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Developing Entrepreneurship for Women and Youth in Kenya

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Acronyms

Acronym	**Meaning**
AMFI	Association of Microfinance Institutions
ASCAs	Accumulating Savings and Credit Associations
ATM(s)	Automated Teller Machine(s)
DFID	UK’s Department for International Development
ESRC	UK’s Economic and Social Science Research Council
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
FSD-K	Financial Sector Deepening Trust – Kenya
KShs	Kenyan Shillings
MFI(s)	Micro-Finance Institution
NA	Not Applicable
NDT-S	Non-Deposit Taking SACCOs
NDT-MFI(s)	Non-Deposit Taking Microfinance Institutions (s)
ROSCAs	Rotating Savings and Credit Associations
SACCOs	Savings and Credit Co-operative Societies
VSLA	Village Savings and Loans Association

1. Introduction

1.1 The Study

This report outlines findings from a study of access to finance and microfinance regulation in Kenya. The research examines the challenges faced by micro-enterprises and informal-economy businesses working in growth sectors of the economy, and their requirements for strengthening access to finance and consumer protection. Micro-entrepreneurs were the main focus of this research, although there are many other users of microfinance.

The study, *Inclusive Growth: Improving Microfinance Regulation to Support Growth and Innovation in Micro-enterprise,* is one of a series of projects funded under DEGRP (DFID-ESRC Growth Research Programme) focussing on three themes of financial sector development, agriculture and growth, and innovation and productivity. The report starts with a literature review on microfinance in Kenya and then discusses survey findings and policy recommendations.

1.2 Objectives

This research examines the link between microfinance and urban livelihoods, exploring the challenges of access to finance for micro-enterprises, the vulnerabilities caused by unscrupulous lending practices, and the potential for improved financial access to contribute to poverty reduction and economic growth.

Since 1983 when the Grameen Bank in Bangladesh began making tiny loans to village savings groups, microfinance has emerged as a key tool of development policy based on the assumption that improved access to finance will trigger entrepreneurship and smooth shocks. Microfinance is now a major supplier of financial services to millions of people in the developing world. Yet concerns have emerged about its reach, regulation and oversight, application in urban areas, and impact on growth, poverty reduction and indebtedness.

Research on the impact of micro-credit and microfinance on poverty is inconclusive, and there is an imperative need to examine further the conditions in which savings and micro-credit help or harm low-income households. For example van Rooyen *et al* (2010 and 2012) concluded that microfinance may make some people poorer, not richer, and the focus on reaching the poorest-of-the-poor may be flawed.

Against this background, the project analyses the barriers, benefits and risks to micro-enterprises in accessing a range of financial services and the potential of improved consumer protection to address problems. It explores demand and supply-side opportunities and barriers influencing micro-enterprises' access to finance, and potential alternatives, particularly in urban settings. The philosophy of the research is that, while microfinance is not a guaranteed route out of poverty, micro-enterprises and informal-economy businesses should have access to secure savings and borrowings with transparent costs, and without excessive interest rates or time burdens.

1.3 Approach

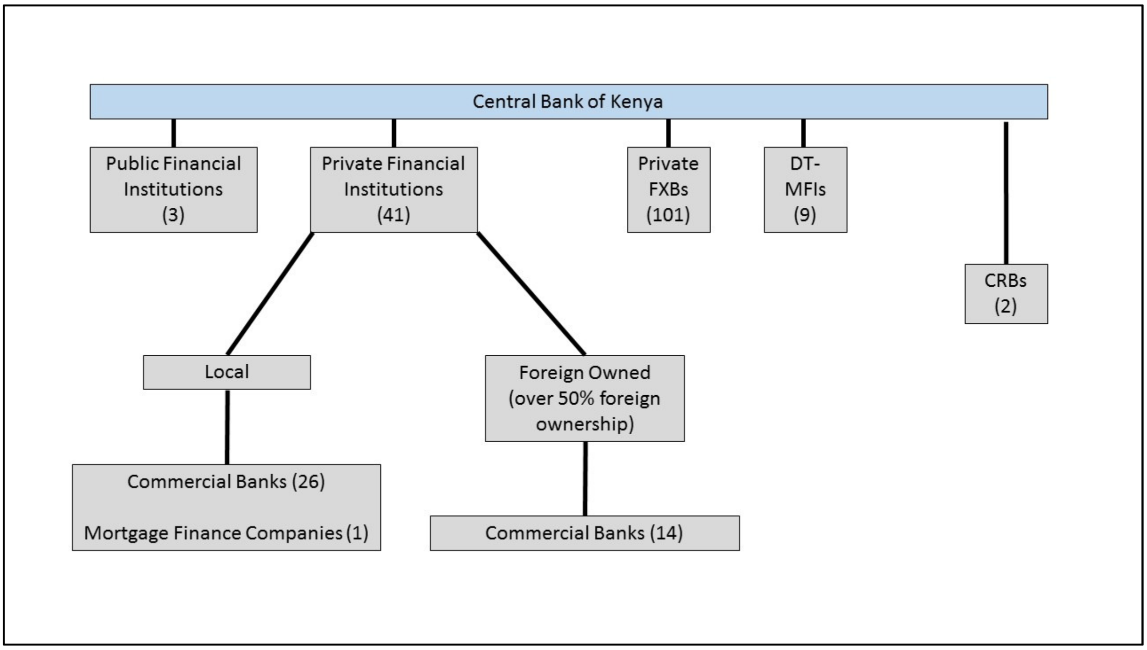
The study is based on comparative research in four countries of East Africa: Tanzania, Rwanda, Kenya and Ethiopia, and a comparison with India's more developed financial system, with a focus on major cities and secondary towns and on micro-enterprises in growth sectors of the economy: vending, construction, tourism, manufacturing and services. The findings in Kenya draw on 208 semi-structured interviews with micro-enterprises in Kisumu and Nairobi and Expert Interviews (EIs) with regulators, microfinance providers/promoters and solidarity savings groups.

2. Micro-credit Landscape in Kenya

2.1 Microfinance Providers

The overall finance sector in Kenya is summarised in Figure 1. At the end of 2013, the Central Bank of Kenya was responsible for the regulation of 44 banking institutions. In addition to full commercial banks, there were nine registered and regulated Deposit-Taking Microfinance Institutions (DT-MFIs) (Table 1) and 101 Forex Bureaus. There were two Credit Reference Bureaux (CRBs). Nationally there were 2,487 bank branches (Central Bank of Kenya 2013, p. 6 & 8). There was also one locally-owned mortgage finance company (MFC).

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



In addition to formally regulated financial providers, a wide variety of organisations provide micro-savings and micro-credit, grouped into the categories outlined in Figure 1. Moreover, with the significant rise in mobile money services offered by Kenya's major providers, a number of savings and loan products have been developed that can be accessed via mobile phones (Smith 2015, pp. 39-54). The Association of Microfinance Institutions in Kenya (AMFI-K) is an industry organisation that lobbies for members and support capacity building.

Table 1: Registered Deposit-Taking MFIs in Kenya (as of July 2014)

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
U&I Deposit Taking Microfinance Limited	April 2014

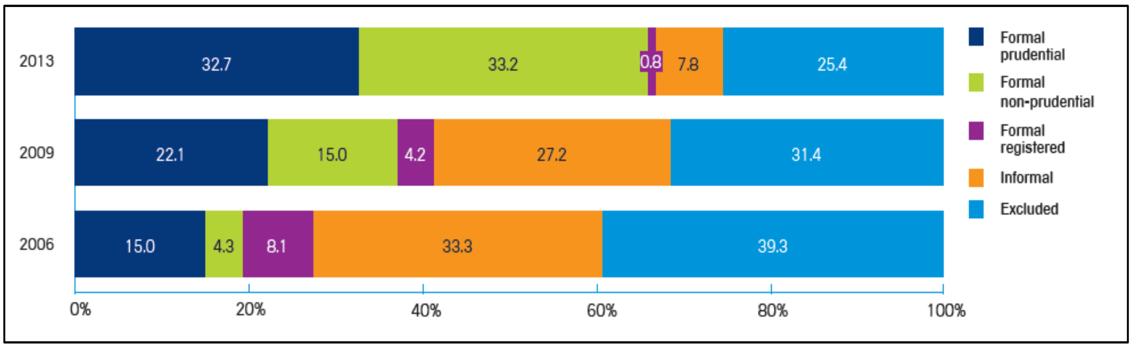
2.2 Access and Reach of Financial Services

It is difficult to provide an accurate account of outreach of MFI services, due to the lack of publicly available statistical information. Institutions that report to AMFI (Association of Microfinance Institutions)[1] reported that by December 2012, there were 832,794 active borrowers with a gross loan portfolio of KSh 49.1bn, achieving a 15.7% annual growth (AMFI 2013b, p. 7). This growth of the microcredit sector contributes to the observation that *"Kenya's financial landscape has considerably changed over the period 2006-2013"* (Central Bank of Kenya 2013, p. 13).

Financial inclusion in Kenya has been tracked through the FinAccess Surveys: three nationally representative financial access surveys undertaken in 2006, 2009 and 2013. The 2013 FinAccess Survey (see Figure 2) 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 only informal financial services declined from 33.3% in 2006 to 7.8% in 2013. This was largely driven by an increase in the use of formal, non-prudential services (e.g. mobile phone providers), from 4.3% in 2006 to 33.2% in 2013. Use of prudentially-regulated services (banks, deposit-taking SACCOS, and DT-MFIs) increased from 4.3% in 2006, to 33.2% by 2013.

However despite the increases in the proportion of people accessing financial services, 25.4% of the adult population remained financially excluded (falling from 39.3% in 2006 and 33% in 2009).

Figure 2: Progress in Kenyan financial inclusion, FinAccess Survey 2013 (Kenya 2013)



The data shows 'financial access strands', showing the highest level of regulation in the services accessed. Thus people using banks will usually use mobile money as well, but are recorded in the 'formal prudential' category. People using 'formal non-prudential services' including NDT-MFIs (non-deposit-taking microfinance institutions) and mobile money may also use informal services.

As the FinAccess survey shows and illustrated in Figure 2, between 2006 and 2013, the proportion of the survey population using banks has more than doubled, financial exclusion has significantly reduced, but the growth of mobile money and access to other non-prudentially regulated services has grown more than eight times in the seven years between surveys.

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[1] Although the Association of Microfinance Institutions, Kenya, (AMFI-K) has published two annual reports in 2012 and 2013, their membership does not cover all Kenya's microfinance institutions, and of the total membership of 32, only 29 institutions contributed to the most recent survey (AMFI 2012, 2013a). Another issue with the reports is the categorisation of different types of lending, as not all banks separate microfinance activities from wider operations, and some have done so under their own definitions (AMFI 2013a). For this reason, although the reports are considered representative by AMFI, they are of limited use in understanding the coverage of microfinance in Kenya. This suggests both that further efforts to gather information on the microfinance sector might be increased in the future, and that the following summary of access and research of microfinance should be read with the above limitations in mind.

2.3 Formal Microfinance

The total assets of the formal microfinance sector expanded rapidly between 2010 and 2012. Overall, the banks dominate the formal prudential sector, with Equity Bank alone comprising 72% of the sector's overall total assets (AMFI 2013b, p. 7). However, DT-MFIs grew the most in 2012 (32%), followed by credit-only MFIs (26%). Banks on the only hand have seen a decline in their growth rate, which has fallen from 36% in 2010 to 20% in 2012 (AMFI 2013b, p. 7). The largest DT-MFI in Kenya was Kenya Women's Finance Trust (KWFT).

As of December 2012, microfinance services were provided by 292 bank branches, 105 DT-MFI offices and 164 credit-only MFI outlets (AMFI 2012, p. 9). The 29 reporting members of AMFI reported 832,794 active borrowers with a gross loan portfolio of KSh 49.1bn, achieving 15.7% annual growth (AMFI 2013b, p. 7). Banks and DT-MFIs are more significant in term of their reach, and it is suggested that most NDT-MFIs *"are small and their total consumer base does not appear to be significant. [As, for example,] the ten Kenyan credit-only MFIs that report to The MIX Market (www.themix.org) had a combined clientele of around 210,000 at the end of 2009"* (Flaming et al. 2011, p. 26).

The sample taken by AMFI suggests that there is a higher concentration of institutions in the southern parts of Kenya and in the main towns and cities, particularly Nairobi. Regressing the number of branches against active borrowers in each province (Appendix 3 analysis by author) suggests that 78% of the variation in the number of active borrowers can be explained by the number of branches available – with a significance F and P-value of 0.0035 and a predictor that for every additional branch opened, active borrowers will increase by over 1,000 individuals.

Women represent a large majority of active borrowers (65.6% of the entire sector and 70.9% of non-bank sector in 2012) but the proportion of male borrowers is increasing. DT-MFIs are the segment with the highest share of women borrowers, as KWFT (having 64% of total DT-MFI active borrowers) lends almost exclusively to women.

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, asset finance, housing and 'green' products. In 2010-2012, business loans represented the great majority of the portfolio, followed by consumption, emergency and agriculture loans (AMFI 2013b, p. 15).

Lending methodologies and costs: DT-MFI and credit-only MFIs offer group and individual savings and loans, supported by regular training and group meetings, involving a higher ratio 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 MFI and bank portfolios consists mostly of individual lending: 57% and 62% respectively (AMFI 2013b, p. 15). 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. The *"vast majority of Credit Only MFIs charge flat interest rates"* (AMFI 2013b, p. 11). This suggests that microfinance has not overcome what many see as unfair lending practices associated with moneylenders. Further fees to customers include loan application fees and loan insurance fees. One area of additional research would be to understand the market operation for insurance; and if financers insist on their own insurance being taken out.

2.4 Informal and Quasi-Formal Saving and Borrowing

Informal financial services have long been provided through social networks in Kenya. Drawing on Atieno (2001, p. 10), three main categories of such provision can be described:

Financial arrangements among relatives and friends: the magnitude of these transactions is impossible to estimate, although research by the Financial Sector Deepening Trust, Kenya (FSD Kenya) (2014b) in Kamba Mathira, Kitui and Nyamira indicates that borrowing from family and friends is widespread, and is embedded in culture. Many such loans are interest-free or charge low interest and do not require collateral, especially when they are for education, health, or to manage other shocks. Repayment arrangements tend to be open-ended, and are based on reciprocity. 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. The introduction of mobile money has allowed the expansion of inter-personal lending, in addition to one-way remittance payments (FSD Kenya 2014c).

Traditional moneylenders: moneylenders are used by individuals to obtain credit, usually at high rates of interest. There is some evidence that formally registered small and medium enterprises use these as a source of working credit.

Shopkeepers: Many small-scale shopkeeper or street-sellers provide informal credit to clients allowing goods to be taken on credit for payment at a later date.

Quasi-formal services are supplied by a variety of community savings and loans groups, which supply credit to millions of low-income people in Kenya. These are found in both rural and urban areas, either as registered social welfare groups or as unregistered groups of friends and family members (these straddle informal and quasi-formal arrangements). These groups have been classified here as quasi-formal organisations, as they may or may not be legally registered, although as will be discussed later, neither category are subject to financial regulation. NGOs have been instrumental in encouraging and supporting the development of community savings groups. For example in Marsabit, the FSD 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 principles there are many individual methodologies, in many cases derived from the group's 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 types of group can be distinguished (Aghion and Morduch 2005, p. 68):

1) *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. Kenyan women have a long tradition of these groups, and the Accumulating Savings and Credit Associations (ASCAs) into which some of them evolve, are rather different from the externally promoted of VSLAs.
2) *Village Savings and Loans Associations (VSLA)* – where weekly savings are made available as credit for the members on the basis of a needs assessment, and allow more than one person to borrow at one time. Most ASCAs and VSLAs charge interest on the loan and have an annual 'share-out' of the accrued profit. In their most formalised form these organisations essentially operate as a credit cooperative or credit union. Rates of interest can be high, but these are set by the communities themselves, and the interest stays within the community and boosts the loan capital. There is some suggestion that this arrangement might suit some members of the community better than others: as where the accumulated funds are divided on the basis of savings, those that have needed to borrow less and have been able to save more will accumulate more funds. 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 data for either informal or quasi-formal credit providing services, although it was estimated in 2000 that there were more than 30,000 ASCAs/ROSCAs, and the 2009 FinAccess survey suggested that 12.2 million adults use financial services from informal providers. More recent evidence suggests that use of quasi-formal credit-giving institutions is geographically and culturally varied. In survey locations in Turkana (with a large population of semi-nomadic pastoralists) membership of savings groups was found to be negligible, whereas in Marsabit (a settled town) approximately 25% of women surveyed were in such groups (FSD Kenya 2014a, p. 10).

2.5 SACCOs (Financial Cooperatives)

SACCOs (Savings and Credit Co-operative Societies) in Kenya can be divided into:

1) Non-deposit-taking SACCOs (NDT-S), providing a limited range of savings and credit products, and registered and supervised under the *Cooperative Services Act, CAP 490*; and

2) Deposit-taking SACCOs (DTS), licensed and supervised under the *SACCO Societies Act, 2008* – which gave SACCOs until June 17, 2014 to become licenced or cease being a deposit-taking SACCO (SASRA 2013, p. 13).

In addition to basic savings and credit products, SACCOs also provide basic 'banking' services including front office savings activities or demand deposits, payments services and ATMs (SASRA 2013, p. 13). As a general trend, SACCOs have started as non-deposit-taking SACCOs and then in many cases developed to take deposits in order to expand the range of financial services to members (SASRA 2013, p. 13).

In 2013, deposit-taking SACCOs numbered 135 which were licenced and 215 non-licenced. The non-deposit-taking SACCOs included around 1,780 compliant SACCOs and over 6,000 which remained non-compliant. However, in terms of sector coverage, most deposit taking SACCOs are specific to a certain community and there are relatively few accessible to the general public. The overall financial performance of Kenyan SACCOs can be seen in *Table 2*.

Most SACCOs accept monthly payments, either income from the sale of produce or monthly salaries for shares (taken as savings), against which members may borrow up to two or three times the value of savings, if they can get other members to guarantee them. Loans 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 many years been larger than urban SACCOS, these have played an important role in providing financial services to their members. This was particularly true from around 1997, when rural SACCOs were substituting for the formal banking sector which was closing many of its rural bank branches as a result of financial problems (Ministry of Finance 2008, p. 7). Usually urban-based SACCOs also offer loans in the form of cash salary advances, popularly referred to as “instant loans” (Wanyama 2009). Under varying conditions, SACCOs approve and pay advances within one day, in order to enable members respond to unexpected social crises. Although SACCOs do not clearly categorise loans, most are recorded as personal/household loans with large amounts utilised for school/college fees, general development and for emergency purposes (SASRA 2011, p. 28).

In terms of assets, some individual SACCOs (for example the Harambee, Posta and Mwalimu SACCOs) are larger than some of the small commercial banks. Their rapid growth suggests that SACCOs are filling a need which has not been met by other financial institutions. Although SACCOs are largely self-sufficient, a number of international development agencies have supported them 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 policy-making and legislative processes by the Kenya Union of Savings and Credit Cooperatives (KUSCCO). KUSCCO 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 organisation for rural SACCOs and other forms of savings and credit associations in Kenya (Wanyama 2009, p. 14). The organisation provides cooperative microfinance workshops to sensitise members on access to finance in rural areas (Wanyama 2009, p. 14).

Table 2: Performance of SACCOs in Kenya[2]

Performance item	2013	
	Total	Licenced
Total Assets (Billion KSh)	503	135
Loans /Advances (Billion KSh)	381	184
Deposits /savings (Billion KSh)	358	172
Share Capital (Billion KSh)	UA	10.6
Turnover (Billion KSh)	UA	33
Members	5.4	2.6

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

2.6 Agent Banking

An amendment to the *Banking Act* through the *Finance Act 2009* permitted banks to use Third-Party 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 presence in rural areas and generally increase the number of people using 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:

- Cash deposits
- Cash withdrawals
- Payment of bills
- Account balance enquiry
- Collection of account opening application forms.

In 2011, the CBK (Central Bank of Kenya) developed the *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 deposit-taking business on their behalf (FSD Kenya 2010b, p. 10).

2.7 Mobile Money: Savings and Credit

While MPesa was originally a money transfer product, it was only the introduction of MShwari at the end of 2012, as a partnership between Safaricom and the Commercial Bank of Africa, that the market was offered micro-savings. The service soon signed up seven million subscribers who transacted more than KSh 156bn. Following this success, all mobile providers now offer such services through various partnerships.

The first phone-based credit facility to enter the market came from the partnership between Faulu and Airtel launched in April 2012 (Microcapital 2014). Mobile money subscribers apply for short-term micro-loans (between KSh 100 to KSh 10,000, repayable in 10 days) from their phones to the *Faulu Airtel kopa chapaa* service (Mbuvi 2012). Access to loans requires being a customer of 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 days and Airtel will refer defaulters to the Credit Reference Bureaux (Mbuvi 2012).

Safaricom then introduced micro-loans through the MShwari 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 Bureaux (JUMA 2012). By early 2014 the service had registered six million users, who had taken KSh 7.8bn of loans, at an average disbursement rate of 30,000 loans per day (Okutoyi 2014). By the same time, 140,000 clients had defaulted on their loans worth KSh 241m, or 3.1% of loans, which is lower than defaults after 360 days from banks (Okutoyi 2014).

2.8 Microfinance Regulation and Policy

Microfinance institutions (MFIs): The regulation of microfinance in Kenya was dramatically simplified through the *Microfinance Act (2006)* and the *Finance Act (2006)*. A full summary of the regulatory system now established in Kenya can be seen in

Table 3 below. However, overall, legislation has divided microfinance services into three tiers, each with different regulatory arrangements:

- **First tier:** Informally constituted MFIs like rotating savings and credit associations (ROSCAs), club pools, and financial services associations are not regulated by an external agency. Donors, commercial banks and government agencies from which they obtain funds or that support them are required to carry out due diligence and make informed decisions about them.
- **Second tier:** Formally constituted microfinance institutions that do not accept deposits from the general public but accept cash collateral tied to loan contracts are regulated and supervised by a self-regulatory (umbrella) body the Association of Microfinance Institutions (AMFI).
- **Third tier:** Formally constituted deposit-taking MFIs (DT-MFIs) licensed, regulated and supervised by the Central Bank of Kenya (CBK).

The CBK commenced the implementation of the *Microfinance Act 2006* 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). 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 a further nine MFIs were licensed by 2013.

Table 3: Summary of Regulatory Financial Regimes

<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="4">Informal</td><td>Moneylenders</td><td colspan="3" rowspan="2">No registration or oversight</td><td rowspan="5">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 & friends</td></tr>
<tr><td>Shopkeepers</td><td colspan="3">Potentially registered, but most likely unregistered businesses</td></tr>
<tr><td rowspan="2">ROSCAs and ASCAs[3]</td><td colspan="3" rowspan="2">Encouraged to be registered with the Ministry of Social Security, but some might remain unregistered.</td></tr>
<tr><td colspan="2">Quasi-Formal</td></tr>
<tr><td rowspan="6">Formal</td><td>Subsidised</td><td>Non Deposit Taking / Credit-Only Microfinance Institutions</td><td colspan="3">Registered as a range of legal forms</td><td>Regulations for NDT-MFIs are yet to be put in place. The Ministry of Finance is discussing the best way forward for regulating non-deposit taking microfinance institutions</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">Registered under the Cooperative Societies Act (1997)</td><td>Deposit-Taking SACCOs</td><td>Registered under the SACCO Societies Act (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>Credit Providers</td><td colspan="3">Registered under the Corporations Act</td><td>Consumer Protection Act (2012)</td></tr>
</table>

[3] ROSCAs = Rotating Savings & Credit Associations; ASCAs = Accumulating Savings & Credit Association

SACCOs: Regulation of the rapidly growing SACCOs sector could not be adequately addressed within the provisions of the *Cooperatives Societies Act (CSA), CAP 490, 1998,* despite numerous amendments (SASRA 2011, p. 32). The Ministry of Cooperative Development and Marketing (MoCDM) promulgated the *SACCO Societies Act, 2008,* providing for the licensing, supervision and regulation of SACCOs (SASRA 2011, p. 32). The Act also establishes the Deposit Guarantee Fund which provides protection to members' deposits up to KSh 100,000 per member. The Act commenced in 2009.

The Act created a new body responsible for the implementation of this regulatory framework, the SACCO Society Regulatory Authority (SASRA), a semi-autonomous government Agency under the Ministry of Industrialisation and Enterprise Development (SASRA 2014), inaugurated in 2009, which started operations in June 2010 on publication of the *SACCO Societies (Deposit Taking SACCO Business) Regulations*.

The *SACCO Societies Act, 2008,* defines requirements for SACCOs for capital adequacy, asset quality, liquidity, and restrictions on non-core business activities (SASRA 2012, p. 15). Section 69 of the Act provided one year from the date of publication of the Regulations (2010) for all deposit-taking SACCOs to apply for a license (SASRA 2012, p. 33) by June 2011, by when 200 SACCOs had submitted their applications for license with SASRA (SASRA 2012, p. 33). The remaining 18 SACCOs did not satisfy the licensing requirements and closed the deposit-taking SACCO business, reverting to non-deposit taking SACCOs (SASRA 2012, p. 33).

By the end of 2011, 15 more SACCOs had applied to commence deposit-taking operations, bringing the total license applications to 215 (SASRA 2012, p. 33). By the end of 2012, 124 were licenced (SASRA 2012, p. 33). A 4-year transitional period to June 2014 allowed deposit-taking SACCOs to become fully licensed and comply with prudential requirements (SASRA 2012, p. 15).

2.9 Consumer Protection

Consumer protection for financial services is generally provided under (i) consumer protection laws without explicit reference to financial services, (ii) consumer protection laws which make explicit reference to financial services, and (iii) consumer protection regulations within the framework of financial sector legislation (Ardic et al. 2011, p. 7).

In Kenya, legislation began with financial service regulation. The *Banking Act (1997)* contained some limited consumer protection provisions, providing restrictions on bank charges and interest on non-performing loans, requirements for disclosures in annual reports, and the provision of credit reference bureaux (Ardic et al. 2011; Flaming et al. 2011, p. 15). These were maintained with subsequent reform (Central Bank of Kenya 2014b), and include restriction on the false advertising of licenced services. The CBK provides some information on interest rates: between 2003 and 2006, it published bank rates in the newspapers, and between 2007 and 2008, published four biannual publications on bank charges, interest rates and lending rates (Central Bank of Kenya 2014a). Reports for subsequent years are not available.

In 2001, the Kenya Bankers Association, an industry association of banks, had published the *A Consumer Guide to Banking in Kenya* (Kenya Bankers Association 2001), but 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 in their strategy for 2007-2010 (CFI 2009). By signing the code, service providers commit to transparency and disclosure, fair practices, plain language contracts, financial education, non-discriminatory behaviour and the establishment of formal and informal dispute-resolution channels and a client feedback mechanism. However, this self-regulation is restricted to organisations who are members of AMFI.

The *Microfinance Act (2008)* included some consumer protection legislation, although this was limited in nature. The Act required: that 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 no specific mention of measures to protect the interests of those taking out credit.

Proper identification of customers and managers, with full disclosure as to who is controlling nominee accounts is required, to protect consumers from fraudulent schemes, although there is no mention how it might be used with credit reference agencies to prevent over borrowing.

The Kenya Constitution 2010 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 undertaken by the Financial Sector Deepening Trust Kenya (FSD-K) 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).*

The 2010 FSD-K/CGAP survey of consumer awareness uncovered other concerns e.g. that 25% of bank depositors expressed "surprise" at charges they did not know about (Flaming et al. 2011, p. v). In 2012, the *Consumer Protection Diagnostic Study: Kenya* (Flaming et al. 2011*),* using World Bank methodology, identified that although regulators provide some consumer protection to the clients of regulated institutions, this was *"incomplete and sometimes inconsistent"* – those using informal services are entirely unprotected. The survey recommended an incremental approach to improving consumer protection, including a cross-cutting consumer protection law.

Following the above recommendations, the first specific law to address consumer protection in Kenya was introduced (Kenyan Government 2012). The *Consumer Protection Act, 2012*, created the Kenya Consumers Protection Advisory (CPA) Committee, to aid in the formulation of consumer protection policy, accredit consumer organisations, advise consumers on their rights and responsibilities, investigate complaints and establish conflict resolution mechanisms. The Act went some way to addressing recommendations of the World Bank diagnostic, but there are some gaps (Table 5). As noted above, there have been sticking points between the Central Bank and the Kenyan Bankers Association, such as the agreement of a methodology for calculating annual percentage interest rates (Flaming et al. 2011, p. 16). Overall there has been only limited progress on meeting many of the recommendations in the diagnostic for the formal banking sector, DT-MFIs and NDT-MFIs and SACCOs. However, it should be welcomed that the Act (2012) might also provide consumer protection for those using informal credit services, particularly given that research found informal credit provided by money lenders or shop keepers was often supported by a contract (with 41% of respondents borrowing from such sources reporting this).

Table 4: FSD-K diagnostic recommendations (World Bank method) and Consumer Protection Act, 2012

Recommendations from FSC diagnostic (Flaming et al. 2011)	**Consumer Protection Act, 2012** (Kenyan Government 2012)	**Progress Achieved** (Authors' analysis) (Coulson Harney 2012)
Disclosure & transparency: Minimum disclosure requirements for credit and savings services (according to a standardised interest rate calculation methodology) and minimum documentation requirements such as a contract and repayment schedule. A simple one-page, standardised Key Facts summary.	Requires a lender to provide an initial disclosure statement which contains "the prescribed information" for a credit agreement, before the borrower enters into the credit agreement (s31). Requiring 12-monthly disclosure statements for credit based on a floating rate and monthly for open credit (s.66).	Affects DT-MFIs, NDT-MFIs, and licenced and unlicensed SACCOs. Despite the requirement to provide "prescribed information" this has not yet been prescribed. This significantly reduces the value of the Consumer Protection Law. It is therefore essential that key information is defined. The requirement for standardised format would potentially future aid comparison.
Plain language and standard contracts for simple products.	Not addressed.	Not addressed. Specifically of concern is that there is no requirement for contracts or disclosures to me made in a language of the clients' preference.
Fair practices: Review the practice of product bundling (particularly credit protection insurance sold with credit).	Prevents lenders rejecting clients use of third party insurers unless on reasonable grounds (s.58).	While clients now have the right to reject lenders insurance, the bundling of products has not been addressed. There is still no of specific requirement to explain the opportunity for alternate insurance, which might form part of the disclosure documents.
Main supplier has liability for agent behaviour	The term 'supplier' includes an agent of the supplier (Part 1 – Preliminary)	Traders had encountered a range of problems in pursing complaints.
Default charges not addressed.	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 by the borrower being dishonoured (s61).	Consumer protection has gone beyond the requirements, although a failure to define how reasonable costs etc. are calculated, leaves outcomes open to question.
Review use of add-on fees and account charges.	Prevents the application of early repayment penalties (s.62).	Failure to limit the possibility of 'other' additional fees leaves the potential for confusion over actual total costs.
Dispute resolution: Effective internal dispute resolution for finance organisations	Decisions achieved in arbitration cannot exclude the option of referral to the High Court (s.88).	
Third party recourse	Created Kenyan Protection Advisory Committee	Lack of established process as a third party arbitration body.

Neither the FSD Kenya diagnostic recommendations nor the *Consumer Protection Act, 2012,* interpret 'fair treatment' very broadly. For example, as identified in previous World Bank research, these could include restrictions on: deceptive advertising and breach of client confidentiality; unfair and high-pressure selling practices, and abusive collection practices. Disclosure requirements should require service providers to disclose information on the terms of financial products in a standardised manner[4].

Perhaps most critically, although The Kenya Consumer Protection Advisory Committee (KECOPAC) held its inaugural meeting on February 5, 2014, progress on establishing a dispute resolution mechanism has not yet been published and there is currently no alternative to litigation for the enforcement of the legal requirements, even if the *Consumer Protection Act, 2012,* has opened the possibility of class law suits (launched on behalf of a group). Indeed, the Attorney General (2014) highlighted that before drafting any regulations concerning how to implement the Act and define specific penalties for non-compliance, there would be a consultation with the Consumers Federation of Kenya (COFEK). It is recommended that the dispute resolution mechanisms be addressed as a priority (Table 5).

2.10 Credit Information

July 2010 saw the launch of the Credit Information Sharing (CIS) mechanism (Central Bank of Kenya 2013, p. 35). By 31 December 2013, a total of 3.5 million and 55,094 credit reports had been requested from the two licensed Credit Reference Bureaux. The credit reports requested by banks increased by 25.6% 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 application*s" (Central Bank of Kenya 2013, p. 37).

[4] Disclosure may be required at the time of advertising or promoting a service (pre-sale disclosure), at the time of signing a contract (account opening) and during the period of the contractual relationship (periodic through regular statements and occasional when terms of service change) (Ardic et al. 2011, pp. 8-9).

3. The Financial Lives of Micro-entrepreneurs

3.1 Savings

Savings Methods: Although 63% of our total sample of 208 micro-entrepreneurs saved regularly and 37% did not. Importantly, women were much more likely to save (71% of female respondents) than men (21%). Amongst the 191 who gave valid responses, 60% used banks, 44% used mobile money, and 27% used a *chama* (informal group). In terms of gender, while more male than female savers used banks (64% vs. 54% respectively) and mobile money (46% vs. 40% respectively), more women than men used *chamas* (39% vs. 21% respectively). Savers were more likely to use banks in Nairobi than Kisumu (68% vs. 56%), and only slightly less likely to use mobile money (40% vs. 46%) and *chama* (21% vs. 31%). The survey found a slightly higher rate of saving through informal means (11%) compared to the FinAccess figure of 7.8% (Figure 2 above).

The spread of savers across the sectors was relatively even, although construction workers were the most likely to save (71%), followed by traders (66%), and tourism and manufacturing (59% and 58% respectively). Of the total sample, those most likely to use a bank worked in tourism (74% of savers working in the sector did so), while the only group making some use of SACCOs were construction workers (still only 12% of savers in this occupation). Another notable finding was that traders were much more likely to use *chamas* (27% of savers using this method, versus 25% for those in manufacturing). However, the use of different means of saving across the sector was relatively even.

Of the respondents who already saved through at least one means or more, 72% were aware of other opportunities, although 28% of the sample lacked enough information to be make an active choice about how they saved their money. This suggests that further efforts to promote savings opportunities would be beneficial for some informal economy workers, for example through TV programmes.

Reasons for saving: Reasons for saving were varied – of 190 valid responses, 62% saved for business (eg: buying stock or investing in tools and premises), 49% saved for family or medical emergencies, 44% for school fees, and 29% for other reasons. Of these other reasons, 40% were for daily or personal expenses, and 25% to start another business or diversify livelihoods (for example, the trader who aspired to own a Public Service Vehicle). Reasons for saving differed by gender: women saved less than men for business (50% vs. 68%) and family emergencies (47% vs. 50%) but more for school fees (51% vs.40%). In Kisumu, respondents were more likely to save for school fees than in Nairobi (50% vs. 35%) and less for emergencies (45% vs. 56%).

Those involved in vending, manufacture and tourism were most likely to save for business purposes. However, those in construction were recorded as most likely to save for reasons other than those specified in our questionnaire (53%) – of these, most individuals were: saving to set up their own business in the future or for a pension. The next most likely reason given by construction workers for saving was for business reasons.

Of the 200 who replied to the question, 30% of people had experienced problems with savings with no major difference across genders. Of these, many reported an inability to save, however: two people had problems having their signature accepted; one had experienced problems accessing banking online when needed; four highlighted breaks and delays in the MPesa service; three reported problems with bank systems when they need to withdraw; one felt there were not enough branches; three had difficulty with maintaining a minimum balance required for the full benefits of the account; three had their savings stolen from informal systems; two reported paying out as guarantors on the loans of others.

Of most significance is that many people report issues that derive from not fully understanding the charges associated with banking. For example, seven people said they feel money has gone missing from their bank accounts; one thought money had gone missing through agent-arranged mobile money account; one claimed they had to fight to close the account and withdraw the final funds.

Four people emphasised that they had encountered unexpected costs, and/or that they had been charged unexpectedly for having a bank accounts. One explained that: *"They have hidden costs to withdraw your money. For example they take KSh 200 to withdraw KSh 5,000. You are not told about these charges when you open the account or join".* This finding shows that despite improved consumer protection in Kenya (see above), problems of consumer information still exist even for clients of the formal banking sector (For previous issues see: Flaming et al. 2011, p. v).

Reasons for not saving: A small group did not save at all, mainly because they felt that they did not have enough money to save or did not earn regularly enough: although 13% of men (0% women) said that they do not trust the banks. Of the sectors, none of the construction workers reported not saving as a result of a lack of regular income, presumably as they were paid a wage for their work, and this was the biggest problem for those working in a job related to the tourist trade (50% of respondents in this sector). Also of interest, was that manufacturing workers were the only group to highlight that they did not save as it was too complicated for them. This might be worth further investigation by financial providers in order to understand if a more specialised product might increase access to savings.

3.2 Borrowing

Means of Borrowing: Friends and family seem to be the most common form of borrowing. Although only 146 valid answers were given to the questions about borrowing, the majority (38%) borrowed from family and friends and 30% from *chamas*, 4% used moneylenders, 2% used bosses/suppliers and 12% used other sources.

Of formal finance, 12% borrowed from banks, 6% from mobile money, 3% from SACCOS, 4% from MFIs, and 1% used Airtime. Men and women in our survey borrowed equally: 70% of each having taken loans in the last 24 months. The type of borrowing used by men and women was largely similar, although more men than women in the sample borrowed from friends and family (45% vs. 26%), while the women appear to have borrowed more from moneylenders (10% vs. 1%) and *chamas* (37% vs. 25%).

These results are similar to other research carried out in Kenya. For example, a previous study amongst rural communities found that only 14% of those had borrowed for initial capital and 11% for operating capital used formal sources, while 86% and 87% got capital from informal sources for initial and operating capital respectively (Atieno 2001, pp. 29-30 & 31-32). This work also found that respondents most often borrowed from ROSCAs (44% of borrowers), and sourced initial business capital from social networks (23%), and operating credit from suppliers (Atieno 2001, p. 32).

In general, traders in the current study were the most likely to borrow (75% of which had taken a loan in the last 24 months) but sectors were mostly equal in accessing credit (66-75%). The sources of credit were also relatively equally used by different sectors. The exception was that those in manufacturing (38%) and vending (33%) were much more likely to use *chamas* than those in either construction (17%) or tourism (15%).

When asked about their knowledge of credit, the majority (60%) of those borrowing from at least one source were unable to name alternative sources of credit. It can be recommended that further efforts to promote such knowledge would be beneficial in deepening financial inclusion among members of the informal economy in Kenya.

Reasons for borrowing: The reasons for borrowing were mainly for business development (50%), or family emergencies (28%). Women were considerably more likely than men to borrow for business development (53% vs. 29%) and school fees (37% vs. 9%). Men generally borrow for other reasons (30% vs. 10% of women). Traders were most likely to borrow for business needs, and construction workers had mostly used credit for emergencies (46%). This situation may well reflect their reported inability to save (see above), and so credit is used for ex-post smoothing as opposed to business investment. Construction workers also reported other borrowing needs and these included personal consumption and the repayment of other debt (15% and 12% of reported other borrowing). On the question of multiple loans, only 17% of those with valid answers had taken more than two loans in the last 24 months. Of these most were from different informal sources. There was only one person with two formal loans. However, of those that had taken multiple loans, and noted that they had problems (n=22), 72% had missed at least one payment and the remainder with valid response (13%) noted that it was challenging to repay multiple lenders.

Reasons for not borrowing: these were mainly because people felt they did not need a loan (38%), including 41% of women compared to 36% of men. A lack of need for a loan was particularly evident in the tourism sector. An important further question however, is why individuals do not want credit. It might be that credit is not appropriate, or that people do not understand the opportunities which might be available.

Of the 79 out of 208 respondents who did not borrow, the next most common reasons were: worried about paying back debt (34%), others reasons (25%), not earning regularly enough (17%), found it too expensive to borrow (9%) or did not trust banks or MFIs (6%). These findings contrast to previous research in the rural environment, where the main reason for not seeking credit was lack of information on how to obtain it (21%), followed by no need for credit (15%) and lack of required security (4.5%) (Atieno 2001, pp. 25-26).

Loans from different sources varied in size, and varied from KSh 10,000-800,000; from social networks KSh 400200,000; from Banks, MFIs and SACCOS from KSh 10,000- 800,000; from *chamas* KSh 1,000-80,000. A good number of the micro-entrepreneurs had an understanding of the interest rates charged, but only in terms of total monthly payback. However, the majority expressed an understanding of the repayment costs of credit in terms of nominal financial values. While some understood the interest in terms of reducing balance or fixed interest rates, the vast majority did not have this understanding. Moreover, even those borrowing from community savings and loans groups where financial capacity literacy had been part of the programme, tended to describe interest rates in monthly terms, as opposed to APR values, which would undermine their ability to make comparisons with the cost of borrowing from formal sector sources. It is therefore suggested that efforts are made to develop this understanding.

Smaller borrowing from banks MFIs and SACCOs was based on collateral, for example the furniture produced by one entrepreneur and household goods. However, the majority of borrowers were secured through guarantors or groups. For larger loans, property deeds and vehicle log books were required.

3.3 Solidarity Groups in Urban Areas

The solidarity model has been very successful in rural areas, particularly where promoted in groups with shared common interested, and their operation has been translated into urban areas by NGOs such as CARE International and World Vision. The research team also visited several urban savings groups, including one in Nairobi, where members had jointly started a small plastics-recycling project, and had set up an off-shoot group designed to bring young people into the savings net.

3.4 Mobile Money, savings and borrowing

Almost all respondents used mobile money in their business (94%). All respondents were micro-entrepreneurs and, as might have been expected, more used mobile money to receive payments (77%) rather than to send money (67%) with no major differences between men and women. For savings and borrowings, a good number of respondents used mobile money to save (46% of men vs. 40% of women), but only 6% of respondents used mobile money to borrow, although this was more than borrowed from used MFIs (4%) or SACCOS (3%) (Appendix 2).

Of the 208 people asked, 23 (11%) of respondents had sent money to the wrong phone number. This mirrors research elsewhere, which found that 11% of the sample had made the same mistake (Flaming et al. 2011, p. 9). Of those sent money to an incorrect number, 45% got their money back through one means or another, although 55% did not, mostly because they said the recipient had withdrawn the funds before customer services could make an intervention. This therefore highlights an important problem not identified be previous work,

4. Conclusions and Recommendations

Kenya has a rapidly changing financial landscape. Around a third of the population now uses a formal bank account or other prudentially regulated services, a third uses mobile money or other non-prudentially regulated services as the most secure level of financial service accessed, and a third uses informal providers. The spread and rate of increase of mobile money poses challenges for regulators, however this is a new field and with limited experience on which to draw. Thus a cautious approach to regulation to enable innovation is important (Christen and Rosenberg 2000).

The study sought to examine the financial practices of micro-enterprises in growth sectors of the economy in the capital city (Nairobi) and a major secondary town (Kisumu) – precisely those who should be spearheading urban economic growth. A key finding of the research is that while many were saving through formal means, very few were borrowing from banks or MFI, which is perhaps a reflection of the income insecurity of interviewees.

The non-inclusion of these micro-enterprises in formal credit systems, and their lack of basic understanding of the financial landscape, highlights areas in which the agenda for financial inclusion has been less successful. This suggests that the social justice perspective of inequality (with focus on those most in need) needs to be addressed.

This research argues that access to financial services, including savings, transfers, and credit is an important but not a sufficient policy approach to support micro-enterprise growth: it must be situated within a broader supporting policy environment. It is evident that access to finance is one of many factors that inhibit the growth of micro-enterprises and informal economy businesses interviewed for this survey. However, the dangers of getting in debt were just one of many risk factors that micro-enterprise operators face. Unless financial inclusion is part of a wider package that recognises the role of micro-enterprises and informal economy businesses in contributing to jobs and growth, then their wider contribution will be continually undermined.

4.1 Micro-enterprise and Informal Economy Businesses (Demand-Side)

As Kenya's urban population increases urban micro-enterprises will play a key role in providing jobs for young job-seekers entering the job market and in contributing to private-sector led growth. Yet, despite extensive government facilitation, these crucially important micro-enterprises that will provide the basis of growth and livelihoods in the future are not fully accessing the services that are available.

While micro-credit is not sufficient to ensure livelihoods' development and economic growth, credit can fulfil important functions in micro-enterprise development: the principle should be that those who need financial services should have access to transparent and affordable forms of savings, borrowing, insurance services and pensions, where all costs are transparent, and users are aware of their consumer rights and the means by which they will be upheld.

The suggestions below outline some of the priorities which this research recommends while noting that some of them are already being addressed in different contexts.

This study identifies six demand-side barriers to financial inclusion and recommendations to address these:

1] Improved disclosure and transparency of financial products for micro-enterprises is key, and a simple one-page Key Facts summary should be provided to all potential clients. Micro-enterprises are frequently unaware of how fees and charges are calculated, and only know their monthly repayments. There should be minimum disclosure requirements for credit and savings services, using a standard rate of interest calculation, and a basic set of documentation requirements. Approaches might include adopting principles of SMART microfinance[5] or codes of conduct.

2] Credit is not always used appropriately, but sometimes is the only or primary financial service that is available to micro-enterprises. Micro-enterprises should have access to a full range of services, with a focus on savings, but also consideration of insurance and pensions, as well as credit. It is essential that consumers be equipped with the necessary financial literacy needed to understand which products are the most appropriate for a given need.

3] Financial products should be developed which accommodate fluctuating incomes, allowing 'bounce-back repayments' when income recovers. Many loan mechanisms require regular payments, but business income is often irregular and unpredictable. Furthermore, although MFIs prefer to lend for business development, in practice much micro-credit is used to 'smooth' consumption spending, eg: for family emergencies or schools when fixed repayments may be difficult.

4] Financial literacy should be tackled at all levels, particularly for existing micro-enterprises and young school leavers. Lack of knowledge about financial services is a widespread problem for those running micro-enterprises, including lack of understanding of basic financial concepts (eg: how savings are held by MFIs and how interest is calculated), with limited awareness of how charges are calculated and the overall cost of borrowing. However, financial literacy is not sufficient to curb over-indebtedness.

5] Training for micro-enterprises, including 'rights' and 'responsibilities, should be a priority and take place at point of access. Limited access to credit is only one of many problems that micro-enterprises face. Those who rely on family and friends for borrowing are amongst the most vulnerable and tend also to suffer multiple shocks including on-going harassment in their place of work and family emergencies. Consumer training for this group should be prioritised, building on good practice already demonstrated amongst larger MFIs.

6**] More understanding is needed of the use of mobile money in credit repayment.** Mobile money has the potential to revolutionise micro-credit by enabling members of solidarity groups to make regular payments without time-consuming meetings. It also allows automatic accounting of repayments. The danger may be in weakening the benefit of group solidarity and support.

4.2 Solidarity Groups in Urban Areas (Demand Side)

VSLAs share a similar social welfare philosophy with SACCOs and are important in building solidarity among the groups involved and developing a savings culture, but are limited in the size and length of loan due to the annual 'share-out'. Many are now operating successfully in urban areas, but experience of these should be shared.

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[5] SMART Microfinance encompasses core Client Protection Principles of: appropriate product design and delivery; prevention of over-indebtedness; transparency; responsible pricing; fair and respectful treatment of clients; privacy of client data; ,echanisms for complaint resolution

1] VSLAs should remain outside the remit of prudential regulation. The community savings and loans group model will clearly remain important in Kenya for some time to come, but groups should be encouraged to adopt good practice in accounting and handling cash. Bank linkages may provide a securer way to protect money, but sometimes undermine the solidary objectives of VSLAs. Best practice should also be sought for ensuring that such groups do not become a mechanism to transfer resources from the most to the least vulnerable.

2] Good practice guidance on successful adaptation of the VSLA model to urban settings should be disseminated. The VSLA model works well to build community solidarity, particularly within stable communities and amongst groups with a majority of women members. Although developed as a rural model there are now a number of successful urban groups, but knowledge on successful adaptations in urban settings is not well-disseminated (eg: for young people trying to set up businesses). More research on VSLAs in urban settings is needed.

3] There is need for simple documentation on the variants of VSLAs. Each VSLA group has minor differences in methodology, but at present there is no mechanism to share experience, apart from the collective learning of NGO providers. A platform for describing variants in the model in Kenya would be useful.

4] Successful VSLA groups should be encouraged to start satellite groups particularly amongst young people. Some groups have been extremely successful in raising funds. Rather than extend the group and therefore the risk, they could be encouraged to share expertise with new satellite groups, for example by providing board members or start-up capital.

5] VSLA groups should be discouraged from lending to non-members. Some successful VSLAs groups are now lending to non-members, but at high rates of interest. This practice should be reviewed as it represents a form of moneylending, despite potentially meeting a short-term need.

6] Mobile money has considerable potential to change the operations of VSLA groups: Groups that use mobile money payments report less time spent in meetings and better transparency in accounting. The danger is that the social solidarity element of groups is weakened. This is an interesting issue which needs further research.

7] Solidarity groups should be seen as a stepping stone to enabling members to graduate to a accessing full range of individual financial services: Despite their strengths in creating social solidarity, enabling peer learning and bringing borrowers face-to-face with lenders, solidarity groups are expensive – for providers to supervise, and for participants in terms of cost, their time and covering for default by a group member. They will remain important for community development, but should not be the only financial service to which members have access.

4.3 Microfinance Providers (Supply Side)

There is considerable innovation amongst MFIs in Kenya, but the different regulatory regimes for deposit-taking and non-deposit taking institutions creates a two-tier system for both MFIs and their customers.

1] While avoiding over-regulation, regulators in Kenya should develop a standard code of conduct for both formal deposit-taking MFIs (regulated by the Central Bank of Kenya) and semi-formal non-deposit-taking MFIs. The code should build on that already operated by AMFI, and avoid over-regulation to draw on existing good practice amongst MFIs, with two elements

i) *mandatory requirements for consumer protection and customer information:* All MFIs should adhere to core standards of consumer protection, promote transparency in pricing and provide clear information on complaints procedures and dispute resolution mechanisms.

ii) *voluntary good practice guidance on avoidance of over-selling and loan recovery practice:* Non-deposit taking MFIs rely on borrowing for their lending capital and need volume to create reasonable profits, which incentivises loan officers to encourage selling and recovery officers to prioritise repayments over broader welfare concerns. Regular training for MFI staff should be encouraged.

2] A 'small bank license' could allow simplified forms of prudential regulation and accounting to provide financial services that bridge the current provision of microcredit and the formal banking system, although there are considerable risks in this approach.

For example, India is currently experimenting with 'small bank licenses', designed to drive financial inclusion. Such institutions will be governed by the Central Bank but with smaller starting capital than full banks, and caps on lending (15% of capital funds to any one borrower and at least 50% of the loan portfolio lend in advances of up to USD 40,000).

3] Agents carry the same legal responsibility as clients, and should be required to undergo basic training on handling mis-payments, and complaints. While the agent model has been successful in extending financial access, there is some evidence that agents' recourse to problem solving is limited. This is particularly a problem with mobile money agents, for example in the case of a mis-sent payment. At present oversight of mobile money agents and super-agents focuses on the financial float they offer, but there is scope for ensuring that agents have credentials and training in good practice in agent operations, which should be part of broader training requirements.

4] A stronger dispute resolution mechanism is urgently required. Dispute resolution is not fully covered under the *Consumer Protection Act, 2012,* and many micro-enterprises may not understand their potential liabilities in case of default. Urgent attention to this problem is required.

5] SACCOs are an important savings mechanism and there is urgent need to create a new image and demonstrate on-going government commitment to SACCOs. SACCOs are widely used by hundreds of thousands of people in Kenya, supported by a sound legal and regulatory framework. However, many SACCOs remain unlicensed and their use in urban settings is not well researched.

On the other hand, India has a strong Urban *Co-operative Banking* sector. Cooperatives are regulated under the cooperative system, but also hold banking licences, allowing them to take 'demand deposits'. Although appropriate governance is essential, such a model offers contributions towards financial inclusion while staying focused on social mission.

7] The Central Bank of Kenya and mobile-money providers should ensure transparent charges for mobile-money products. Mobile money is changing the landscape of financial services provision, both as an enabler and a potential threat. Mobile money is widely used as a form of saving, but much better information is needed on the charges for deposit and withdrawal, and potential returns, including savings, credit and insurance. CKB and mobile-money providers should lead a financial education programme about the new products, perhaps facilitated by the communication network e.g. short educational message via text.

Appendices

APPENDIX 1. Expert Interviews

African Development Bank
Central Bank of Kenya
SASARA – SACCO supervision
Ministry of Industrialisation and Enterprise Development
    Department of Micro and Small Industries
Financial Sector Deepening, Kenya
AMFI (Association for Micro-finance Institutions
CARE Kenya
    Head Office
    Field Officers, Kisumu and Nairobi
World Vision
    Head Office
    Field Officers, Kisumu
Vision Fund
Kenya Women's Finance Trust
Equity Bank
Owezu DTM
Microfinance Consultant (Kenya)
Family Bank
Kisumu County:
    District Development Office
    Youth Development Office
    Social Development Office
    District Cooperative Office
    City Planning Department
Kisumu Urban Project
KENASVIT – Kenya Association of Street Vendors and Informal Traders
Jua Kali Association, Kibuye Market, Kisumu
Dandora Jua Kali, Nairobi

APPENDIX 2. Survey Data

Saving (Multiple Choice Question)

	Bank	%	SACCO	%	VICOBA	%	MFI	%	Mobile Money	%	Airtime	%	Chama	%	Home	%	Friends	%	Other	%	Missing	Total
Nairobi	49	68	2	3	0	0	2	3	29	40	0	0	15	21	7	10	0	0	3	4	6	78
Kisumu	66	56	3	3	0	0	5	4	55	46	0	0	37	31	8	7	2	2	5	4	11	130
Total	**115**	**60**	**5**	**3**	**0**	**0**	**7**	**4**	**84**	**44**	**0**	**0**	**52**	**27**	**15**	**8**	**2**	**1**	**8**	**4**	**17**	**208**

Regular Saving

	Yes	%	No	%	Missing	Total
Nairobi	43	59	30	42	5	78
Kisumu	79	65	42	35	9	130
Total	**122**	**63**	**72**	**37**	**14**	**208**

Saving Motivation (Multiple Choice Question)

	Business	%	Business Emergencies	%	School Fees	%	Family/Medical Emergencies	%	Land/House	%	Other	%	Missing	Total
Nairobi	43	60	6	8	25	35	40	56	5	7	19	26	6	78
Kisumu	74	63	10	9	59	50	53	45	4	3	36	31	12	130
Total	**117**	**62**	**16**	**8**	**84**	**44**	**93**	**49**	**9**	**5**	**55**	**29**	**18**	**208**

Reasons for not Saving (Multiple Choice Question)

	Don't need savings	%	Don't have money to save	%	Don't earn regularly enough	%	Don't trust in Banks	%	Too complicated	%	Other	%	Missing	Total
Nairobi	0	0	5	100	1	20	0	0	0	0	0	0	73	78
Kisumu	0	0	12	86	3	21	2	14	1	7	1	7	116	130
Total	**0**	**0**	**17**	**90**	**4**	**21**	**2**	**11**	**1**	**5**	**1**	**5**	**189**	**208**

Saving Problems

	Yes	%	No	%	Missing	Total
Nairobi	26	35	49	65	3	78
Kisumu	33	26	92	74	5	130
Total	**59**	**30**	**141**	**70**	**8**	**208**

Loan (last 24 months)

	Yes	%	No	%	Missing	Total
Nairobi	53	68	25	32	0	78
Kisumu	93	72	37	29	0	130
Total	**146**	**70**	**62**	**30**	**0**	**208**

Borrowing

Borrowing (Multiple Choice Question)

	Bank	%	SACCO	%	VICOBA	%	MFI	%	Mobile Money	%	Airtime	%	Chama	%	Moneyllender	%	Boss/Supplier	%	Friend	%	Other	T%	Missing	Total
Nairobi	4	8	2	4	0	0	2	4	3	6	1	2	10	19	2	1	1	2	27	51	5	9	25	78
Kisumu	13	14	2	2	0	0	4	4	5	5	1	1	33	36	4	10	2	2	29	31	12	13	37	130
Total	**17**	**12**	**4**	**3**	**0**	**0**	**6**	**4**	**8**	**6**	**2**	**1**	**43**	**30**	**6**	**4**	**3**	**2**	**56**	**38**	**17**	**12**	**62**	**208**

Borrowing Motivation (Multiple Choice Question)

	Business	%	Business Emergencies	%	School Fees	%	Family/Medical Emergencies	%	Land/House	%	Other	%	Missing	Total
Nairobi	26	50	2	4	8	15	15	29	2	4	14	27	26	78
Kisumu	46	51	3	3	19	21	25	28	2	2	19	21	39	130
Total	**72**	**50**	**5**	**4**	**27**	**19**	**40**	**28**	**4**	**3**	**33**	**23**	**65**	**208**

Reasons for not Borrowing (Multiple Choice Question)

	Don't need a loan	%	Dont earn regularly enough	%	Worried about not paying back debt	%	Don't trust banks or MFIs	%	Too Expensive	%	Other	%	Missing	Total
Nairobi	16	50	6	19	15	47	1	3	1	3	6	19	46	78
Kisumu	14	30	7	15	12	26	4	9	6	13	14	30	83	130
Total	**30**	**38**	**13**	**17**	**27**	**34**	**5**	**6**	**7**	**9**	**20**	**25**	**129**	**208**

Mobile Use (Multiple Choice Question)

	Business, customers, suppliers, trans, agents	%	Send M-Payments	%	Receive M-Payments	%	Missing	Total
Nairobi	71	100	48	68	57	80	7	78
Kisumu	102	90	75	66	86	75	16	130
Total	**173**	**94**	**123**	**67**	**143**	**77**	**23**	**208**

APPENDIX 3. References

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