropriate use, and that both transaction and interest costs are considered in the decision to access credit (Kariuki 1995). Formal Banks have stronger power in the market to provide lower interest rates as they source 67% of capital from savings and only 11% from loans; as compared to DTMs who borrow 34% of their lending capital and raise 43% in deposits, and Credit Only MFIs who primarily fund operations from borrowings (AMFI 2013a). It might in theory be possible for lending institutions to source cheaper external credit, which could be make available cheaper than paying transaction costs of consumer deposits, but this has not been the case.

Adjustment to New Licensing Slow

Requirements of new regulation and graduation to DT-MFIs requires significant change for many organisations. In many cases the adjustments required in the ownership structure of MFIs have been slow and therefore, prevented formalisation. It is also it is essential that both the management teams and Board of Directors evolve accordingly and have the appropriate expertise. “The Boards of many participating MFIs are not comprised of members with the appropriate knowledge and/or experience to meet these regulatory standards. The structure and operations of an MFI become more sophisticated as it makes the transition from a non-profit or non-regulated institution to a fully regulated financial institution” (FSD Kenya 2010a, p. 10).

Consumer Protection and Over-Indebtedness

Despite the development of Credit Agencies – which facilitate the sharing of individual credit histories for clients and potential clients – there remains the risk of client over indebtedness in contexts where microcredit is highly accessible. One specific reason for this is that Credit Only MFIs and SACCOs were not included in mainstream credit information sharing as of 2013, and this has reduced the effectiveness of this mechanism (AMFI 2013a). Furthermore, credit information can be used by institutions differently, and in theory there can be discrepancies between the use of individual credit histories to 1) protect the interests of the lender and 2) protect the interests of the consumer.

Consumer Protection in the Microfinance Sector

In 2001, the Kenya Bankers Association, which primarily serves as a lobby for the banks' interests, published the A Consumer Guide to Banking in Kenya (Kenya Bankers Association 2001). However, according to the centre for financial inclusion, in 2008, “Political stagnation between the country's power-brokering fractions has prevented the government from taking action on consumer protection policies. The status of client protection in Kenya is very weak due to little or no action taken by government, non-government, and banking entities. There has been action against corruption, with a commission passing a general code of conduct for co-operative societies, but the code is vague and falls short of creating a consumer protection framework. No actions on consumer protection by the banking networks have been made public to date” (CFI 2009).

A general consumer protection bill was introduced in July 2007 and AMFI included the creation of a code of standards into their strategy for 2007-2010 (CFI 2009). In 2007 and 2008, the CBK produced four biannual communication of bank charges, interest rates and lending rates for all banks as a means of promoting market discipline and competition among the players (Central Bank of Kenya 2014a). However, this activity was not continued.

The Microfinance Act (2008) did include some consumer protection legislation, although this was very limited in nature. The Act required:

- Institutions shall not provide ‘reckless credit’, although this is described as being constituted by lending “detrimental to the institution interest or the interest of depositors or the general public” with specific mention of actions that transgress “limits set under the Act or Central Bank of Kenya”, are ‘contrary to any guidelines or regulations issued by the Central Bank Act’, ‘failing to observe the institution's policies as approved by the board of directors’ or involve the ‘misuse of position or facilities of the institution for personal gain’. There is however, no specific mention of limitations designed to protect the interests of those taking out credit with an organisation.

- Proper identification of customers and managers, with full disclosure as to who is controlling nominee accounts. This measure was designed in order to protect consumers from falling prey to fraudulent schemes; although there is no mention of the way such a measure might be used to conjunction with credit reference agencies to prevent over borrowing.

The new Kenya constitution also has specific provisions on consumer rights. “This agenda has grown out of concerns related to expansion of regulated financial services to large numbers of first-time retail consumers, the large spread between lending and deposit rates, the exposure of consumers to substantial losses through pyramid schemes, the introduction of increasingly complex financial products and the blurring of lines between types of financial service providers” (FSD Kenya 2011, p. 1). This is an important area as the FinAccess survey of 2009 identified that:

“Not all users received a written loan agreement. While this is expected from informal lenders, only 93% of bank borrowers and 95% of SACCO borrowers said they had received a written agreement. Of those that did receive one, most but not all were able to take it away to study it before signing. However, many were still pressured to sign the agreement immediately, even in formal institutions such as banks (10%), MFIs (10%), SACCOs (14%) and hire purchase (10%). Those who had taken a loan or credit often were required to offer some type of collateral. In 42% of cases, this involved the rights to a home or other asset; in 45%, this involved someone signing surety (i.e., providing a guarantee); and in 7%, the lender withheld the borrower’s ATM card and pin number, which is a highly improper lending practice that warrants further investigation… Practically speaking…, many respondents still find…it difficult to completely understand loan documents and many [6-9%] were surprised by how much is actually charged for loans… after taking out a loan” (FSD Kenya 2011, p. 3).

However, until 2012, Kenya did not have a specific law that governs consumer protection. The Consumer Protection Act created the Kenya Consumers Protection Advisory (CPA) Committee, to aid in the formulation of policy related to consumer protection, accredit consumer organisations, advise consumers on their rights and responsibilities, investigate complaints and establish conflict resolution mechanisms amongst other duties. In terms of credit, the Act (Coulson Harney 2012):

- Prevents lenders rejecting clients use of third party insurers unless on reasonable grounds.
- Prevents lenders applying default charges other than 1) the legal costs incurred to collect payment, realising a security interest or protecting the subject matter of the security interest or 2) reasonable charges incurred due to a payment instruction issued by the borrower being dishonoured
- Prevents the application of early repayment penalties
- Requires a lender to provide an initial disclosure statement for a credit agreement, prior to the borrower entering into the credit agreement
- Requiring 12-monthly disclosure statements for credit based on a floating rate and monthly for open credit

Credit Information

July 2010 saw the launch of the Credit Information Sharing (CIS) mechanism (Central Bank of Kenya 2013, p. 35). Since then, and as of 31st December 2013, a total of 3.5 million and 55,094 credit reports had been requested from the two licensed Credit Reference Bureaus (CRBs). The credit reports requested by banks increased by 25.6 percent from 2012 to 2013. In 2013 there was a revision of the Credit Reference Bureau Regulations to incorporate amendments to the Banking Act and the Microfinance Act, which allowed Commercial Banks and Microfinance Banks to share both positive and negative (full file) credit information and enhance the robustness of the existing CIS framework. The full file information sharing requirement took effect in 2014 (Central Bank of Kenya 2013, p. 35). It was believed by the Central Bank that “This will go a long way in providing a holistic assessment of an individual’s or entity’s credit history and credit worthiness which will in turn enable providers of credit to make accurate and credible decisions when determining credit applications” (Central Bank of Kenya 2013, p. 37).

Mobile Banking

Throughout the 1990s, big banks expanded their networks of Automated Teller Machines (ATMs) while the small and medium size banks explored the possibility of establishing shared ATMs (Central Bank of Kenya 1999, p. 8). The use of credit, debit and charge cards also expanded (Central Bank of Kenya 1999, p. 8). Towards the end of the 1990s, several banks began to offer internet banking and established websites. At this stage, a major constraint on further technology related products was reportedly “the lack of modernisation in telecommunications sector” (Central Bank of Kenya 1999, p. 8). However, over time there has been increased convergence of banking and mobile phone platforms as banks explored more convenient and cost effective channels of providing financial services (Central Bank of Kenya 2013, p. 11).

One of the key regulatory moves was the liberalisation of the telecommunications sector in 1999 (Central Bank of Kenya 1999, p. 8). The newly created Communications Commission of Kenya issued the mobile licenses in 2000 to two Mobile Network Operators (MNOs): Safaricom, a 60/40 percent joint venture between the government-owned Telkom Kenya and Britain's Vodafone; and Celtel, a subsidiary of Africa's third-ranked phone company. By the end March 2008 there were 11,986,007 subscribers representing a penetration of 35.25% (CCK 2008b, p. 2). Later in 2008 Telkom sold shares in Safaricom and partnered with the Orange Group to launch Orange Kenya; Celtel is now owned by Bharti Airtel (2010) and trades as Airtel; while YuMobile, also launched in 2008 by the African telecommunications company, Econet. In March 2014 however, YuMobile was bought by Safaricom and Airtel (Mulligan 2014). As a result of the development of this infrastructure and subsequent growth in mobile phone coverage and usage (see Table 19 and Table 20), the opportunities for mobile banking have been well established.

Period	**Mobile Subscriptions**	**Mobile Penetration (per 100 people)**	**Mobile Money Subscriptions**	**No. of Mobile Money Agents**	**Total Deposits (KSH)**
2007/08	11,986,007	35	UA	UA	UA
2008/09	17,362,357	46	UA	UA	UA
2009/10	20,119,304	51	UA	UA	UA
2010/11	25,279,768	64.2	17,395,727	42,313	486,846,424,518
2011/12	29,703,439	75	19,505,702	49,079	672,300,539,552
2012/13	30,549,422	77	24,840,404	88,466	UA

June 2014	32,300,000	79.2	26,600,000	109,286	UA

Table 19: Growth in Mobile and Mobile Money in Kenya (CCK 2008a, 2009, 2010, 2011, 2012, 2013, 2014a)

In 2004, The Co-operative Bank claimed that it "leads the market by pioneering mobile banking in Kenya, by launching M-Banking, a banking service delivered via mobile phones. M-Banking enables customers to access their bank accounts and carry out various transactions that include getting bank balances, registering for salary alerts and loading airtime on cell phones, among others" (Co-Operative Bank 2014). In 2006 the Bank launched SACCO Link: an IT system that integrated the banking systems of SACCOs with those of the Co-operative Bank, to enable members of SACCOs to access banking services from the service outlets of the Bank (Co-Operative Bank 2014).

However, the telecommunications organisation which has had the most impact on mobile banking in Kenya is Safaricom. This was originally a department within the Kenya Posts & Telecommunications Corporation, which held a monopoly over the telecommunications sector. Safaricom started operation in 1993 before being incorporated on 3 April 1999 as Safaricom Limited under the Companies Act as a private limited liability company (Safaricom 2014b). The company was converted into a public company on 16 May 2002 due to a 60% shareholding by the state corporation Telkom Kenya Limited ("TKL") (Safaricom 2014b). However, in 2008, 25% of the state ownership was sold to the public neutralising its status as a public company. Safaricom has subsequently become the most successful mobile phone provider in Kenya. According to statistics published by the Communication Commission of Kenya in 2014, mobile penetration in Kenya currently stands at 79.2 percent, with Safaricom recording the largest subscriber share of 68% per cent (CCK 2014a, p. 8).

Network	**Subscribers (December 2013)**	**Percentage**
Safaricom	21.2 million	73.2
Airtel	5.1 million	14.3
YuMobile	2.6 million	7.3
Orange (kenya)	2.2 million	5.2
Total	31.3 million	100%

Table 20: Mobile subscriptions in Kenya (CCK 2014b)

In 2007 Safaricom launched M-Pesa. Originally intended as a micro savings product, M-PESA developed into a peer-to-peer mobile-phone based money transfer service for people who have access to a mobile phone, but no or only limited access to a bank (Standard Digital Reporter 2014). The services provided by this and other mobile money system are summarised in Table 21). By the first of November 2007, there were just over 1 million active M-Pesa users: 2 million by March 2008, 3 million by July 2008, 10 million June 2011, 15 million April 2012, 17 million February 2013 (Safaricom 2014a) and 18.1 million in 2014 (Standard Digital Reporter 2014). This means that M-PESA commands more than one third of all mobile money transactions in the world (Standard Digital Reporter 2014). The introduction of M-PESA has had a profound impact on financial inclusion in Kenya. Between 2005 and 2010 there was a large jump in total formal inclusion (formal + other formal) from 26.3% to 40.5%, and this was "largely driven by the introduction of the M-PESA mobile phone based payments system" (FSD Kenya No Date, p. 5). However, coverage by the company is geographically limited and large, particularly rural, areas of Kenya remain unserved by Safaricom (FSD Kenya 2010b, p. 4).

A number of factors have facilitated this growth. Firstly has been the network of agents that facilitate the conversation of physical cash and mobile money, working on behalf of financial service providers but not directly for them (Central Bank of Kenya 2013, p. 11). When regulatory reform allowed agent banking the agent network was built from their existing airtime distribution (FSD Kenya 2010b, p. 5). In addition, the use of aggregator agents, who oversee multiple outlets, allowed Safaricom and others, very quickly to increase the number of agents by signing agreements with a limited number of retailers (FSD Kenya 2010b, p. 5). Aggregated agents also improved cash management, balancing cash float issues between their different outlets caused by regional imbalances between deposits and withdrawals (FSD Kenya 2010b, p. 5). There are estimated to be more than 93,000 mobile money agents in Kenya, according to the Communications Commission of Kenya, and 26 million mobile money subscribers across the four mobile network operators in Kenya (Kamau 2014). Safaricom has a substantial chunk of the agents (81,025). Furthermore, Safaricom has developed strategic partnerships with large companies who accept M-Pesa for bill payment: for example Qatar Airways customers can now book tickets online or through the reservations office and make their payment through M-PESA (Standard Digital Reporter 2014). Behind these factors it is also relevant that the "level of financial literacy in Kenya may have eased adoption of M-PESA" (FSD Kenya 2010b, p. 2). It took more than two years before the service broke even in the beginning of 2009 (FSD Kenya 2010b, p. 3).

In addition the M-Pesa money transfer system, Safaricom previously partnered with Equity Bank on M-Kesho, a banking and savings service. Although this proved to unsuccessful due to complications over revenue sharing between the stakeholders, the idea of linking mobiles to formal banking services has also taken off. Following the initial failure, Safaricom then partnered with Commercial Bank of Africa (CBA) to launch a similar product branded as M-Shwari at the end of 2012. The system offers a micro savings and lending facility and signed up 7 million subscribers who transacted more than KShs 156 bn. The move led to a growth in CBA's loan accounts by more than 800%, from 89,000 in 2012 to 897,000 in December 2013, therefore total loans of KShs 13 bn. 2012-2014 (BiztechAfrica 2014). On this basis, CBA claimed to have overtaken Equity Bank as the lender with the highest number of retail loans (Heinrich 2014). For the year ended March 31, 2014, Safaricom posted KSh144.7 bn gross profit, KShs 26.6 bn of which came from M-PESA earnings.

Safaricom is not the only network provider to offer mobile money services, and all companies now provide such options. These are summarised in Table 21:

System Brand	**Mobile Network Operator**	**Bank**	**Services**
YuCash	YuMobile	Equity Bank & Co-operative Bank	Move funds directly between YuCash and partner bank accounts
			Send & receive money to/from other mobile numbers
			Request money from other users
			Top up airtime from YuCash account
			View YuCash balance and statement
			Deposit and withdraw YuCash via YuCash agents and banks
			Withdraw funds from Equity ATMs without a card
			Pay utility bills
M-PESA (2008) & M-Shwari	Safaricom	Commercial Bank of Africa (CBA)	Move funds between M-Shwari savings account and phone
			Send & receive money to/from other mobile numbers
			Top up airtime from M-PESA account

(2012)			View M-PESA balance and statement
			View M-Shwari balance and mini-statement
			Deposit and withdraw M-PESA via agents and banks
			Pay utility bills
			Withdraw funds from Equity ATMs without a card
			Transfer money to M-PESA pre-pay VISA Card
			Access micro credit product (minimum of KSh.100 any time)
Airtel-Money (2011) Previously Zap	Airtel	Equity Bank Co-operative Bank Equatorial Commercial Bank Standard Chartered Bank	Move funds between bank and phone
			Send & receive money to/from other mobile numbers
			Top up airtime from
			Access Equity account balance and statement
			Send and receive money to/from other Airtel users
			Deposit and withdraw money via agents and Axis Banks
			Withdraw money from ATMS
			Pay utility bills
			Spend and withdraw using Airtel Money debit card directly from Airtel account
		Faulu Microfinance	Access to microcredit product
Orange Money (2010)	Orange Kenya	Equity Bank	"Mapped bank account": the phone is used to access a bank account held with Equity Bank
			Move funds directly between Orange Money and Equity Bank accounts
			Send & receive money to/from other mobile numbers
			Top up airtime from Orange Money account
			View Orange Money balance and statement
			Deposit and withdraw Orange Money via Orange agents and Equity banks
			Withdraw funds from Equity ATMs without a card
			Pay utility bills
			Spend and withdraw using Orange Money debit card directly from Orange Money account
			Repay loans from Equity Bank
			Undertake loan applications through agents

Table 21: Mobile Money Services in Kenya (2014) Compiled from analysis of the websites and literature from the respective companies.

As can be seen above the network providers offer a range of microcredit products. Although the M-PESA system began as a means to disburse and repay loans offered by the MFI Faulu, it was converted into a money transfer system during the trials (Mbuvi 2012). Attempts to offer credit services in partnership with Equity Bank then failed. Therefore, the first phone based credit facility to enter the market came from the partnership between Faulu and Airtel launched in April 2012 (Microcapital 2014a). Mobile money subscribers apply for and access to short-term micro loans (between KShs 100 to KShs 10,000, repayable in 10 days) from via their phones from the 'Faulu Airtel kopa chapaa' service (Mbuvi 2012). Access to loans requires being a customer Airtel for at least six months and to have made more than 2 transactions on the service (Mbuvi 2012). Interest rates rise if the loan is rolled over beyond the first 10 day period and Airtel will refer defaulters to the Credit

Reference Bureau (Mbuvi 2012). Kopa Kredo – Kenya, offers Airtels' customers (for more than 3 months) credit for airtime top-ups, which they repay next time they top up with credit, plus a service fee of 10% (CFI 2009). Also in January 2014, Airtel Kenya announced a new loans product in partnership with a Mauritius-based consumer credit firm AFB (FSD Kenya No Date). It was suggested that loans would be offered to customers without security, but using savings, airtime consumption patterns and use of Airtel's money transfer service as the tools of credit appraisal (FSD Kenya No Date).

Safaricom offers microloans through the M-Shwari system. These small loans do not technically carry interest but incur a 7.5% facilitation fee payable only once for each loan taken (JUMA 2012). The loan is payable within 30 days but If the loan is repaid in less, a customer's loan limit qualification will increase (JUMA 2012). If the loan is not repaid, another 7.5% charge is added for another 30 days (JUMA 2012). Defaulters have their details forwarded to Kenya's Credit Reference Bureau (JUMA 2012). By early 2014 the service had registered $2.35 million in daily deposits from six million users, resulting in customer savings of over KShs 24 billion and KShs 7.8 billion loaned to users at an average disbursement rate of 30,000 loans per day (Okutoyi 2014a). By the same time, 140,000 clients had defaulted on their loans worth KShs 241 million, or 3.1% of loans which is lower than defaults after 360 days from banks (Okutoyi 2014a).

Orange offers access to credit from Equity Bank via applications made through their agents. Equity Bank also offer current customers, or those signing up for an account, credit to buy organise hardware products such as phone and computers (IT News Africa 2010).

Family Bank in Kenya, announced the PESA MOB loans in December 2013, which was to be accessible across several mobile networks in Kenya and provide a full suite of banking services including microcredit (Presse 2013). However, the service does not yet appear to be available.

In addition to the microfinance services offered by the network companies, other private lending firms offer microloans through mobile phones. In 2012, VL Capital and Flexus Systems launched the second phone based microcredit facility into the market, Pesa na Pesa. Following registration, clients can access credit via an SMS request, which initially must be repaid in a maximum of seven days (Mbugua 2012). Interest rates will range from seven to 10 per cent (Mbugua 2012). A maturing cheque, an upcoming salary or a chama merry-go-round or loan is required as collateral. M-Pepea launched in May 2012 to provide instant loans to workers at a fee via their mobile phones (Sangare 2012). To be eligible, employees and their employer register for the service and then borrowers can request loans by sending an SMS to M-Pepea. The system will automatically send a request to M-Pepea to credit the borrower's number with the specified amount depending on their contract. The loan is repaid incrementally from the borrower's salary at an interest rate ranging between 10 to 15% (Sangare 2012).

In addition to mobile money services offered by other Mobile Network Provider, the Communications Authority of Kenya, granted Mobile Virtual Network Operator (MVNO) licenses to three new mobile money transfer services in April 2014: Finserve Africa Limited, Zioncell Kenya Limited, and Tangaza Mobile Pay Limited (Heinrich 2014; Microcapital 2014b). The three firms will provide services via the network of the Kenyan subsidiary of Indian telecommunications firm, Bharti, Airtel. Airtel Kenya was launched in 2000 as Kencell, rebranded to Zain in 2008 and finally Airtel in

2010. The introduction of new MVNOs[10] was expected to encourage greater competition in the mobile money sector, and there is some indication of this possibility. Equity Bank is the parent company of Finserve Africa. In June 2013 the bank announced a new cashless payment card system called BebaPay, which is expected to enable users to pay bus fares without the use of cash (Microcapital 2013). In addition Finserve Africa was expected to launch its new SIM cards linked directly to bank accounts in July 2014, therefore allowing its customers to access their accounts and apply for loans via their mobile phones (Centre for Financial Inclusion 2009).

More specialised mobile based financial services are also being developed. CARE International, Kenya's Equity Bank, and French telecommunications operator Orange partnered to provide CARE's village savings and loan associations (VSLAs) with the facilities to make deposits and withdrawals at Equity Bank and with Orange agents' (Microcapital 2012). At the beginning of 2012, 25 Kenyan savings groups had enrolled in the program with 175 saving groups scheduled to start in September 2012 (Microcapital 2012).

Limitations and Issues with Mobile Technology

There are consumer protection concerns associated with the mobile money sector. A report from CGAP investigating the opportunity for social cash transfer payments, including Cash for Assets (CFA) in Kenya, highlighted the possibility for loss due to agent or staff misconduct; lack of transparency and disclosure of terms and fees; lack of adequate or effective avenues for recourse and redress, and; data privacy and protection challenges (Zimmerman et al. 2014). However, focusing on M-Pesa services it was found that users "were very clear about what to do when problems arose and overwhelmingly stated that problems were resolved quickly when reported. Participants were even able to recite the telephone number of customer care at M-Pesa, and many respondents noted that even when money was sent to the wrong person, it was often easy to recover the money" (FSD Kenya 2011, p. 4).

In remote areas, the electronic transfer of funds into the community, such as under trials of electronic social support payments, has the potential to lead to a lack of physical money by agents as recipients crowd to withdraw funds (Zimmerman et al. 2014). Indeed, in a FinAccess survey in 2011 "22% have had a problem when there was no cash at the agent" (FSD Kenya 2011, p. 4).

Despite efforts to facilitate competition in the mobile money sector, Safaricom still dominates. Indeed, M-PESA commands more than one third of all mobile money transactions in the world (Standard Digital Reporter 2014). This dominance was for a long time reinforced through the terms and conditions of their agents' employment: as they were prevented from also selling the services of other operators under threat of losing their processing equipment (Kamau 2014). However, in February 2014, and ahead of a ruling in response to a petition submitted by Airtel for the restriction to lifted by the courts, Safaricom removed all exclusivity provisions in from M-Pesa agent contracts (Okutoyi 2014b).

Additionally, the new 'thin SIM' technology announced by Equity Bank's is designed to break Safaricom's dominance. The is a thin layer of plastic printed with a circuit that fits over existing card,

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[10] A Mobile Virtual Network Operator is a wireless communications services provider that does not own the physical network over which it provides those services to customers. All three new MVNOs will be hosted by Airtel.

allowing continued access to the original network but with added functionality of the secondary provider (NYABIAGE and WERE 2014). This means that users will not need to migrate to another network to access different mobile money providers, as the Thin SIM can work alongside all four mobile operators in Kenya — Safaricom, Airtel, yuMobile and Orange (NYABIAGE and WERE 2014).

The quality of agency banking serves is also potentially problematic. Agents surveyed in 2014 said unreliable service is also a major challenge, saying they experienced downtimes close to nine times per month (Kamau 2014). As a livelihood, working as a mobile money agent has limitations. According to a report which covered East Africa, Kenyan agents generate the highest number of transactions per agent, but the lowest amount of individual profits in the region (Kamau 2014). Kenyan agents earn a lower median profit per month ($70) than both Tanzania ($95) and Uganda ($78) (Kamau 2014). It is reported that, "With new agents consistently joining the market, competition is having a negative impact on profits and driving existing agents in having to expand their business outside digital finance to supplement their income" (Kamau 2014).

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