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One Step Beyond?:

Tackling the 'frontier' of microfinance provision in Kenya

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"Pushing the Frontier to Provide Financial Services to the Excluded"

One step beyond? Tackling the 'frontier' of microfinance provision in Kenya

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Abstract:

As the microfinance industry matures, the challenge of extending financial services to more rural and remote areas is of increasing concern, especially in Africa. This paper reviews six organisations in Kenya in order to establish how far they are reaching both in terms of geography and poverty. It postulates the existence of a 'frontier' of provision for centralised models and discusses strategies for extending outreach. In particular we suggest that de-centralised user-owned models have potential to provide services to poorer people and in remoter areas if improvements in their operation can be brought about at a price poor people can afford. In East Africa donor policy has neglected working with these models and there is now an urgent need to develop working relationships with the extensive range of NGO initiated microfinance groups that already exist.

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One Step Beyond? Tackling the 'frontier' of microfinance provision in Kenya

1. Introduction

Providing financial services in rural areas of Kenya on a sustainable basis remains a challenging goal. The Kenyan rural environment is characterized by poor communications infrastructure, relatively low population density, low levels of literacy, low profitability and/or high risk of many rural economic activities, and relatively undiversified economies. As a result they have so far proved unattractive to NGO microfinance institutions (MFIs), let alone commercial financial institutions.

Since the early 1990s support to the microfinance sector has focused on the development of sustainable service provision. In Kenya this emphasis resulted in donor investment being concentrated on a small number of microfinance organisations in an attempt to achieve scale and sustainability. The result of this has been a focus on small-scale businesses and especially traders, who can manage the relatively inflexible loan products on offer, and consequently also a concentration of their activities in urban environments and market centres. While they are now beginning to develop new products the group-guaranteed, working-capital loan is still the core of their business. With outreach of between 150,000-200,000[2] these MFIs are however not yet reaching the bulk of poor Kenyans. The overall size of the adult population is some 12m, of whom approximately 20% use the formal sector banks and co-operatives. Of the remaining 9.6m, some 75% live in rural areas i.e. 7.2m. Since the majority of people are in some way engaged in the cash economy, however marginally, safe places to save and the ability to take loans – however small and for however short a period - are essential to reducing vulnerability aswell as offering the potential for investment and accumulation.

Historically the marketing co-operatives were the mainstay of rural credit provision for farmers of cash crops such as coffee, dairy and pyrethrum. However, this has mainly been in areas with the high agricultural potential associated with the production of these crops. With the gradual liberalisation of marketing systems and changes in co-operative legislation during the 1990s this sector has faced both opportunities and significant challenges. Co-operative liberalisation has resulted in new types of SACCO emerging, some based on 'check off' systems such as those in the tea industry and those based on transport associations (*matatus*, taxis etc). At the same time, restructuring of marketing systems in the dairy and coffee sectors (and the international price fluctuations in the latter) also resulted in the credit components of these systems virtually ceasing to function. Moreover, to the extent that the banking system and state-owned parastatals, such as the Agricultural Finance Corporation, did provide services in smaller towns and to the agriculture sector, re-structuring in these sectors as a result of liberalisation has in many cases also resulted in the closure of rural branches and reduced rural provision. However, the extensive role of the informal sector in rural areas, especially Rotating Savings and Credit Associations (ROSCAs) and Accumulating Savings and Credit Associations (ASCAs) is well documented (Alila 1992; Kimuyu 1999).

With this background, this study set out to review a number of organisations and models of provision that were known to be operating in more rural or remote areas of Kenya in order to better understand the criteria for improving provision. The next section summarises the results of this review. The following section then attempts to identify a 'frontier' of sustainable provision. This frontier is two dimensional: first is a 'geographical' frontier for which population density is

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[2] Estimates from the Kenyan Association of Microfinance Institutions.

a proxy. Inevitably the physical transactions costs of provision rise with remoteness and low population densities as physical and communications infrastructure are often also poor. Second, is the poverty frontier for which we use poverty incidence as a proxy. Higher numbers of poor people means that sustainable services must be able to accommodate smaller deposit and loan sizes. Of course, these two dimensions are often also interlinked. Remoteness is often also associated with poor agro-ecological conditions, and hence high-risk lending environments for agriculture along with consequently higher poverty incidence. Finally we discuss strategies for tackling the frontiers identified.

2. Organisations reaching further - a review

The review identified six organisations that were thought to be reaching beyond the core market of the main MFIs such as KREP, KWFT, Faulu, SMEP and Pride. The review sought to establish the following:

- Organisational structure and the model of provision including the characteristics of services provided
- Characteristics of the rural/remote areas that the model was serving in terms of population density, poverty incidence, local economic and agro-ecological conditions
- Socio-economic status of clients using the services based on PRA exercises
- Financial sustainability of outreach into these areas.

We review the six models starting with the most formal and centralised. Table 1 summarises the key characteristics of the models involved and their outreach.

2.1 Equity Building Society mobile units

Equity Building Society has flourished in the last few years as it has begun to identify itself as a microfinance provider and design its products - especially savings accounts – to appeal to ordinary Kenyans who have been excluded by the cost of access to the mainstream banking sector (Coetzee, Kabbucho et al. 2002; Johnson 2004). With subsidy funding from DFID it has experimented with a mobile banking service. The mobile banks are adapted four-wheel drive vehicles that are based at a branch and visit market centres on designated days. In May 2003, Equity had slightly over 10,000 clients attached to its six mobile units serving 21 locations in 4 Districts of Central Province. This constituted approximately 10% of each branch's customers, with mobile depositors being 6% of total depositors and 3% of total deposits – hence suggesting that their deposit balances are approximately half the mean of all customers. To date Equity has only provided individual savings accounts through the mobile branches with clients going to the branches for loans, but is soon planning to offer loans below Kshs 50,000 (US$ 666) through the mobile units.

Coverage of these parts of Central Province involves population densities of over 400 persons per square kilometre, in only one division is it below this. The incidence of poverty in these areas is between 20 and 40% according to data based on the Welfare Monitoring survey data of 1994 ie. it is one of the richest parts of the country. (Central Bureau of Statistics 2003) The farthest location that is being served by a mobile unit (once per week) is 65 Kms from Thika town. In other districts the furthest locations that are being served are between 17 and 25 kms from the District Headquarters and the furthest location is 17 kms off the paved road.

Participatory exercises with clients indicated that it is mainly men in the middle income and well-off categories who make use of Equity's services. The middle group having tea, coffee or diary farms, having small businesses or in formal employment, while the well-off tended to have quite

large tea or coffee farms. Most of these people thought that Equity's services did not suit the poor although Equity has been attempting to move down market and its outstanding loan size in mobile units was (Ksh. 9,570 or US$130).

Analysis of the costs of the mobile units suggests that overall they are making a small positive contribution to profits with an operational self-sufficiency ratio of 102%. Where a critical mass of accounts had not been achieved they were likely to make a net loss. The data suggests that for a branch to run mobile operations profitably, it should have at least 1,100 depositors; a savings portfolio of not less than Kshs 5 million (US$67,000); and serve at least four centres in order to be profitable. Out of seven units, four branches were making a net loss. (Coetzee, Kabbucho et al. 2003) Two of these branches were planning to add one or two market centres where the mobile units stop in order to increase the number of clients. Two branches did not intend to increase the number of centres but rather to intensify the marketing efforts in the existing centers. Further recruitment of clients and rationalisation of operating modalities will no doubt improve these results, but at present this experience shows that extending outreach of Equity's high-quality savings services into areas which have high population densities and relatively low poverty incidence is challenging in terms of depth of outreach and financial sustainability.

2.2 Nyeri Farmers SACCO

Nyeri Farmers Savings and Credit Cooperative in Central Province started as a Banking Section of Nyeri District Co-operative Union – primarily a coffee marketing cooperative - through which farmers in the district received their payments. During the late 1980s Union Banking Sections were often mismanaged and this resulted in government policy aimed at separating Union Banking Sections being separated off and transformed into autonomous SACCOs. As of May 2003, Nyeri Farmers SACCO had 111,000 members. Due to poor performance in the coffee sector, Nyeri farmers is attempting to expand its common bond to include tea and wheat farmers in the district. It serves the remoter rural clientele with mobile vans although these only offer individual savings accounts. The furthest location that the SACCO mobile vans serve is Gatarakwa, where the population density is 77 persons per square kilometre. It is 55 kms from Nyeri District HQ and 20 kms off the paved road. Nyeri is one of the richest districts in Kenya with overall poverty incidence of 20-40%.

In the past Nyeri Farmers SACCO has been a key provider of financial services to all coffee farmers. It used to provide advances against coffee payments, and loans for both short term needs such as school fees and emergencies aswell as longer-term development (three years). Focus groups in the remoter areas being served indicated that the SACCO serves mainly men in the middle-income group in the area and some of the better off. The middle-income groups use the SACCO a lot because they sell their milk through the dairy cooperative society and proceeds are paid through the SACCO. Members were mainly men with women being more likely to have non-members accounts.

Overall the SACCO is just self sufficient at 102% and has a profit margin of 2%. The data to assess the financial performance of the mobile units themselves was not available. This marginal financial situation reflects high levels of bad debts due to the restructuring of the coffee marketing sector in the 1990s[3] as well as poor coffee prices and consequent low levels of new lending in the past few years.

2.3 WEDCO

3 Liberalisation of cooperative legislation and some aspects of coffee processing led to the splitting up of large district wide co-operatives as well as the separation of the banking section activity. This also meant that it was easier for farmers to avoid repayment of outstanding loans.

The Women's Enterprise Development Company Ltd (WEDCO) was initially a project of CARE International that provided credit to women in rural areas in micro and small business activities in Nyanza and Western Provinces. WEDCO offers working capital loans for up to 12 months as well as emergency and school fees loans, through a standard group lending methodology. The main challenge facing WEDCO is its cost structure since its 12,000 clients are spread over a large geographical area.

In most of the areas in which WEDCO is operating population density is high (over 300 per square kilometre) but the incidence of poverty in western Kenya is much higher than in Central Province and roughly equally split between areas where 60-80% the of population are living below poverty line and 40-60% of the population are below the poverty line. In terms of distance from District headquarters, the farthest groups in Busia are some 47 kms away. The population densities in the farthest locations in some cases do drop below 300 per square km. Initially, WEDCO staff travelled to groups in the villages by motorbike. But this has proved costly and the approach is now to provide services to the clients in market centres on market days. This will decrease the costs of delivery for WEDCO but increase them for clients who would not normally travel to the market centres and hence is likely to reduce access.

The majority of WEDCO's clients are women not more than 10% are men. Average loan outstanding in 2003 was Kshs15,000 which is relatively low for an MFI in the Kenyan MFI context.[4] WEDCO is marginally short of achieving operational self-sufficiency. Portfolio at risk is 9%, which is relatively high for an MFI using this methodology.

2.4 SAGA

SAGA Thrift and Enterprise Promotion Ltd is a cocktail of three organisational forms: accumulating savings and credit associations (ASCAs), SAGA Thrift and Enterprise Promotion Ltd and SAGA SACCO. Independent ASCAs are affiliated to SAGA Thrift and Enterprise Promotion and receive capacity building support designed to enhance their ability to deliver services to their members. Once affiliated with SAGA Thrift the ASCAs qualify to join SAGA SACCO Ltd in Bondo or Kisumu Districts, which gives legality to their savings and credit activities. As of May 2003, SAGA had almost 4,400 members. SACCOs provide ASCA members with voluntary savings accounts and loans up to 12 months. The loans can be up to three times members' shares.

Roughly half of the area that SAGA is covering has relatively low population densities (201-300 persons per square kilometre) and relatively low rainfall that is best suited for cattle and sheep grazing and for cotton growing. The proportion of the population below the poverty line in most of this region is 60-80%. The farthest groups that SAGA is serving are 35 kms from the District Headquarters and 20 kms from paved roads.

SAGA clients indicated that the principal users of SAGA services are the middle-income category who were engaged in small-scale farming of vegetables, groundnuts, cotton and so on, some are in small businesses such as kiosks, retail shops or maize mills, and a few were teachers. SAGA data indicate that 47% of SAGA clients are men, so that women are in a slight majority.

The district level SACCOs first seek to cover their own costs before contributing to the cost of the support operations that SAGA Thrift provides to both the ASCAs and the SACCOs. As a

[4] Johnson 2003 indicates that average outstanding loan size for MFIs in Karatina in 2003 was Kshs50,500 (US$675).

result the operational self-sufficiency of the SAGA Thrift component is very low at 16%. It is important to acknowledge that the model is still in the early stages of development, having started in 2000, and that scale will be required to enable the support services to become sustainable. Low profitability to date also appears to be due to a small loan portfolio since only some 10% of the members have outstanding loans and, portfolio at risk is also relatively high at 15%. This may well reflect the fact the programme was initially marketed as a savings programme which attracted many clients not interested in borrowing.

2.5 WEDI

The Women's Enterprise Development Institute (WEDI) is the largest organisation operating with the managed ASCA model (Johnson, Mule et al. 2002) having some 20,000 clients. The model is operated by at least nine organisations[5] in Central Kenya and has outreach of approximately 36,000. Management services are provided to women's groups for a fee. Women save in groups of approximately 30 and take loans from the fund – an accumulating savings and credit association (ASCA). ASCAs provide both savings and loan products. Members must make a minimum monthly saving of Kshs100 and can withdraw them at any time with notice – and for small amounts without notice. Members also receive dividends at the end of the year. The ASCA manager charges a fee based on the value of the group's total fund. The managers travel to the groups once a month and help them run their operations. They also assist in following defaulters. The costs of this model are kept low because the managers use public transport, rent modest offices and employ diploma level staff.

WEDI operates in eight districts, mostly in Central Province, but also in drier areas of neighbouring districts. We have estimated that approximately 45% of WEDI groups operate in areas where the population density is below 200 persons per square kilometre. Further, 35 groups (5% of total) are in areas where the average population density is below 100 per square km. The majority of WEDI groups in Central Province are in areas where the proportion of people below the poverty line is between 20% and 40% of the population but it is also in operating in neighbouring districts where poverty incidence is higher (40% to 60%). In the remoter areas they are serving the groups are 70kms and 135kms from the District Headquarters and 26 kms off the paved road. WEDI prefers to serve the group near their home. When staff realise that some women are coming from far they are advised to form or join other groups nearer their homes.

In the areas visited PRA exercises with WEDI clients indicated that it was mainly serving women in the poorest wealth strata but the groups also included some in the middle-income category. The main activities of the WEDI clients in the groups visited were small scale - usually subsistence - farming of maize, beans, and bananas. With limited scale production of some cash crops such as coffee or french beans. Several members were operating kiosks or small retail shops and buying and selling cereals and fruits. Others were engaged in casual labour mainly in the bigger farms. This client profile underlines the benefits of the model in allowing for very small amounts of savings (as little as Kshs 100 (US$1.33) per month) and concomitantly small loan sizes.

WEDI itself –as a provider of management services - has an operational self-sufficiency ratio of 113% and a profit margin of 6%. This is a healthy position since the groups generate enough

[5] Three organisations based in Karatina have been operating the model: PFP, WEDI and SEDI. Between 2000 and 2003 around 4 of the staff of these organisations broke away and set up their own organisations. In addition a women's group in Nyeri also copied the model: Songa Mbele. Further, an organisation called KEPP based in Thika operates the model.

income from the loans to maintain the model and meet the operational needs of the managers in WEDI. Operational expenses are approximately 5% of the total value of the loan funds they manage. This is achieved by employing relatively low cost staff and by making use of public transport to reach the groups which is far cheaper than operating private vehicles. However, the financial performance of the groups themselves is much harder to assess, as data is not kept in a centralised form. Previous studies (Johnson, Mule et al. 2002) have highlighted some very good performance at the group level but this is balanced by concerns over default and mechanisms for follow up and an overall picture is hard to establish. When default becomes significant in these groups members are at considerable risk of losing their savings.

It is important to point out that there is a cross subsidy between the groups. The management fee is set at 1% of the value of the group's loan fund. As a result older and well-established groups pay more than new groups or those whose loan fund is small. Where they have urban groups of middle-income women with large funds, these therefore subsidize the rural groups. In the opinion of the Programme Coordinator it would therefore be very difficult to operate the model only in the more remote and rural areas.

2.6 Financial Service Associations

Financial Service Associations (FSAs) are a model that KREP Development Agency (KDA) has used to reach further into rural areas. Members buy shares and the capital raised is used for on-lending. Starting with at least 300 members the FSA elects a board, employs a locally recruited manager and cashier and commences lending. Interest rates of initially 10% per month help the fund to grow and costs to be covered. Salaries tend only to rise as the FSA is capable of paying them. Since 1997 67 FSAs have been established in 17 Districts with a total of almost 39,000 shareholders. A number have been established in very remote rural areas, such as Marsabit and Turkana, where no other formal financial providers exist. However, there are also several FSAs in high potential and high population density areas, especially in Western Kenya. FSAs usually start with short term loans of 3-6 months and gradually extend the length up to one year, with the loan amount being up to four times the member's shares. Many have also introduced a range of other products such as school fees loans, money transfer services and voluntary savings accounts and fixed deposits, which are not on-lent.

Over half of all the FSAs (37) are located in areas where the population density is less than 100 persons per square kilometre, and some FSAs are operating in areas were population densities are extremely low. In all, approximately 30% of of FSA clients live in areas where the population density is below 100 per sq. km. and 51% in areas of below 300 per sq. km. Poverty incidence in districts where the population density is below 100 per sq. km are around 60%, and 56% in areas of below 300 per sq. km. The distances from the furthest FSA to the District Headquarters are 250 kms in Marsabit and 120 kms in Garissa districts in Northern Kenya. However, KDA has increasingly found it difficult to supervise and support the FSAs in these very remote areas and in attempting to find a long-term financially sustainable support and supervision structure it is unclear whether they can be maintained.

Discussions with clients of an FSA in the Coastal region (Mkongani) suggested that approximately 9% of clients were in the richest category locally, while 38% were in the middle category and 53% in the poorest group suggesting that the FSAs are able to provide products that some of the least well-off in these areas are able to use.

Financial data for 38 FSAs indicates that 22 were in surplus and 16 in deficit. Perhaps unsurprisingly nine of those in deficit were in areas of very low population density, however 14 in the same areas were in surplus suggesting that this is not necessarily a primary determinant of financial sustainability. The overall operational sustainability for 63 FSAs stands at 201% while the profit margin stands at 9%. However, KDA's own analysis indicates that the challenges facing FSAs are great. Dondo (Dondo 2003) reports that 44% of their total loan portfolio is in default. Since lending is usually restricted to the share capital this does not usually put voluntary savings at risk. However, the situation is serious and arises from the lack of ability of FSA managers and governors to ensure repayment. KDA's experience is that management and governance has been weak. Fraud has been a particular problem – usually perpetrated by managers – and may be a response to low salaries. In addition local communities often say that they understand why the person has done it and may not take effective action to recover the funds. AGMs usually do not provide sufficient oversight.

While KDA's original vision was to establish FSAs and then withdraw, it has become increasingly clear that this has only been possible in a few cases and that it is necessary to attempt to find models of ongoing support and supervision which will in themselves be financially sustainable. To simply spin-off KDA's current support infrastructure would not be financially viable either. A number of approaches are now being tried. First is a management contract bringing in a professional manager who is supported by KDA but on the basis of a declining subsidy over time. This tests the idea that improved FSA level performance brought about by the professional manager will in itself generate sufficiently high returns that the FSA will itself be able to sustain this in the longer run. A second strategy is to try to establish an apex organisation that would franchise FSAs, and a third option is for outside entities to invest in FSAs in return for a significant voice in its operations.

3. Discussion

Figure 1 maps the coverage of these six organisations in terms of population density and poverty incidence. It proposes two frontiers: the first is a geographical frontier operating at 300 persons per sq km; and the second is a poverty frontier at approximately 50% of the population below the national poverty line.

This diagram makes it clear that Equity is operating in the bottom right hand quadrant. Equity represents a formal sector provider regulated by the Central Bank, hence offering high quality savings services in terms of their security, along with a range of loan and money transfer products. The provision of such services comes at a cost – both to the organisation and to clients - who may find the service inaccessible in terms of price. While mobile units are extending their provision into more rural areas, the viability of these units then depends on the socio-economic profile of the clients and the ability of these to generate sufficient demand to make the service viable. This evidence starts to make the challenges for extending provision by the formal sector much more apparent. Even if it is possible for Equity to further increase the efficiency with which these services are provided and find new ways to generate income, on current evidence it would seem that significant cost savings would be necessary to enable provision on a significant scale to less dense areas with higher poverty incidence.

Nyeri Farmers SACCO similarly operates in the bottom right hand quadrant with some outreach across the geographical frontier using their mobile units. Nyeri Farmers is still seeking to effectively re-establish its operations after transforming into a SACCO and in a relatively competitive environment for financial services in this part of Kenya (Johnson 2003). Operating in the semi-formal sector it is a less secure option than Equity in terms of savings facilities, and it

is in part its user-owned status that has enabled it to keep costs relatively low and survive this period. The viability of its mobile units into remoter areas is not yet established.

The core microfinance model of group-based lending provision used by WEDCO has reached areas of high poverty incidence and high population density. It however appears to have reached limits in terms of cost-effective outreach and in order to address its operational sustainability targets has had to shift transactions costs to clients by requiring them to meet in market centres. It would be helpful to be able to cross-check this finding with the experience of other major MFIs which have been extending their operations into some more rural areas (eg Kenya Women Finance Trust) but the data is not yet available.

Figure 1: Geographical and Poverty Dimensions of the 'Frontiers' of Provision

Geographical Frontier

Poverty incidence \ Population density	1-100	101-200	201-300	301-400	400+
81-100%					
61-80%	FSAs	FSAs	WEDCO SAGA	WEDCO SAGA	WEDCO SAGA
41-60%	FSAs	*WEDI* FSAs	FSAs	*WEDCO* FSAs	*WEDCO* FSAs
21-40%	WEDI	WEDI	*WEDI* Nyeri SACCO	*WEDI* *Equity* Nyeri SACCO FSAs	*WEDI* *Equity* Nyeri SACCO FSAs
0-20%					

Poverty Frontier

Organisations that are financially sustainable are written in *italics.*

The organisations that are reaching furthest out geographically are the FSAs and WEDI. Both of these models have relatively flexible savings services and can offer very small loans that enable greater depth of outreach amongst the clientele in remoter areas. Both models have strong elements of user ownership with varying models of support. Financial sustainability can be built into the operation of entirely user-owned systems from the outset. However, the key concerns in these models arise from the weaknesses related to management and governance. The default and fraud problems in FSAs are significant, and despite the management support, group performance in the managed ASCA model can also be problematic. There is then a need for ongoing support and supervision services which can assist in addressing these problems and which are in themselves financially sustainable. Only the managed ASCA model is currently financially

sustainable at the level of the support services provided but this also relies on cross-subsidy from operations in high population density, less poor areas, an option which is not so readily available to SAGA. The managed ASCA model is not however without some incentive problems (such as the incentives for the management agency to undertake default follow up) and the key issue is whether their management services can be cost-effectively upgraded. KDA's services to the FSAs are entirely subsidised.

We have also proposed a poverty frontier in Figure 1. WEDCO is working in both high density and high poverty incidence areas. Its outreach into the highest poverty incidence areas is being cross subsidised by groups in major towns where the poverty incidence is lower (Kisumu, Eldoret, Kitale and Kakamega), but in order to reach operational sustainability, it has been decreasing its operations in the lower population density areas and concentrating them in the high population density areas.

In general, the impact of higher poverty incidence[6] (for a given population density) is that there is a smaller absolute number of people above or around the poverty line who may be relatively easily reached by MFI services. Or who, by being able to sustain higher levels of indebtedness are able to effectively cross-subsidise an organisation's outreach to poorer clients.
This problem is most serious for MFIs with a relatively rigid lending methodologies (ie.group guaranteed working capital loans) for whom lending under Kshs5000 (USD75) is hardly cost-effective. In this context, organisations that can offer a wider range of loan and deposit facilities have better potential to capture a mixture of business which is more likely to be financially viable and the lower end limits of service cost are crucial. That is, the basic cost of operating a savings account. The user-owned models such as WEDI, SAGA and the FSAs are in the main able to do this as both savings and loan amounts can start very small – (eg <USD10).

This discussion is a tentative one as we lack data on a sufficient range of models, and on the depth of their outreach. In particular, we lack a comparable model of more dynamic formal sector provision such as Equity in the higher poverty incidence areas - Equity's branches are mainly in Central Province, which is both rich and densely populated; or data on MFIs that have been moving systematically into Western Province.

Never the less, these findings help to identify a gap between the outreach of more formally regulated or centralised models of provision and more de-centralised models of user-owned provision. Centralised models such as banks and building societies that are owned by shareholders have higher standards of governance and management[7], indeed to be regulated by the Central Bank particularly with respect to deposit mobilisation. The outreach of these models is therefore constrained by the cost of offering a standardised service with high degrees of accountability and transparency due to highly qualified management and high standards of supervision.

Decentralised, user-owned models do have the potential to reach further and this is because of their lower costs of provision. They are able to mobilise local savings on which the return is uncertain (though may be high), keep profits in the fund, mobilise low cost or voluntary labour, and keep overheads low with, for example, low cost offices[8] oversight is provided by local

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[6] We have not accounted for poverty depth or severity here.
[7] External supervision is necessary because of the shareholding structure and the fact that shareholders in these organisational forms cannot be assumed to be operating in the interests of depositors.
[8] User ownership overcomes an information problem associated with centralised provision in which banks usually have to signal their quality and commitment by investing in expensive offices (see Johnson, S. (2001). From

people also at low cost. As a result services tend to be lower quality in terms of transparency and accountability because of the weaker levels of management and governance that these systems employ (Johnson, Malkamaki et al. 2002).

Currently MFIs occupy a middle ground between these models[9] in terms of the degree of regulation and supervision and consequent costs involved. A question is how transformation under new forms of registration and supervision in many countries will affect these cost structures and hence the potential for extending outreach. Many transforming MFIs are owned by shareholders who may not require a commercial return on their investment but the costs of regulatory compliance may never the less significantly affect their cost structures and as a consequence the cost of services and so ultimately outreach. The challenge for them is to produce economies of scale once formal registration is in place that enables costs of service to fall sufficiently to significantly widen access.

The above findings therefore suggest that the challenge of promoting better quality service provision in as yet underserved areas and to underserved populations are essentially twofold. The primary concern for Kenya is not necessarily the most remote areas but the extension of provision to areas with relatively high population density but high poverty incidence – these are the areas where large numbers of poor Kenyans live.

First, it is necessary for centralised providers to innovate to find ways of lowering their costs of provision and provide affordable services to clients in remoter and poorer areas where deposit and loan sizes are necessarily smaller. New developments in information technology offer significant potential to achieve this.

Second, existing models of decentralised provision involving user-ownership are currently reaching further but face significant challenges in terms of the standards of their management and governance, and the need to find financially sustainable mechanisms for the provision of supervision and support services.

The trade-off then is between centralised models with higher cost structures and higher quality services – especially in terms of savings security – and user-owned systems with lower cost structures and lower security. However, as Wright and Mutesasira (2001) explain, the issue for poor people is one of relative rather than absolute risk. The fact that it will take time to lower the cost structures of regulated providers sufficiently to allow extensive access for poor people means that in the meantime poor people will necessarily be faced with choices among lower quality providers – as is the case with a range of services such as health and education also. However it may also be possible to improve the quality of these services and reduce the risk to the savings of the poor in these providers by investing in them. If improvements in quality can be made at a price poor people can afford, such improvements also have the potential to be sustainable.

The extensive use of user-owned financial mechanisms is well known across Africa (Ardener and Burman 1995; Bouman 1995) as in Kenya (Alila 1992; Kimuyu 1999; Johnson 2004). Finding ways to improve the operations of groups is one potential strategy for improving the quality of

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Fragmentation to Embeddedness: towards an institutional analysis of financial markets. FDRP Working Paper no 29, IDPM, University of Manchetster..

[9] Indeed, Nyeri SACCO does too. While it is user owned as a cooperative model, it is relatively large and centralised in its governance and management. The distinctions are not therefore hard and fast between these two categories. Equally it would not be correct at present to categorise Nyeri SACCO as formally regulated since the regulatory regime is much weaker than that for banks.

financial services available to poor people in remoter areas. Indeed, working with savings-led group-based systems is increasingly being recognised as a key strategy through which the outreach of financial services can be extended at relatively low cost (Ashe 2002) and a range of models have been experimented with. In developing these models, there are key issues about the long-term sustainability of the groups. The ROSCA is the most basic and simple mechanism that exists in group-based finance and its simplicity is able to enhance its transparency. The approaches that have been used range from a very simple ASCA, to more complex ASCAs that require book-keeping, to also ensuring that there are some support services available for a fee:

- CARE's MMD programme in Niger sets up ASCAs. Women form groups and save for a common purpose, the savings amount is fixed, and there are set weeks when loans can be taken from the fund. Cash is kept in a locked box for which three different people hold a key. The system is sufficiently simple that written records are not necessary. After a number of months – usually 10 – the fund is distributed for the purpose for which all had saved. The regular breaking and distribution of the fund therefore provides an accountability system. The group may be immediately re-formed. The extent of use (and re-use) of the system has been huge - some 162,000 women. (Grant and Allen 2002).
- The Women's Empowerment Program in Nepal sponsored by PACT has introduced ASCAs to some 130,000 women. It trains the groups in book-keeping through local NGO partners. The program has now finished and ongoing sustainability of the groups is not yet clear. (Ashe and Parrott 2002)
- ASHRAI in Bangladesh has attempted a similar approach but in this case - due to very low literacy rates amongst the target groups - the groups often pay someone to keep their books. (Matthews and Ali 2002)
- Community Savings Funds in Mexico are provided with toolkits and videos on how to run their systems. The project has also certified promoters as a means through which ongoing support can be provided to the groups – who would hire them. (Zapata 2002)

Ashe points out that the costs of training and monitoring in these models varies from USD5 to USD30 per member (externally funded). Although the improvements in the quality of services may be small, they are also therefore being bought at much lower cost to funders and are more likely to be affordable by members themselves and hence sustainable in the long run. Little is known about the losses involved (i.e. to members in terms of lost savings through mismanagement or default) but even if these are reduced such that groups function effectively for longer periods of time, or clients are willing to pay for ongoing support services that reduce these losses on an ongoing basis, then the benefits of the investment can still outweigh the costs and offer improved choice to users. Risks can never be entirely removed (even in the formal sector[10]) but investments in reducing risks can still be worthwhile.

At the level of group operation, low cost interventions could therefore include the provision of tools to groups such as guidance on group formation and monitoring, or simple book-keeping systems that can be easily adopted and replicated by groups. Models of ongoing support to groups are a still relatively uncharted area in order to answer the question of what level of support and supervision can be provided at a price that poor people can afford. The managed ASCA model is somewhat unique in this regard in being entirely sustainable and its potential in a wider range of contexts is therefore worthy of experimentation. It provides a level of oversight, and support to enforcement although it is not without dilemmas (see above). In addition it may

[10] According to the survey reported by Wright and Mutesasira (2001), savers in Ugandan formal sector institutions lost 3% of the average amount saved over the previous 12 months.

be possible to upgrade the managed ASCA approach although extreme care must be taken in doing this without damaging its current sustainability.

Moreover, there is an opportunity to be grasped. One of the main interventions that NGOs operating in these poorer and more remote districts of Kenya adopt is the establishment of savings and credit groups – usually ASCAs – or what the Indian literature usually refers to as Self-Help Groups (SHGs). Some 300,000 people are estimated to be involved in such groups in the 50 NGOs that last year formed the Micro-net in Kenya, and there are undoubtedly many more such NGOs not reported in these figures. At present many of these NGOs do not have access to adequate materials that can better inform their approach to their savings and credit operations. Moreover, a key concern expressed by these NGOs is the long-term sustainability of these groups after the NGO withdraws. The need to develop viable systems to sustain these operations into the future is vital.

Crossing the 'frontier' identified in this research is now a key challenge for microfinance in Kenya. Inevitably, no single approach is likely to be sufficient and a plurality of approaches should be adopted – including encouragement to more centralised systems to lower costs and reach further out. The argument of this paper is that decentralised and user-owned models such as ROSCAs, ASCAs, FSAs and small SACCOs are a necessary component of a strategy to extend outreach and improve the quality of financial services available to rural people.

Table 1: Summary data on the institutions

	Equity Building Society Mobile units	Nyeri Farmers SACCO	WEDCO	SAGA	WEDI	FSAs
Model	Fixed branches and mobile branches	Rural SACCO recently transformed. Also mobile branches	Group-based lending model	SACCO apex body for ASCA groups.	Managed ASCA	Owned by local shareholders; employ staff and operate from an office.
Products	Individual savings and loan accounts. Loans require no collateral up to Kshs50,000. Range of voluntary savings accounts. Farm input loan available.	Development loans up to 3 years, 3 times shares; also shorter term loan products. Range of front office flexible savings accounts.	Working capital loans (Kshs 3000-500,000) for 12 months; emergency loans & school fees loans	Loans up to 12 months, compulsory saving, 3 times shares 2,5% per month	Monthly savings min Kshs100; short term loans 1-3 months (no min) at 10% per month; longer term loans at 17% p.a. when loan fund big enough.	Individual savings accounts. Loans up to one year 4 times shares, interest decided by the boards: from 2% to 15% per month. Agricultural loans in some FSAs.
Financial sustainability % (operational)	102 (mobile operations only)	102	98	16	113 (service provider)	118 (Mkongani FSA, Coast Province)
Organisational sustainability	Sustainable	Sustainable	Sustainable	Currently has external support	WEDI as service provider is sustainable	Many governance problems - require ongoing support.
Outreach Main area of operation	Central	Central	Western	Western	Central Province	Natrionwide
Total outreach (As of May 31st 2003)	Total: 180,000 Mobile: 10,000	111,000; 40,000-50,000 active	12,000	4,400	20,000	39,000
% of clientele by pop. density: 1-100 /sq km 101-200/sq km 201-300/sq km >301 /sq km	 0 0 0 100	 0 0 10 90	 0 0 20 80	 0 0 50 50	 20 25 8 47	 34 9 8 49
Percentage of population living below poverty line (Kenya Welfare Monitoring Survey III, 1997)	Central province 32%	Central Province 32%	Homa Bay 77% (highest in country); > 65% poverty rate Nyamira, Kisumu and Busia	Siaya District in Nyanza province: 58%	Mostly in Central province 32% Remotest – Laikipia District – 34%	Several FSAs in the poorest districts of the country: Busia (66%), Kilifi (66.3%), Taita Taveta (65.8%), Makueni (73.5%)
Socio-economic outreach [11]	Middle-income and relatively wealthy	Middle-income and relatively wealthy	Middle-income and relatively wealthy	Middle-income and some poor	Mostly poor, also middle-income	Relatively wealthy, middle, some poor
Average o/s loan size ($1=78Ksh)	9570 (mobile clients)	43,000	15,100	7,850	7,850	4,320 (Mkongani)

[11] Based on wealth ranking estimates of the organisation - so is relative in the local situation, so that poor clients in Central are not likely to be as poor in absolute terms as poor clients in Western.

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