FSD KENYA:

TEN YEARS OF A MARKET SYSTEMS APPROACH IN THE KENYAN FINANCE MARKET

AUGUST 2016

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Financial Sector Deepening

FSD Kenya: Ten Years of a Market Systems Approach in the Kenyan Finance Market

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The Kenya Financial Sector Deepening (FSD) programme was established in early 2005 to support the development of financial markets in Kenya as a means to stimulate wealth creation and reduce poverty. Working in partnership with the financial services industry, the programme's goal is to expand access to financial services among lower income households and smaller enterprises. It operates as an independent trust under the supervision of professional trustees, KPMG Kenya, with policy guidance from a Programme Investment Committee (PIC). Current funders include the UK's Department for International Development (DFID), the Swedish International Development Agency (SIDA), and the Bill and Melinda Gates Foundation.

Government of Kenya

UKaid from the British people

EMBASSY OF SWEDEN
Nairobi

BILL & MELINDA GATES foundation

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Abbreviations

CAK	Competition Authority of Kenya
CBA	Commercial Bank of Africa
CBK	Central Bank of Kenya
CGAP	Consultative Committee to Aid the Poorest
CIS	Credit information sharing
CRB	Credit reference bureau
CRS	Catholic Relief Services
DCED	Donor Committee for Enterprise Development
DFID	Department for International Development
FAP	Financial Access Partnership
FSD	Financial Sector Deepening
HDI	Human Development Index
KBA	Kenya Bankers Association
KCB	Kenya Commercial Bank
KWFT	Kenya Women's Finance Trust
M4P	Making markets work for the poor
MFI	Microfinance institution
MoU	Memorandum of Understanding
MNO	Mobile network operator
MTP	Medium-Term Plan (for the financial services sector)
NPL	Non-performing loan
PIC	Programme Investment Committee
SACCO	Savings and credit cooperative
SASSRA	SACCO Societies Regulatory Authority
SIDA	Swedish International Development Agency
TA	Technical assistance
USAID	US Agency for International Development
VCF	Value chain finance

FOREWORD

Today the very concept of financial inclusion is widely understood as encapsulating a systemic approach. Reflecting the consensus on the importance of financial services in the development process, in 2013 World Bank President Jim Yong Kim announced a goal of universal financial access by 2020. Meeting this goal can only be accomplished by changing the financial system from which 2.5 billion adults are excluded. While the rationale for taking a systemic approach seems unimpeachable, seeking to have a practical impact at a systems level is rather more challenging. In the not too distant past, much work relating to financial services and the poor was focused on discreet and manageable projects in which if systemic impact was mentioned at all it was more as an aspiration than a concrete objective.

Financing Sector Deepening Kenya - FSD Kenya, a multi-donor initiative, was among the earliest programmes attempting to take a systems wide approach to developing financial markets for the poor. It had the good fortune to be working in Kenya – which turned out to be one of the most dynamic markets for financial inclusion worldwide. Today's programme has its origins in the Department for International Development's (DFID) work across Eastern Africa to support the expansion of microcredit. Following nearly a decade of micro-finance support projects, DFID established FSD in 2001 as an umbrella programme with the goal of improving "capacity of Kenya's financial sector to meet the needs of poor rural and urban households, micro, small and medium enterprise on a sustainable basis". To allow the programme to get closer to the markets it needed to impact on, the aim from the outset had been to implement FSD outside DFID through a separate, special purpose vehicle. Policy considerations initially prevented this from happening and FSD was initially implemented directly by DFID. However, in 2005 the FSD Trust was finally created allowing the programme to evolve into a separate multi-donor initiative funded by Swedish International Development Agency (SIDA) alongside DFID, followed over time by the World Bank, Agence Française de Developpement (AFD) and the Bill and Melinda Gates Foundation.

Developments globally, and in Kenya in particular, have opened up the potential for change in financial markets undreamt of by the early pioneers of microcredit. FSD has sought to help Kenya harness the opportunities presented, working with those who shape and form the market from policy makers and regulators to infrastructure providers and retail financial institutions. In this period, reflecting the developments in the markets we sought to influence, FSD has itself gone through enormous change. Although the commitment to a market development approach has remained unchanged, the very conception of what pro-poor financial market development means has itself evolved and continues to do so today. How we work and who we work with has shifted significantly – in some ways predictably while perhaps unexpectedly in others. As an organisation we expanded from an initial staff of three to over forty, experiencing many of the challenges which growth entails.

This case study provides a long-term perspective on the trials and tribulations of trying to bring about market change. We were fortunate in being able to persuade Alan Gibson, a pioneer of the 'making markets work for the poor' development paradigm, to undertake this study which covers the decade of FSD's existence as a Trust. While there are aspects of our work which were more successful than we dared hope, in other areas we have frankly failed. What is important to understand here is not so much which initiatives worked and which did not, but rather why? The market development approach necessarily means taking risks – if everything we'd tackled turned out according to plan then it would surely have shown that we were either lacking in ambition or – worse – simply pinning our work to market developments which would have happened anyway. Our experiences point to some positive lessons, but of equal – if not greater value – are instances where we clearly took the wrong path. Although I've been directly involved with FSD throughout its existence, I have learnt much from the analysis here. Alan's insights have already provided much impetus to shaping our next strategy and – perhaps even most pertinently – how we go about realising it. It is my hope that the lessons here will prove equally valuable to others involved in the praxis of market development.

David Ferrand
Director

EXECUTIVE SUMMARY

Kenya is seen widely as a 'stand out' success story on financial inclusion. The ten-year period from 2005 to 2015 witnessed enormous change in the financial sector. In 2015, two-thirds of the adult population have access to formal financial services compared with one-quarter in 2005; eight million more people have gained access to services. Finance providers, previously little engaged with and in retreat from the mass, low-income market, are now innovating and expanding.

These changes have coincided with the life of FSD Kenya, an organisation formed in 2005 to facilitate financial inclusion, with a distinctive approach – market systems development or 'making markets work for the poor' (M4P), and a distinctive organisational form – an independent trust.

This case study is about FSD Kenya, the role it has played in Kenya and what can be learned from this. It shows that FSD Kenya's contribution to financial inclusion, while varying between individual activities, has been substantial in aggregate, and that, globally (beyond Kenya), there are important lessons emerging from this experience for development funding and facilitating organisations.

Change in financial inclusion and FSD Kenya's contribution to change

The Kenyan financial system is bigger, more dynamic, more profitable and more innovative than ten years ago. It is also more inclusive, even if poor people have not been the biggest beneficiaries of its growth. Although helped by a generally favourable environment, FSD Kenya has contributed significantly to this change, pushing inclusion more quickly and successfully into the workings of the Kenyan financial sector.

It has done this by intervening in a range of ways, throughout its ten-year life, and with different partners in the public and private sectors. While the specific focus of interventions has varied it has involved work on different aspects of the market system including capacity-building, innovation, regulation, research and public infrastructure. From this, FSD Kenya has helped to change the underlying factors shaping the market system:

- It has played a quiet but hugely effective role in developing a policy and regulatory environment that is conducive to the new era of digital finance. Its research has percolated into the thinking and functioning of the sector and made inclusion real and tangible. Without FSD Kenya these changes would have been significantly reduced.
- Its work directly with companies has provided a strong push to the momentum of corporate growth and inclusion. Most notable is its contribution to the phenomenon of Equity Bank and to the development of the M-Shwari product – both of which reached millions of people and have had a major catalytic impact on the market system as a whole. While both of these would have developed without FSD Kenya, their wider impact would have been neither as pervasive nor as rapid.
- While its work in developing key 'public' functions – credit information sharing and payments systems – has had little impact thus far, this is on the brink of converting into major change in the efficiency of the sector which will have far-reaching impacts, including for low-income groups. Without FSD Kenya this would not have happened in the same time frame, perhaps not for many more years.

Against these important changes, in other areas, FSD Kenya's impact is less clear and has to be qualified. Its work in policy and regulation is successful but the regulatory system is, to some degree, reliant on continued inputs from FSD Kenya. And the research function on financial development and the poor, effectively created by FSD Kenya, is still largely coordinated, funded and led by it, with no clear picture of how this can be made sustainable in the longer-term. In terms of the private sector, there are some signs that finance providers are investing more in capacity building and innovation and that a service market is developing - but FSD Kenya's contribution here has been mixed.

A more fundamental issue is the degree to which advances in headline financial inclusion is translating into meaningful change in the lives of poor people. Evidence here is ambiguous. The extension of services from banks and through M-Pesa helps people to manage their financial lives better but the main beneficiaries are likely to be in income groups immediately above the poor. A more inclusive financial system would also provide more income-earning opportunities for poor people, but finance for the real economy has changed little. Indeed lending to agriculture (the main livelihood source for the poor) has actually reduced. Official data on poverty levels will not be available until 2016 but there is little to indicate that a major, positive shift has taken place.

What is indisputable is that the supply-side of the finance market has benefitted greatly from the last ten years. Banks' sales have increased by 2.5 times and profits by 3.5 times, with profit margins also increased; the 'inclusion years' have undoubtedly been good years for the banks. This apparent contrast between conspicuous supply-side success and a still-poor economy – mirroring international debates - raises questions on the role of the finance sector. In particular it begs questions on who/what it is there to serve, and on the incentives that drive behaviour. Discussion on these issues, however, on the wider 'social contract' of the finance sector, are limited in Kenya currently.

Change in the financial sector is therefore benefitting poor people. Finance is a market working better for the poor; but it is working even better for others.

Learning from the FSD Kenya experience

For funders and facilitators alike, the most important lesson from the experience is that FSD Kenya's positive impact is a vindication of its different function and form. The M4P approach that has guided its work has provided an appropriate framework and guidance for intervention and set a level of ambition that matches the development needs of the sector. As a trust, it has had the flexibility, operational space, resources and independence to engage effectively.

More specifically, FSD Kenya has been effective because it has 'got the big things right' as a market facilitator. Among the key factors that have driven its success have been:

- **The quality of its people** – their understanding of and closeness to the market and market players
- **Independence and neutrality** – seen as a 'third party' able to engage with multiple partners
- **Analysis and knowledge-led** – able to offer relevant and informed insight through interventions.
- **Flexibility** – able to adapt what it offers – technical assistance, information, grant support, guarantees – depending on the situation and need
- **Longevity** – able to take on tasks requiring longer-term engagement for success and ownership
- **A culture of closeness and engagement** – having the right networks and credibility to know 'who' as well as 'what' in relation to market players

Beyond these bigger lessons on the attributes of successful facilitators, more specific lessons on the technical 'how to' of implementation draw both from FSD Kenya 'successes' and 'failures'. These lessons relate to operationalising the M4P approach. Among the key points here include the importance of: applying the same analytical framework to interconnected systems; ensuring that interventions that deliver directly are positioned in a market system context; putting incentives at the heart of analysis and action; understanding the sequential nature of market change in interventions; and ensuring transactional clarity in developing functional relationships with partners.

Overall, for the financial inclusion/financial market development field globally, FSD Kenya's experience therefore offers valuable learning for development organisations - funding agencies, practitioner facilitators, policy makers and researchers. It does not – cannot – provide all the answers to the challenge of facilitating inclusive financial markets, where some of the issues to be confronted – such as the 'how much is enough' challenge and political economy dilemmas – are inherently intractable. Nonetheless, FSD Kenya's experience suggests a clear direction on how to engage effectively to bring about systemic change in financial (and other) markets.

For Kenya specifically, and for FSD Kenya, future challenges are to build on the achievements and address the limitations of the experience to-date, and in doing so apply the lessons learned in how to pursue genuinely inclusive market system change.

Chapter 1

INTRODUCTION

Business and technological innovation has led a new era of digital finance; and formal providers have expanded massively, including to the mass, low-income market. Kenya is now seen widely to be a - for many the - leading example of progressive, financial inclusion in action.

The last decade has witnessed unprecedented change in the Kenyan financial sector. Much of this has been related to financial inclusion, the degree to which financial services are relevant to and are helping poorer people. In 2005, around one-quarter of the adult population had access to formal financial services, many banks were reducing their branch networks and retreating from the low-income market, and the primary route to more inclusion was seen to be not-for-profit providers, especially micro-finance institutions (MFIs) – a parallel 'other' to the mainstream industry.

In 2015, at least two-thirds of the population have access to formal finance, 8 million more people than in 2005; business and technological innovation has led a new era of digital finance; and formal providers have expanded massively, including to the mass, low-income market. Kenya is now seen widely to be a - for many the - leading example of progressive, financial inclusion in action.

This period of change has also coincided with the 'life' of the Financial Services Deepening Trust Kenya (FSD Kenya), an organisation established in 2005 *"to support the development of financial markets as a means to stimulate wealth creation and poverty reduction"*[a]. FSD Kenya is an organisation with a distinctive approach – a market systems or 'making markets work for the poor (M4P)' approach, and form – a Kenyan-registered trust rather than a conventional donor project entity. FSD Kenya has also, like Kenyan financial services as a whole, been the subject of considerable positive review.

This case study is about FSD Kenya. It aims to be a learning document that examines the contribution FSD Kenya has made to inclusive financial market development in Kenya. It considers what can be learned from this ten-year experience on the 'how to' of market facilitation. In doing so, building on an understanding of the market systems approach, it explores the issues and dilemmas faced by FSD Kenya as a market development facilitator.

The case doesn't aim to be a definitive 'how to' guide; more modestly, it is a response to the question: "what have we learned?" As such it seeks to be of value to FSD Kenya as it considers its future path, to other FSD Network organisations, to the wider financial inclusion field beyond Kenya, and to other development spheres which aim to bring more effective, lasting change in the lives of poor people. It also forms part of a wider suite of learning case studies of financial market facilitation from across the FSD Network[1].

The case structure is given below. It forms one document but, to some degree, each section within it is self-contained and can be read and referred to separately without going through all the preceding sections.

- Section 2, *The bigger picture – change in Kenya, 2005-2015,* sets out the nature of change which has taken place in the last ten years, contrasting financial services directly in 2005 with the position in 2015.
- Section 3, *The origins of FSD Kenya – a different function and a different form,* explains the rationale for and essence of FSD Kenya's approach to inclusive financial market development (which is expanded on in Annex 1), and its organisational form.

1 The FSD Network comprises two regional financial sector development programmes in South Africa and Kenya, and seven national programmes in Kenya, Mozambique, Nigeria, Rwanda, Tanzania, Uganda and Zambia.

- Section 4, *The FSD Kenya experience*, the main part of the case, highlights FSD Kenya's strategic path and then focuses on different strands of activity, through a series of eight mini-cases. Individually, these present distinctive elements of FSD Kenya's work and can be read separately; together they encapsulate the raw learning material from FSD Kenya's experience.
- Section 5, *Market impact: what difference has FSD Kenya made to the financial market system?* considers FSD Kenya's impact both in terms of headline market changes but, more important, to the underlying factors that shape market development.
- Section 6, FSD Kenya – *the organisation: has form made a difference?* considers how FSD Kenya's different organisational form may have contributed to its performance.
- Section 7, *Learning: what do we get from the FSD Kenya experience?* builds on the preceding sections to highlight the main lessons that can be learned for FSD Kenya and others – practitioners and funders - seeking to pursue market systems development.

This case study seeks to throw light on the FSD Kenya experience from a learning perspective. Self-evidently, over a ten-year period and with such an ambitious mandate, this is a diverse and complex experience which does not always lend itself to simple clarity or explanation. For those who like their learning in a neatly linear form – analyse, conclude, learn-lesson . . . closure, move-on – the FSD Kenya experience may seem (unfortunately) nuanced and qualified. However, this reflects the sometimes 'messy' reality of facilitating major market system change and of an organisation learning about the 'how to' through experience. This then is a lesson-learning case, but it is also a discussion case.

A number of caveats and explanatory notes should be mentioned at the outset.

First, with respect to methodology, the analytical framework for the case – the lens through which FSD Kenya's work is viewed - builds from the market systems approach. Gathering information for the case has been based on discussions with FSD Kenya managers and more than twenty FSD Kenya stakeholders, and an examination of FSD Kenya's extensive internal documentation – a process which began in July 2015 and ended in September 2015. The case does not seek to be comprehensive in its coverage of FSD Kenya's work nor has it selected particular aspects of its work for deeper analysis through a random sampling process. Rather, it focuses on a set of experiences selected because individually they offer valuable insight (both positive and negative) and, critically, because together they provide the best basis for broader learning, which is the overarching priority for the case[2].

Second, the case is not an evaluation *per se* – it does not seek to offer an overall assessment of FSD Kenya's work against objectives. But is *evaluative* in the sense of reviewing critically with a view to extract points of learning.

Third, there are many different perspectives on FSD Kenya and financial inclusion in Kenya; the case aims to be a learning resource relevant to this broad audience and is written, appropriately enough given its content, in a manner which is inclusive.

Fourth, the study makes use of quotations from stakeholder interviews but, in the main, these are cited anonymously, at the request of interviewees. Quotations are also drawn from internal FSD Kenya documents which are not in the public domain - and not referenced.

Fifth, budget figures are cited where appropriate, in US$, calculated on the basis of prevailing exchange rates at the time of expenditure. These figures also include an estimate of FSD Kenya's internal costs such as relevant salaries and therefore offer an indication of total resources devoted to projects.

Finally, while conducted and reviewed in consultation with FSD Kenya, FSD Africa (FSDA), the Consultative Group for the Assistance of the Poor (CGAP), and the Donor Committee for Enterprise Development (DCED), the case is an independent, externally-authored study.

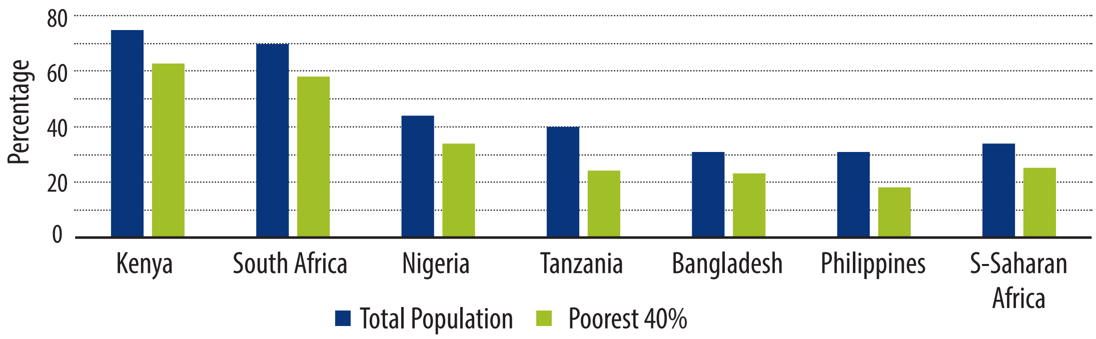
2 Some important aspects of FSD Kenya's work that have not been examined here include government safety-net payments and the financial services associations.

Chapter 2

THE BIGGER PICTURE – CHANGE IN KENYA, 2005-2015

This section sets out relevant facts on the Kenyan context with respect to financial inclusion and the wider economy in the 2005-15 period, and which form a suitable backdrop for the case study.

Figure 1: Kenya leads on financial inclusion .... adults with an account from a formal provider (selected countries/regions), 2014



The appropriate larger context within which to view FSD Kenya's performance is change in Kenya over the last ten years with respect particularly to financial inclusion, financial market development, the economy, and the position of the poor within this. FSD Kenya, of course, exists to facilitate (positive) change to this picture – and the case explores this – but, at the outset, the key features of this bigger picture need to be established.

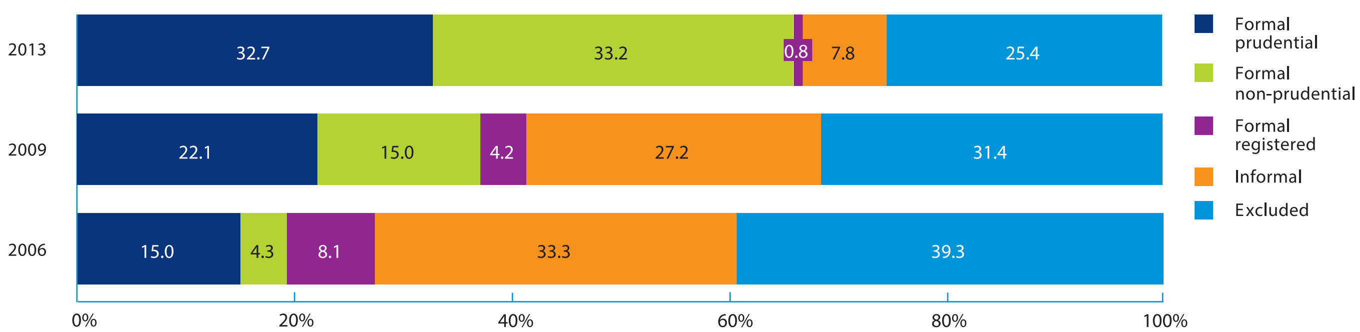
2.1 FINANCIAL INCLUSION

The key headline indicator in global financial inclusion 'industry' is the proportion of all adults and the proportion in the poorest 40% with access to an account from a finance provider. Notwithstanding the limitations of these indicators – not least that they do not cover usage (let alone benefit) – as Figure 1 shows, by these criteria, inclusion in Kenya is more advanced than in other comparable low- and middle-income countries.

The scale of the change this presents is revealed by data from FinAccess surveys. As Figure 2 shows, the proportion of adults with access to formal providers grew from 27.4% in 2006 to 66.7% in 2013 - 8 million additional people -as customers of finance providers. This figure is expected to be considerably higher in the next FinAccess survey due in 2015/16. The inclusion story can be further sub-divided in numerous ways. For example, in the digital finance sphere, 65% of the Kenyan adult population has a digital stored value account, compared with 33% in Nigeria and 25% in Bangladesh. And between 2005 and 2012 the number of deposit accounts increased six-fold to 17.6million. Whatever figures are used, the headline story emerging is the same: from being at best a middling performer in 2005, Kenya is now the 'stand-out' international success story on financial inclusion.

These hard figures are supported by a simple observation of finance in Kenya; inclusion is 'in the air'. The Central Bank of Kenya's (CBK's) mandate, as well as its conventional responsibilities of 'efficiency' and 'stability' also now includes 'access.' Fintech start-ups refer to inclusion on their websites and amid the media buzz and plethora of events on innovation and entrepreneurship, financial inclusion features strongly. Inclusion – once seen to be the preserve of the well-meaning (for some also the peripheral and feckless) non-profit sector - is now a live issue, known about and discussed, and part of the mainstream financial sector's make-up.

Figure 2: After a decade of dramatic change: access strands by year in Kenya



2.2 THE FINANCE SECTOR AS A WHOLE

The above headline performance on financial inclusion should be seen against a backdrop of the sector's overall growth. Again, a number of different indicators tell the story:

- Average growth rates in finance have typically been 50% more than for the economy as a whole. Average GDP growth for 2010-2013 was 4.9% - and for financial services specifically 7.6%.
- As a consequence, the financial sector's contribution to the economy, 3.5% in 2005 and 5.2% in 2012, has grown.
- Employment in the banking sector has more than doubled within this period from around 15,000 (in 2006) to more than 34,000 (in 2014).

Banks, key organisations in the sector, have been especially successful. Between 2005 and 2013, banks' operating income in aggregate grew – in real terms – by two-and-a-half times. Profits increased three-and-a-half fold in the same period, which also coincided with an increasing role for locally-owned banks and a reduction in the proportion of the sector made up of foreign-owned banks.

The financial sector is seen internationally to have improved its performance. The Global Competitiveness Index , an often-quoted measure of countries capacity and performance is comprised of twelve 'pillars' – covering for example labour, education, institutions and technology. 'Financial market development' is one of these pillars and is itself comprised of eight sub-indicators. In 2014, Kenya ranked 90th globally for the overall Index but for financial market development ranked 24th. In 2008, its finance position was 44th, indicating a perception of substantial improvement.

Supporting these quantitative measures is a wider recognition that financial services are of greater importance. Mobile network operators (MNOs) and banks take up no less than seven of the top ten positions in the Kenya stock exchange by market capitalisation and their activity and interactions occupy a high-profile in the media. Many have conspicuous, new headquarters. Finance brands, especially M-Pesa, are known widely. Finance has more visibility and presence in the Kenyan economy than ever before.

2.3 THE ECONOMY AND POVERTY

The last ten years has seen a fortunate combination of favourable trends which have impacted on the financial sector as a whole and on FSD Kenya, providing opportunities for both. The end of the Moi era in 2002 brought with it a release of optimism and a new interest in technocratic analysis and research in the political process. The security situation, while never ideal, has been relatively stable. The growth of the middle-class and of urbanisation, some a catch-up from the 1990s, has provided a ready market for financial services. Serendipity has played a part in the last ten years.

These factors have helped shape an era characterised by generally higher growth and, from available evidence, some (if rather limited) reduction in poverty. Spurred by a change in economic policy and political climate, average growth in the 2005-2014 period was 5.3% annually, twice its rate in the five-year period immediately before this (2000-04). Regarding poverty, the evidence is thinner and mixed. In 2005 46% of the population lived below the poverty line. Preliminary figures for 2012 indicate that this may have dropped to 38%, but a more complete picture will only emerge from the Government/ World Bank national survey to be conducted in 2016. However, the broader indicator of the Human Development Index (HDI) suggests limited progress. The HDI includes dimensions related to health, education and standard of living – so a reflection, in some way, of poverty levels. Kenya's global HDI rank in 2012 was 147th, exactly the same position it held in 1980. Notwithstanding the financial sector's ascendance, relative to other countries, Kenya's development progress appears relatively static.

Overall, the environment in which FSD Kenya has operated is one which has seen significant, unprecedented improvement in financial inclusion, as well as major growth in the financial sector (and economy) as a whole. The degree to which FSD Kenya has brought influence to bear on this environment – and caused change – is a more debatable point, discussed in Section 4.

Chapter 3

THE ORIGINS OF FSD KENYA – A DIFFERENT FUNCTION AND A DIFFERENT FORM

This section sets out the two distinctive features which marked FSD Kenya from the outset – function and form – what these were and the reasons for them.

FSD Kenya started in 2005 as an initiative by the UK's Department for International Development (DFID) and the Swedish International Development Agency (Sida) aiming to provide a *"unified programme of support"* to Kenya's financial sector. This built initially on an existing DFID project. However, from the outset, FSD Kenya was a departure from the norm in donor-funded programmes in two distinctive ways, both of which have shaped its subsequent development: FSD Kenya's function – its approach to working with the financial sector, and its form – its organisational structure.

3.1 FUNCTION: A DIFFERENT WAY OF DOING THINGS

The late-1990s and early-2000s was a period in international development circles characterised by much reflection and discussion about the approach that development agencies should follow, especially in the private sector development field[3]. Prompting this was a sense of widespread frustration at the efficacy of conventional approaches, then dominated by a narrow supply-side perspective emphasising subsidy/support for delivery[4]. Reviews of experience with this approach showed it to be resulting in very low levels of long-term outreach and limited sustainability, with partners struggling to move beyond donor support. This was development as small puffs of virtuous, fleeting impact which, in aggregate, amounted to very little.

The DFID project , which was the predecessor to FSD Kenya and from which it grew, exemplified many of the limitations of the conventional approach. Its purpose was to improve the capacity of the financial sector primarily by providing sizeable, intensive inputs – grant investment and technical assistance – to a small number of providers. Its main partners were MFIs and more 'socially-oriented' organisations such as the Post Office Savings Bank. Formal sector banks were not seen to be "playing a significant role." The central target of the project, with a $19 million budget and a 5-year timeframe, was to increase access to only 100,000 households – in simple terms implying a spend of almost $200 per household. It was the self-evident 'smallness' of this project and others like it, in terms of its potential and its ambition, that prompted frustration in DFID and among other agencies and a search for a different approach – a new paradigm - that would stimulate more substantial, meaningful change rather than simply 'buy impact'

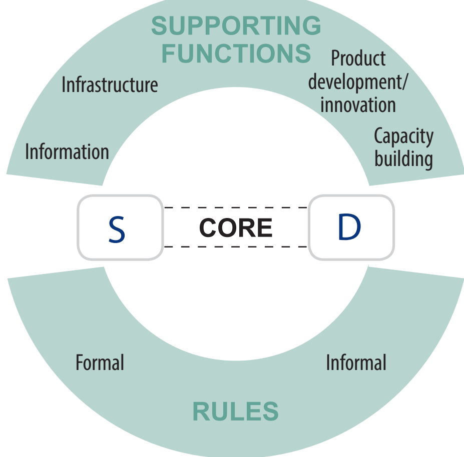
The approach adopted by FSD Kenya, and other programmes in the economic development field, emerged from this context. Variously described as 'market systems development', 'market facilitation', and 'making markets work for the poor' (M4P)[5], the essence of this approach is manifested in three defining features (see Annex 1):

1. Objective – to make the overall market system work more effectively for poor people. This sets the ambition of the approach but also recognises the reality of poor people (always) being part of a bigger system. Real change is about changing the system not just individuals themselves. M4P is a systemic approach.

2. Analytical framework – based around a 'multi-function, multi-player' market system framework. In simple terms, as Figure 3 shows, this has three main parts:
   - *Core function:* the main transaction or exchange between supply and demand
   - *Rules:* both the formal rules – laws, regulations – and 'informal rules' – attitudes, norms, power relations – that together shape the incentives of key players.
   - *Supporting functions:* the collection of other functions required to foster exchange – such as services, information, infrastructure and advocacy.

   Ultimately, how a market performs – what happens in the core - is dependent on the supporting functions and rules, on what's around the core. Change that is effective has to address the underlying causes to be found here – and therefore effective interventions have to bring about change here.

Figure 3: key elements in a market system



3. Guidance for action – that builds on experience dealing with the 'how to' of intervention and forms a set of 'good practice' principles (rather than restrictive commands). The role of aid-funded agencies (such as FSD Kenya), is to facilitate change in the system – not be a player in it, even if that may be necessary in the short-term. Facilitation aims to 'crowd in' or stimulate wider and lasting activity beyond the immediate partners/ functions that a facilitator works with directly.

3 Some of this was manifested in new guidelines from the Donor Committee for Enterprise Development.

4 Other aspects of support included research and service delivery development

5 These terms are used interchangeably in the text

Facilitation good practice for example emphasises having action led by analysis, establishing quid-pro-quo/transactional relationships, building on partner incentives and ownership, technical credibility, closeness to the market, and developing an exit plan from the outset. Applying these principles allows implementers to create momentum and catalyse change throughout the market system.

Underpinning M4P, and explaining its difference from conventional approaches, is a different theory of change; i.e. a different logic model of the change process that intervention should instigate. Whereas a conventional direct delivery approach focuses on supporting the delivery of services – the core of the market only – a market systems approach places emphasis on ensuring that the underlying causes are addressed, in supporting functions and rules. This does not mean, operationally, that facilitators should not engage directly in the core of the market – for example with finance providers such as banks. On the contrary, in practice, this is often required. However, from a market systems perspective, for intervention in the core to be valid it has to cause change in the wider market system – for example in attitudes to risk, in information available on products or in willingness to invest in specialist services – which in turn catalyses further development in the core of the market. No matter the point of intervention therefore, consistent with M4P's theory of change, for change to be systemic is has to be manifested in change in supporting functions and rules.

Interestingly, at this time in the early-2000s, in the finance development arena there was generally less interest in pursuing this new paradigm that was to shape FSD Kenya's work. Official guidance to agencies at the time (the 'Pink Book') acknowledged the different levels of the sector – micro, meso and macro – but was largely an endorsement of conventional supply-side support. Only now, a decade later, have new guidelines advocated a market systems approach. There were some nascent examples of programmes pursuing a different way at that time – most notably in South Africa with the DFID-supported FinMark Trust, started in 2002 and whose early work was stirring interest. But for FSD Kenya this was not a crowded path with numerous models from which to learn.

3.2 FORM: A DIFFERENT ORGANISATIONAL ENTITY TO DO THINGS

Given that a different approach was envisaged – and in accordance with the 'form follows function' principle – the question for DFID, as the lead funder, was what organisational vehicle was most likely to implement the approach successfully? To answer that meant considering what attributes were desirable in implementing an M4P approach. A number of characteristics appeared to be important.

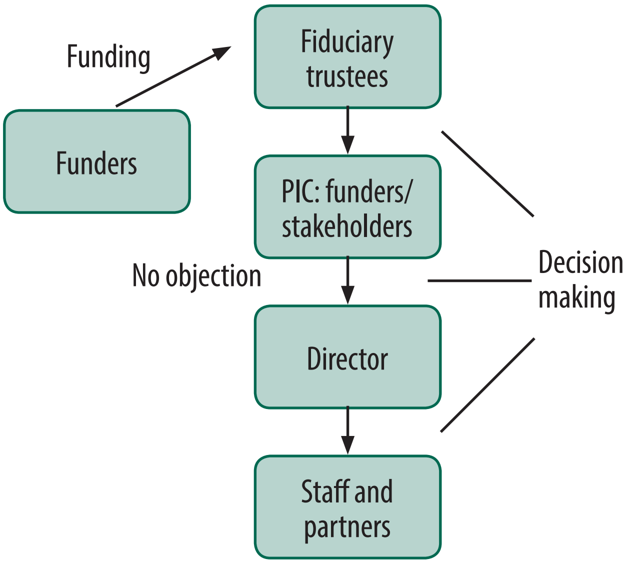
- Flexibility and responsiveness – avoiding the need to define in advance structure and activities, allowing freedom to adapt interventions in the light of new opportunities and experience as a programme proceeds. This is especially important given the dynamic nature of markets.
- A focus on outputs/achievements – consistent with the point above, rather than focusing on prescribed activities and 'deliverables', accountability around overall objectives with the means to achieving these kept open.
- A (potentially) longer time horizon – recognising the intractable nature of some market constraints and the importance of change processes being owned by local actors, a planning framework which allowed potentially longer-term engagements.
- Credibility – drawing on sound technical competence, allowing close and influencing relationships to be formed with key organisations and individuals.
- Efficiency – allowing the greatest proportion of resources to be concentrated on resourcing the facilitation tasks of M4P

Through this lens, it was felt that establishing FSD Kenya as a locally-registered trust with charitable status would be the best option (Figure 4). This has a split governance structure with fiduciary responsibilities met by independent professional trustees (an accounting firm) and strategic and technical guidance provided by a separate Programme Investment Committee (PIC). The PIC is comprised of representatives from funders and other independent appointees selected for their insight into financial services and has a 'no objection' authority in relation to new proposals rather than decision-making per se. These governance arrangements provide more space, and place more responsibility on the FSD Director to develop a programme of activity. For a number of reasons this was felt to offer a better fit than the more conventional arrangement of a donor-funded project implemented by contractors.

A non-profit trust would potentially offer a better alignment of incentives between implementer and funder around long-term development impact, than the for-profit nature of a contracted-out model.

- A trust would provide a practical, defined separation from official donor processes and the inevitable restrictions that accompany these – such as pre-defined components – and therefore offer more scope to respond to market change. Contractors with a more direct line of accountability to funders, especially if output-based aid, have less flexibility.
- Given that projects are 'packages' of activity and resources in a finite period – typically 3-5 years – their potential to embark on market change that might breach this time frame would, inherently, impose restrictions. Trusts, on the other hand would have fewer of these barriers.

Figure 4: FSD Kenya Trust structure schematic



- A trust, grounded in the local milieu and embedded in the market context, would allow credibility, expertise and relationships to build, all important in successful interventions. Contractors and their personnel are also more likely to be branded as donor projects and be considered short-term, if generous, 'intruders' into a market space.
- With reduced interaction with donors, overall management costs would be reduced in a trust and, with lower overhead costs than foreign-based contractors, efficiency would be increased.
- Compared with a project structure, which usually has donor-specific restrictions within it, the trust would offer a means of harmonising and pooling of funds from multiple donor sources.

These arguments were advanced knowing that conventional projects, donors and contractors were, in practice, more heterogeneous than a simple analysis would indicate. Nonetheless, a trust arrangement was seen to be more appropriate for the task of developing a more inclusive financial sector in Kenya.

Chapter 4

THE FSD KENYA EXPERIENCE

This section focuses on key themes of FSD Kenya's work in a series of eight mini-cases. Individually, these highlight distinctive strands of FSD Kenya's work which are related but also represent self-contained examples in their own right. Collectively they capture the overall nature of the FSD Kenya experience and its performance.

The overarching framework for FSD Kenya's work is set by the M4P approach, but FSD Kenya's understanding and articulation of the approach is provided in its overall strategy. Before considering the specifics of FSD Kenya's work, this strategy context should be set out. In FSD Kenya's ten-year life it has had three strategy periods: (1) 2005-2007, (2) 2008-10, (3) 2011-2015. Brief examination of these highlights the common themes that have underpinned its work as well as the development of its priorities as the Kenyan financial market has grown in size and sophistication.

Strategy 1 (2005-07)

FSD Kenya's first strategy established the main areas of focus throughout the different interdependent levels of the market system – with providers directly (micro-level), in relation to policy and regulation (macro) and with respect to services, information and infrastructure (meso). The strategy recognised that ultimately the performance of individual finance providers was shaped by the environment around them but thought reliance on market response without active steps at instigation was over-optimistic and naïve. The central theme therefore was direct, selected support to key finance providers, providing a tangible demonstration to others in the market on the nature and benefits of change. The strategy's overall objective, very similar to the DFID project that preceded FSD Kenya's formation, was to *"deepen the capacity of Kenya's financial sector".*

Strategy 2 (2008-10)

By 2008 it was clear that the market had moved. Led by Equity Bank, commercial providers were expanding into the mass market and the arrival of the M-pesa money transfer service signalled the start of the digital finance era. Armed with the data from the first FinAccess survey, the strategy was able to offer a more detailed analysis of the market as it impacted on poor people. And now three years in, a more complete assessment of wider constraints – for example related to services, the payments market and credit information sharing – was emerging. The strategy reaffirmed the importance of working directly to improve the capacity of providers and also identified agricultural and SME finance as priority areas.

Strategy 3 (2011-2015)

FSD Kenya's last (5-year) strategy was developed after an independent impact study reported significant impacts across the market system with *"strong synergies"* between different FSD Kenya projects. The strategy redefined FSD Kenya's strategic objective, away from its previous capacity-building thrust to *"increased use of a broad range of quality financial services provided by a stable and competitive financial system in a way which benefits the livelihoods of under-served lower income groups".* Though a *"deliberately dense"* statement the new objective marked a recognition of the multi-facetted nature of market system change

- *"use"* and *"quality"* not just access to services per se,
- the importance of creating a competitive market,
- *"broad range"* reflecting the need for a pluralist market,
- *"stable"* emphasising the importance of sustainability not just 'one-off' change.

The strategy identified four main theme areas reflecting the objective's multiple quality – the infrastructure and rules around low-cost retail banking, direct support in reaching 'hard to reach' groups, SME finance and research/knowledge, with a fifth on innovation added later as the importance of digital finance grew.

From an initial, relatively narrow starting point in its first strategy period that was a legacy of previous direct capacity-building efforts to a broader, more open systems orientation with multiple facets in its third, the strategies reflect FSD Kenya's own path of learning on what the M4P approach means when applied to finance. Throughout, strategy has been marked by a continued commitment to applying M4P, to the theory of change and the key principles that define it, but also a willingness to engage in different ways and in different places in the market to put this approach into practice. This includes, for example, capacity-building and grant support to providers, studies and advice to inform policy-making and regulation, coordination among industry groups, research and technical assistance on innovation, and support for safety-net government-to-person payments. It has been a 'journey' that has included a diverse and growing list of experiences.

This case does not include every aspect of all of these. Rather eight different 'mini-cases' of experience have been identified which encapsulate key themes and learning points. These address different parts of the financial system (with respect to Figure 1) but are all consistent with the overall theory of change. Discussion on each of these is structured in three parts:

- Its significance - the 'so what' of the theme, the fit with the M4P theory of change, what happened and why this is significant;
- Key elements of 'the story' – a summary of the process, highlighting the most significant features
- Learning and discussion points – immediate issues raised by the example.

Mini-case 1: Supply-side capacity building – it works! (except when it doesn't)

Mini-case 2: Adventures in the innovation 'space'

Mini-case 3: Creating the market system around (and beyond) the M-Pesa disruption

Mini-case 4: Building the public building blocks, then doing it sustainably

Mini-case 5: Service markets – still a challenge

Mini-case 6: Matching incentives and 'offer' when engaging with the 'real' economy

Mini-case 7: Pluralism and crowding-in: seeing informal financial services through a market system lens

Mini-case 8: The information and knowledge base: yes, it's good, and important . . . . . . so who's going to do it?

4.1 MINI-CASE 1: SUPPLY-SIDE CAPACITY BUILDING – IT WORKS! (EXCEPT WHEN IT DOESN'T)

Significance

At its outset, FSD Kenya saw the single biggest constraint to pro-poor market development as weakness in retail capacity. A shaky supply-side of the market, it reasoned, meant a weak basis for any further development; "a supply-side to work with" was required.

Its major intervention to address this was the provision of technical assistance (TA) directly to a small number of organisations to raise their capacity and "produce convincing demonstrations of viability", that would stimulate wider 'crowding-in' of change.

Through the example created by direct support, the objective of this set of interventions was to stimulate wider market change (beyond directly supported organisations). This would happen through finance providers, with attitudes changed and information available on the benefits and nature of change, being incentivised to invest in capacity-building, and by providers of capacity-building services being drawn to providing these services.

FSD Kenya undertook capacity-building interventions in different parts of the supply-side – with commercial banks, MFIs and savings and credit cooperatives (SACCOs). For its first five years, this was a key focus of its work.

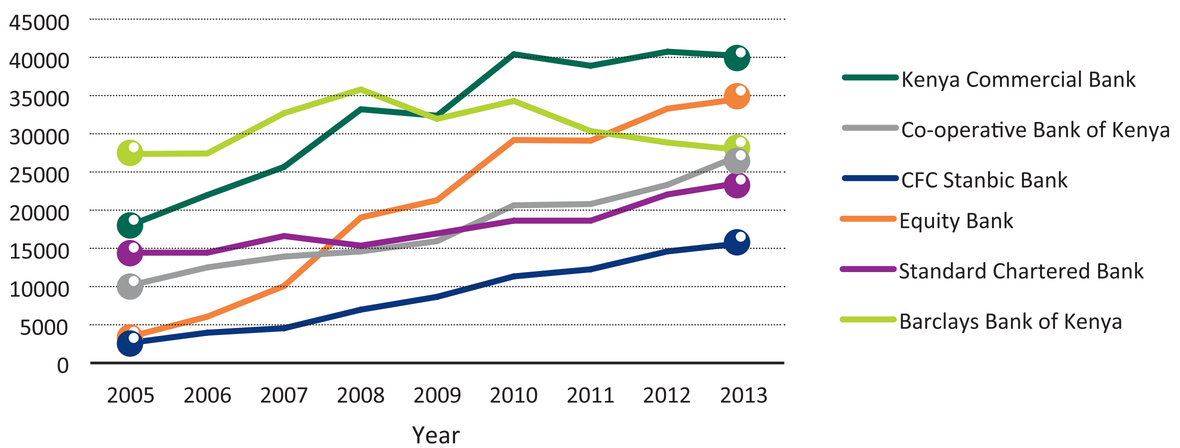
In some cases the results of this appear to have been successful. In particular, FSD Kenya contributed substantially to the growth of the banking sector – especially the success of Equity Bank. As Figure 5 shows[6], Equity (which has grown more than ten-fold in real terms) has led a period of remarkable growth, some of which has been into the previously underserved mass market.

But in other areas – such as MFIs – impact has been more modest while with SACCOs there has been little meaningful demonstrable impact. Indeed an external review in 2015 concluded that the weaknesses of the SACCOs sector in 2015 were largely the same as they had been in 2005, and that "the intended demonstration effect of the institution-level efforts had not had the expected positive effects on the SACCO sector".

What explains this mixed experience? Looking at each provider-type in turn throws light on this.

6 This draws on publicly available data on Kenyan banking sector performance

Figure 5: Banks keep on growing: real income growth in top six banks, 2005-13 ('000 Ksh - 2013)



THE STORY

Banks

FSD Kenya worked with a number of retail banks but Equity was by far the most important. Equity had been a building society which, from the 1990s, had started on a process of change, aimed at the underserved mass market. Learning lessons emerging from MFIs' experience, it was the first bank to recognise the potential value of being more customer-driven (rather than product-led) in this market, and its ambition and willingness to learn marked it out as an obvious partner.

Equity had had some limited donor support before, but a period of concentrated TA support began in late-2002[7] and continued for around 5-6 years. This was provided by three agencies working in collaboration – FSD Kenya, Microsave[8] and Swisscontact, the latter two having previously worked with Equity.

The immediate purpose of this capacity-building effort was to facilitate the organisation's growth and to manage the strains of massive growth - and put into practice its ambitious strategy. There was an initial focus on five areas (1) institutional transformation – from a building society to a bank (2) credit development (3) operations and IT (4) marketing and product development and (5) human resource development. After a first phase of support, FSD Kenya then focused in a second phase on Equity's lending strategy – particularly important since Equity's main experience had been in savings. Throughout this period a range of TA was provided by international specialists – individuals and firms – some long-term and others short-term in nature.

But the bare facts of the intervention may be less important than 'how' it worked. The main reason for its success (according to Equity's CEO James Mwangi), was the close collaboration between Equity and the three technical partners manifested in a Steering Committee, whose members were the partners (and Mwangi). The Committee was created to coordinate the capacity building process in a "holistic manner" and, meeting monthly, acted as a, de facto, advisory board to Equity. Its external members were fully committed to the task, but were clear that their role was to facilitate a change process with Equity and its people and not to push themselves to the fore. So while being close, effectively *"complementing our management capability"* they understood where real ownership of change had to lie.

While the quality of the technical resources provided were (obviously) critically important, the framework or working was created by the Committee. FSD Kenya had an important part to play in this. It was providing most of the resources but recognised that misusing this 'muscle' could easily undermine the intervention's collaborative spirit. According to Mwangi, *"with them we laid the foundation",* developing not just Equity's structures and processes but its ethos which was, *"implanted throughout the organisation".* However, self-evidently this was an organisational culture already in the making – there was a momentum behind Equity's growth and its eagerness to learn and progress was clear. The interventions were able to align closely with the organisation's own incentives.

For Equity, this was not a 'traditional' donor project. Moreover, FSD Kenya's longevity in the market, coupled with the recognised knowledge of FSD Kenya people, afforded them genuine insights and credibility that encouraged the development of a collaborative and flexible relationship.

Unpicking the specific additionality from the intervention now is not possible but some insight into the kind of change attributable to it is shown with respect to Equity's credit portfolio performance. In the two year period to December 2008, Equity grew its credit portfolio by 346% while reducing the proportion of loans at risk by more than one-third from 13.2% to 8.6%, an effective turnaround in performance. In 2015, 6-7 years after this direct capacity building effort finished, Equity is one of the largest banks in Kenya with assets in excess of $3 billion, 7000 staff, a branch network in excess of 130 and a customer base of 10m. Given its drive and capability, there's little doubt that they would have grown and been successful without this capacity building effort, but not at the same pace, nor with the same level of innovation.

Similarly, while Equity would have stimulated some kind of change among other banks, the scale and quality of its performance change meant that banks, driven by commercial incentives, and aware of market trends, responded quickly. FSD Kenya did not have to undertake additional measures to encourage other banks to learn – a tangible message was being sent in the market. *"We have taken financial inclusion on board because of Equity. It was they who saw the importance of the bottom of the pyramid",* according to one competitor. Banks responded by investing[9] in organisational change and by poaching Equity's (newly-capacitated) staff, all seen to be part of the Equity 'magic'. Without the capacity building intervention, the external impact – the wider systemic change – is unlikely to have been as dramatic.

FSD Kenya's contribution to the process cost approx. $1 million, with Equity contributing a further 20% in the first phase and 30% in the second phase. Cost-sharing was deemed to be appropriate for Equity – both as a profit-making entity and to ensure commitment – but for neither party was the size of this share especially significant. What mattered was that the financial 'deal' fostered the right kind of productive, working relationship.

This was also a relationship which tapped into wider motivations for each party: Equity's desire, as an (then) upcoming organisation, for international endorsement and exposure, and FSD Kenya's need, as a facilitator, to learn

7 Support for Equity started in late-2002 as a project within DFID – it then fell within the FSD Kenya purview from 2005.

8 Microsave was initially funded by DFID and then, from 2005, by FSD Kenya.

9 In some cases with donor support and in some cases without

In 2005, SACCOs were seen by FSD Kenya to be an important financial service provider for the poor. Membership-based, not-for-profit organisations embedded strongly in Kenyan society, an estimated 3200 SACCOs had approximately 1.6 million members.

from 'real-life' work with key providers which would then help to inform and have synergies with its work with other partners. The relationship aligned with each of these incentives.

MFIs

By 2005 the potential of commercial banks to address financial inclusion was gradually being recognised but MFIs – the traditional focus for donor support - were still seen as important. FSD Kenya partnered with the two largest MFIs – Faulu and KWFT (Kenya Women's Finance Trust). Both of these were aiming for compliance with impending legislation related to deposit-taking, and this provided a specific focus and incentive. Both organisations had received donor-funded support before. FSD Kenya offered technical assistance for direct capacity building support in the period 2007-10 - in areas such as financial restructuring, market research, and information technology – for Faulu costing $1 million, for KWFT $0.7 million.

Both organisations clearly benefitted from the intervention and as licensed deposit-takers, have subsequently grown - KWFT from a client base of 150,000 to more than 500,000 and Faulu from 76,000 to 230,000 by 2014. FSD Kenya used these interventions to package the lessons from the experience into an MFI transformation study. It did not support any other MFIs to transform to deposit-taking institutions, but a number did using their own (or other) resources and drawing on the study as one resource in the process. But beyond this, the demonstration effect in terms of organisation and portfolio growth was limited. MFIs, mainly non-profit organisations, appeared to have neither the means nor the incentive to instigate growth themselves. By 2013 only 3.5% of Kenyans used MFIs – a proportion which was unchanged from five years earlier.

SACCOs

In 2005, SACCOs were seen by FSD Kenya to be an important financial service provider for the poor. Membership-based, not-for-profit organisations embedded strongly in Kenyan society, an estimated 3200 SACCOs had approximately 1.6 million members. They were also recognised to have very mixed levels of capacity. Serious constraints in relation to financial management, internal systems and governance were common, with the majority likely to be in a position of technically insolvency after adjustment for non-performing assets.

At the heart of FSD Kenya's support was direct capacity-building for eight of the best-run SACCOs. This experience would provide, it was argued, the basis for the development of the supply and demand-sides of a business services market focused on capacity-building. A training course was developed for providers of these consulting services with eight main subject areas. On the demand-side, considerable (75%) support was offered to the eight SACCOs for a *"comprehensive"* package of TA capacity-building to implement new systems and processes.

From 2006-10 FSD Kenya invested $2.3 million in SACCO capacity-building but by 2010 recognised that this hadn't worked. Working with individual SACCOs at best produced isolated pockets of excellence but there was no spread beyond these. Despite regulation in 2008 giving tighter rules (particularly around capital adequacy, liquidity ratios and governance) SACCOs showed little inclination to change. In 2010, FSD Kenya designed a new batch of support aimed both at strengthening the SACCO regulator and providing a broader approach to capacity-building ($0.6m). This time there was less emphasis on direct individual SACCO capacity-building and more concentration on the development of a series of narrower, more practical training programmes, and a market for both training (from the Cooperative College of Kenya) and consulting services (from individual providers).

The overall results of this series of interventions, like the first, were disappointing. In 2015 an external review of the SACCO sub-sector and of FSD Kenya's role within it reported little positive change. It also found that, despite other benefits, SACCOs that had gained from direct capacity-building were just as likely to be non-compliant with regulations as others. Demand for training and capacity-building from SACCOs was weak.

What lay behind this poor performance was an incentives problem; SACCOs didn't want or see the need to change. This in turn was caused by, first, the traditions and value around SACCOs. As community-owned institutions and part of a 'movement' many SACCO members felt entitled to loans and resented external pressures to change. This view was promoted by the SACCOs' association and had powerful political backing. These views prevailed despite the declining relative position of SACCOs. SACCOs continue to be important (9.1% of the population were members in 2013) but, as Figure 2 illustrates, while in 2006 8.1% of the population's highest level of reported use of a financial service was through SACCOs, by 2013 this had declined to 0.8%. Paradoxically, SACCOs' membership has grown significantly but for most members they are, self-evidently, secondary sources of finance. New competition (from M-PESA and banks) for SACCOs has not increased members' incentive to change. The second incentives issue related to the SACCO regulatory regime: in practice, the regulator SASSRA (SACCO Societies Regulatory Authority) did not have the resources or the political support to enforce the provisions of the 2008 Act. Even in 2015, SASSRA continued to see itself *"as the only one that believes in the gospel of financial discipline"* in the SACCO sector but, by its own admission *"is a dog that never bites".* It can't be 'tough', and SACCOs know it.

In this context, even though it had recognised the central incentives problem in SACCOs as early as 2010, FSD Kenya's analysis underestimated the strength of the informal rules around SACCOs and overestimated the power of formal rules. With some exceptions, SACCOs as a whole still don't have the right incentives to change and therefore limited interest in investing in capacity. No matter the excellence of the TA provided, FSD Kenya's capacity-building endeavours were never likely to be successful when they were so palpably battling against the prevailing incentives grain.

Learning and discussion points

- Objectives – a mixed experience: SACCOs, MFIs and commercial banks are different types of organisations. Moreover, the Equity phenomenon is unique, so comparison risks simplicity. Nonetheless, FSD Kenya's different experiences on the efficacy of direct capacity interventions in stimulating wider change show success with banks, failure with SACCOs and with MFIs an approximate middling between the two.
- How to deliver – the experience with Equity demonstrates a number of key success factors in how to engage effectively: understanding the market and the partner within this, technical competence, personal credibility, a 'low ego' to allow ownership, flexibility in developing an appropriate 'deal' and changing the nature of the service being given (the 'offer') as a situation develops.
- The critical importance of incentives - interventions (such as capacity-building) with individual players in the core of the market can only be successful in stimulating wider change when consistent with, and tapping into, the incentives shaping behaviour in individuals and organisations that make up markets. Interventions on 'how to change?' only work if they are consistent with 'why change?'
- Difference from conventional approach? – FSD Kenya's initial capacity building interventions were, in part, a legacy of previous direct delivery times. Some aspects of these – duration, scale, the deal with partners – might have been different had its own learning been more advanced. However, where there has been success it is because intervention has been positioned in market system context.

4.2 MINI-CASE 2: ADVENTURES IN THE INNOVATION 'SPACE'

Significance

For the finance market to move in a pro-poor direction, amongst other changes, products have to be developed that address the needs of poor people. Innovation in product development is an essential function in any market system, and in Kenya, especially in relation to digital finance which is important in reducing transaction costs and extending inclusion.

FSD Kenya has engaged directly in supporting product development on a number of occasions. The objective in supporting product development directly is to provide examples of success, stimulating the environment (especially information, attitudes and aspirations), motivating financial providers to invest in their own product development and to engage with appropriate specialists in doing so.

Its most notable intervention has been in relation to M-Shwari, a combined savings and loan product, launched in 2012 through a strategic partnership between the Commercial Bank of Africa (CBA) and Safaricom, Kenya's largest MNO and which operates the M-Pesa money transfer and financial service. In 2015 it has more than 11 million accounts and, given its scale and originality, is creating a significant disruptive ripple in the market.

Some of the M-Shwari innovation is reaching previously under-served groups. But other innovations supported by FSD Kenya have proved less successful prompting questions over what explains this difference and what can be learned from it?

The story

M-Shwari

In 2011 Safaricom began discussions with CBA over a potential collaboration. The rationale here was to combine the M-Pesa 'rails' to reach a large customer base (M-Pesa is used by 68% of the adult population) with all the services that a bank could potentially provide. For people in the industry, this type of collaboration was expected and was a logical next step, especially in the light of a recent, partnership attempt between Safaricom and Equity which had failed.

CBA knew and had engaged with FSD Kenya before, and approached them for their thoughts and potential input. FSD Kenya saw this as an opportunity to influence an innovation which, in some way, was going to happen anyway, so that it was more likely to be successful and more oriented to low-income people. This was an opportunity to build on this experience and develop a technology-based product that responded to the real needs of poor people as revealed through the seminal 'Portfolios of the Poor' publication in 2009, particularly their need for flexible savings and loans to allow both liquidity and convenient saving for investment. For FSD Kenya this was also a chance to build on an earlier, unsuccessful initiative. FSD Kenya (along with CGAP) had supported an action-research project with a start-up company in 2010-2011– Jipange-KuSave – to develop a savings-loan product (at a cost of $0.27 million). Although this generated considerable learning, it didn't succeed in pushing the idea sufficiently close to commercialisation – and in this sense it failed.

FSD Kenya and CBA agreed on a relatively open-ended collaboration. The first year of this was based mainly on qualitative and quantitative research to understand potential customers and the market in more detail. It also included a range of technical inputs. Of particular note here was the credit scoring model where, repayment records for customers for phone airtime were to be used as the basis for scoring. FSD Kenya's input was technical and drew on their own staff and, for specific tasks, external experts.

M-Shwari was launched in late 2012, with strong interest from customers immediately. However, FSD Kenya was concerned that the credit-scoring model was rejecting too many (poorer) customers. Post-launch they initiated an experiment with CBA to assess the effectiveness of a new scorecard. In this case their input was not just technical but an agreement to underwrite the experiment financially, capping CBA's potential losses. In practice, losses were moderate and a revised scorecard that increased the acceptance rate for credit applications from 42% to 57% was introduced in December 2014 so effectively extending credit to poorer customers.

For CBA, M-Shwari has been broadly successful, and the collaboration with FSD Kenya has been central to this success. This can be attributed to a number of factors – both general and specific. In a general sense, FSD Kenya's flexibility *("the great thing is that they respond. If it's something that want to do, they'll do it quickly")* and responsiveness encouraged a trusting "cards on the table" relationship. Non-disclosure agreements were signed but more than legal compliance, for CBA, aware that FSD Kenya worked with other competitor companies, it was FSD Kenya's credibility (manifested in key personnel and in a long record of previous work) that offered confidence. Part of this general attractiveness was also a practical modesty in FSD Kenya's approach; its instinct was, as much as possible, to keep in the background rather than intrude into the public view. In this way it hoped that the potential for distortion from the artificiality of foreign donor support could be reduced; noticeably, there is no mention of FSD Kenya in any of the CBA-Safaricom material on M-Shwari.

In a specific sense, FSD Kenya was seen to have an 'offer' - insight and knowledge that would be useful, and this was different from CBA's normal experience with donor support; *"We need to be very precise. With all due respect, we don't have time to waste on workshops etc. We're not fluffy. We both need to see value in discussions. Donor-funded institutions don't give me the confidence that they can add value."*

CBA recognise that FSD Kenya added value throughout – from the initial *"eye-opening"* research process to the detail of the credit scoring model. Here, initially CBA felt that this, as a bank, was 'their' home territory and were more resistant to FSD Kenya input but in hindsight they acknowledged that FSD Kenya's technical input changed their approach considerably.

Is this perception of success accurate? Has M-Shwari really worked? The answer, inevitably, has to be qualified. Its huge scale and the technical significance of the innovation is unarguable. However, an analysis in 2014 showed that the profile of M-Shwari's 11 million account holders, who use services for a variety of personal and business reasons, was skewed towards people above the poverty line. And more than 40% of those who seek credit are refused, a group drawn mainly from the ranks of lower-income groups. At this point, M-Shwari does not yet represent the high-minded product response to the 'Portfolios of the Poor' that was originally envisaged. Some express the view that short-term commercial concerns led the CBA-Safaricom collaboration away from that goal. Another, more positive interpretation might be that, as with most innovations (including M-PESA), the initial take-up of M-Shwari is from easy-adopters in higher income consumer groups and that as the market develops new offerings will emerge for poorer groups. In the first year of operation 19% of M-Shwari customers were from below the poverty line; in the second year this had risen to 30%.

For FSD Kenya, expenditure on M-Shwari was $0.65 million, a significant sum but dwarfed by CBA's $14 million investment in the project. The added value from FSD Kenya was not therefore that the M-Shwari would not have proceeded without them – with this scale of investment, something would have happened. It is rather that M-Shwari is better – more successful, offering more value – because of FSD Kenya's input (and this is acknowledged by CBA).

This perception of M-Shwari success is important if it is to be a catalyst of wider market development, as FSD Kenya hope. In 2015 this began to happen with the launch of a Kenya Commercial Bank (KCB)-Safaricom product as a direct competitor to M-Shwari, with higher credit limits and aimed at middle income groups. One optimistic scenario is that crowding-in of new products aimed at lower-income groups will follow. The sheer, unavoidable scale of M-Shwari has been the prime driver of competitor interest but FSD Kenya have also helped spread information on it through a case study, even though this is aimed at development agencies as much as other finance providers.

Other

If M-Shwari can be seen as a success, other FSD Kenya collaborations have fared less well. Notably, a partnership between Orange (an MNO) and KCB, the country's biggest bank, based around the research and development of a radical new product platform targeting low-income people, failed. This was an ambitious project using a human centred design exercise to introduce a PayPlan mobile-based cashflow management product, and was led by an international team. In this instance, a number of factors but, especially the ownership and commitment of the partners (exacerbated by change in key personnel), appears to have undermined the project, whose cost to FSD Kenya was $0.25 million. And, self-evidently, the relationship – written, financial, formal and informal - between FSD Kenya and the partner companies did not test their commitment to the project. This was especially important since the change idea in this instance was more externally driven than in the case of M-Shwari.

FSD Kenya's other work in innovation represents much smaller versions of the approach adopted with both M-Shwari and PayPlan: technical support for novel ideas lying somewhere between concept and seed capital, the so-called 'valley of death' for new (usually start-up) innovations. FSD Kenya's hope is that, in this process, they will find a disruptive innovation that will generate far-reaching change, the Holy Grail for development agencies. It is too early to say how many of these will be successful, but the nature of innovation means that most of them will not be successful. Picking winners – nudging innovators towards success - is inherently a risky activity. Venture capital for example, in comparison, typically might expect a success rate of 25-50%. However, the binary – success/fail, good/bad – distinction in considering innovation can be overstated; 'failure' for example, may well result in learning which feeds into future 'success'.[10]

Learning and discussion points

- Objectives – even if the impact on the wider market, and on low-income consumers in particular, is still unclear – M-Shwari has been successful in opening up opportunities for more innovation. It is a major shift, and it has been significantly influenced by FSD Kenya. Other work in the innovation space has had limited impact, but such is the inherently risky nature of innovation support that is focused on individual firms.
- How to intervene - although there is an element of serendipity in this story, there was no luck in FSD Kenya being in a position to intervene successfully. This was built on key attributes - reputation, market knowledge, networks, technical understanding, flexibility – all of which have been consciously built.
- Risk and innovation – defraying risk and encouraging a pro-poor character in new products is a common way for facilitators to intervene. One attractive feature here is the one-off nature of the partnership – and therefore the tempting view that intervention is non-distortionary. This might be slightly illusory. If a market system (and a business) is to embrace innovation, it needs to be a continual activity – and aid-supported intervention should be as wary of placing itself at the centre of this as any other function (recruitment, marketing etc.) deemed vital to banks' performance.

10 Learning from an earlier 'failed' innovation – Jipange Kusave – was useful in the development of M-Shwari.

- Going beyond individual firm support - the potential to go beyond the role it has played in the innovation space, which has been primarily responsive to individual opportunities and which has an inevitable picking winners' character, is not yet clear from FSD Kenya's experience. Indeed, what such a role might be – creating a system for 'good quality' innovation – remains a challenging point.

4.3 MINI-CASE 3: CREATING THE MARKET SYSTEM AROUND (AND BEYOND) THE M-PESA DISRUPTION

Significance

M-Pesa has exerted a dramatic impact on financial services in Kenya, and globally. Not only is it the primary reason for the increase in overall access to finance but it has also changed the essential rules of the game in finance, introducing new rails on which to reach consumers with finance-related services. Transaction costs have been reduced and an era of digital finance has opened. M-Pesa is the premier brand in Kenyan finance, a brand whose ubiquity is such that – like Google – it has become a verb; a brand which is internationally recognised.

With more than 20 million accounts (out of 27 million mobile money accounts), 90000 agents (three-quarters of the total) and 95% of the market share by active money wallet users, M-Pesa dominates the market. This dominance has provided a functional low-value retail payments platform that has acted as a catalyst for a plethora of other services. However, in recent years it has begun to stifle market competition and growth, especially for poorer consumers, a reality increasingly recognised by regulators and other stakeholders.

FSD Kenya has played a unique if often unrecognised role in the story of M-Pesa. Initially this focused on creating the regulatory space to allow M-Pesa to happen. But, over many years, it has engaged in other ways to mitigate M-Pesa's influence and shape a better, fairer market system for all players. The objective of FSD Kenya's intervention here has been to nudge the environment around M-Pesa – the information, regulations, coordination and product development functions – so that the market system as a whole encourages more and better innovation, and service quality.

M-Pesa has been a recurring theme throughout FSD Kenya's 10-year life. Examining the varying roles it has played with respect to M-PESA illustrates the range of tasks - and attributes – required of a market facilitator, as well as their limitations.

The story

M-Pesa was born out of a pilot project undertaken by Vodafone (an MNO), in conjunction with Faulu (an MFI) and CBA (a bank). Its initial objective was to explore a better way of doing microcredit disbursements and repayments but focus group discussions showed interest for a wider money transfer service. The project was supported with a £1 million matching grant from a DFID-funded Challenge Fund, support which allowed the project to be prioritised over other, lower risk investment alternatives within Vodafone. But while the story of the DFID grant in supporting Vodafone's initial innovation is widely publicised, the importance of the change that had to take place in the regulatory environment to accommodate M-Pesa and FSD Kenya's role in this is less known, even if it was just as crucial.

Vodafone's approach throughout the pilot project was to keep the Central Bank of Kenya (CBK) informed of progress. They were aware that (what became) M-Pesa posed a quandary for regulators – as a financial service it was not clear how it fitted with existing banking regulations. The withdrawal of Faulu from the partnership in some ways clarified that M-Pesa was not a bank while CBA remained as the bank holding the trust account for M-Pesa. But still the instinct of CBK, according to one CBK insider, *"was to say no"* to a largely unknown new financial service. Indeed, most central banks throughout the world followed this instinct at that time when faced with the new mobile money challenge. That this didn't happen in Kenya is, in large part, due to the close relationship FSD Kenya held with CBK and the influence it was able to exert.

FSD Kenya knew key individuals within CBK well, having worked with them intermittently for years. Moreover the 2006 joint-launch of the FinAccess survey had pushed financial inclusion to a position of more importance in CBK's agenda. Building on this, FSD Kenya played a major role in convening discussions with CBK and others, in defining what needed to be understood and in bringing in the right people to offer advice. This was critically important in swaying the internal debate within CBK *"and winning over the conservatives, including the Governor"*, providing CBK with the confidence it needed to bring in *"innovation from a regulation perspective"*. Vodafone's pragmatic approach to regulation had always been not to seek permission, to ask CBK to say yes, but rather to invite CBK 'not to say no', an approach which resulted finally in CBK issuing a 'Letter of no Objection' to Vodafone and this became the regulatory cover for its operations for eight years.

By December 2008, M-Pesa's startling growth was obvious. Banks' complaints about this newcomer were becoming louder and had reached the political stage with questions being asked in Parliament. CBK however were able to respond to the critics by citing evidence of clear benefits from an extensive survey of M-Pesa customers undertaken by FSD Kenya, and the real threat of closure was resisted.

FSD Kenya's work in these early uncertain days for M-Pesa was largely in the background. It built on a number of factors – its perceived neutrality but closeness to the key issues and players (public and private), its insight into the issues, its flexibility in being able to respond in a timely manner to a fast-moving situation, and its networks of international expertise. It is very unlikely that M-Pesa's remarkable growth would have been achieved without FSD Kenya – more likely, with a less supportive regulatory space, is that digital finance would have taken the slower, more cautious path to development found in most other countries. And Kenya, consequently, would not have led.

If early complaints from banks about M-Pesa had something of a 'who is this upstart?' quality, quite quickly it became clear that M-Pesa's growth was allowing it to exert monopolistic market power. This shows itself in particular in its control of the digital rails to reach customers which allows it to set highly preferential terms for providers seeking access to this for products such as savings and credit, payments mechanisms and asset finance. Criticism of M-Pesa therefore assumed a more valid character.

In this context, FSD Kenya's role has been – standing outside the market – to intervene selectively to develop a more competitive, fairer digital market. This has taken a number of forms at different levels in the market:

- Advising the Competition Authority of Kenya (CAK) on more transparent pricing and access to M-Pesa's communications layer of infrastructure, or alternatives to it such as USSD.[11]
- Undertaking detailed studies on the potential risks from 'overlay SIM technology' (literally sticking a SIM onto a primary SIM), the new technology being used by Equitel (a collaboration between Equity and Airtel, an MNO) and a new competitor to M-Pesa. This evidence contributed to court decisions rejecting Safaricom objections to this new competitor.
- Supporting the introduction of the regulations that operationalised the National Payments Act which were finally published in 2014. Among other provisions, these prohibited agent exclusivity by licensed payment service providers and therefore allowed 90,000 of M-Pesa's agents to have agreements with other MNOs.
- Through the development of new product innovations (M-Shwari primarily), encouraging the development of new applications that use (and collaborate with) M-Pesa to provide new financial solutions to customers.
- Under the auspices of the CBK and the Kenya Bankers Association (KBA), coordinating the main industry players in developing shared infrastructure that will allow interoperability between banks payments systems and effectively create an alternative to M-Pesa (see 4.4 below).

FSD Kenya's inputs here therefore have taken a variety of forms including TA to individual organisations, coordinating different players in tasks of mutual benefit, and studies (and informal advice) as evidence to regulators/policy makers.

Learning and discussion points

- Considerable success in meeting objectives. FSD Kenya has played a quietly effective role in the development of a more conducive environment for the introduction of M-Pesa and subsequently one that 'gets the best' from M-Pesa for the market as a whole.
- A number of roles but all drawing on key attributes. FSD Kenya has only been able to intervene successfully because it is a known entity with a long-term presence, generally respected for its knowledge and technical rigour, and perceived as being independent, rather than a market player.
- Technical quality is central to credibility and relevance. This is a contested, high stakes market, with competing interests and robust exchange between different providers. It is not a place for partially-informed engagement. In this context, *facilitation* requires *facilitators* to have the confidence that derives from detailed knowledge over the challenges facing the market system as a whole.

Balancing tactical opportunism with strategic direction. Many of the roles FSD Kenya has played in the M-Pesa story have required immediate/quick action where, had FSD Kenya not acted, potentially negative consequences would have resulted. The challenge from this – discussed elsewhere – is how to build this capacity (for example in regulation) among others in the market system to play this role on a sustainable basis.

4.4 MINI-CASE 4: BUILDING THE 'PUBLIC' BUILDING BLOCKS, THEN DOING IT SUSTAINABLY

Significance

For a more advanced financial market system to develop, a range of 'public' functions – shared services, mechanisms and rules that benefit the sector and its consumers as a whole - are required. Three of these relate to credit information sharing (CIS), payments, and regulation. While different, these are all 'public' in nature, in that they should be provided by either government or

11 Unstructured supplementary service data

The Central Bank of Kenya: The objective of the FSD Kenya intervention here was to facilitate the development of public supporting functions and rules in the financial sector – and so provide a conducive environment for financially inclusive services.

associations or by for-profit providers within strong regulatory regimes.[12] They all require significant cooperation and market organisation, are all systems in their own right, and are all vital building blocks in a successful financial market system. All have been a key focus for FSD Kenya.

The objective of the FSD Kenya intervention here was to facilitate the development of public supporting functions and rules in the financial sector – and so provide a conducive environment for financially inclusive services – but to do so in way that allow these functions to continue to be provided without external input.

The idea of improving CIS between lenders to improve decision-making, mitigate risk and reduce the cost of lending had been actively discussed in Kenya since the 1990s. In 2005 there was still no organised CIS system. But by 2015, legislative change which made sharing information mandatory between lenders was in place, an organisation to coordinate the new industry had been formed, and the number of requests for information from credit reference bureaux (CRBs) had grown three-fold in four years. Though still in the throes of development, the CIS system is beginning to take place.

The idea of an interoperable switch ('the Switch') that allows integration of all major retail payments channels – and transfers between different banks – has also been discussed for many years. M-PESA has been the dominant system for transfers over the last ten years and there has been no shared system between other payment providers. In 2015, however, the industry was on the brink of agreeing on the technological, organisational and management details of a switch system for the banks. It is expected that when operational this will allow major new competition to M-PESA, and choice and substantially reduced prices for consumers.

Regulation around finance has changed considerably since 2005, though the system through which regulation is made and reformed is largely unchanged. Regulatory change has produced some noticeable achievements especially to accommodate the growth of digital finance. FSD Kenya has played an important if unheralded role in many of these changes in the last ten years; in 2015 its involvement is greater than ever.

While work on CIS and the Switch has proved to be a more protracted marathon than envisaged, a future picture of better functioning and sustainable systems in both is emerging. For regulations, however, reliance on FSD Kenya is even greater than before – and no clear view of the future without FSD Kenya is emerging. FSD Kenya's process of working in each area and the common ground and differences between these experiences throws light on the facilitation challenge.

12 In economic terms, these display some key public good features – such as being non-rival/non-excludable and with positive externalities.

The story

Credit information sharing (CIS)

In the years from the 1990s, when the finance industry struggled with high levels of non-performing loans (NPLs) and bank failures, CIS featured in regular but generally ineffectual discussions between the industry and CBK, with few concrete actions emerging. In 2007, a new law requiring negative information sharing was introduced but was not being followed. A Joint Task Force to force progress on CIS was established - with KBA and CBK as the key players – but little was being achieved and, much as had been the case for the preceding 5-10 years, there was a palpable sense of drift.

In 2008, a 3-day workshop was held by the Task Force. FSD Kenya, seeing an opportunity and a need, took the initiative in proposing to coordinate the work of the Task Force. For the members, FSD Kenya represented a good choice – they were trusted, known, neutral and involved. A project manager was appointed in 2009, and seconded to KBA. He brought considerable personal credibility – having been with the CBK and World Bank – and been engaged in the CIS discussions for some time. But the challenge was considerable; banks were supposed to be compliant with guidelines on information sharing by February 2009 – but none were.

A range of activities were undertaken in the first few years, many of them designed to raise interest in and demand for a CIS system. Study tours for key stakeholders were undertaken in South Africa where the CIS model was seen to be most relevant. Two CRBs were licensed but a pilot exercise in 2010 produced very disappointing results, with low quality information being provided by the banks to the CRBs, showing that there was little faith among lenders in the mechanism.

In 2011, FSD Kenya organised an East African conference at which the benefits of full information sharing from wider international experience were highlighted. It was an important revelatory moment for many, and encouraged the project to continue.

From then FSD Kenya has played a range of facilitator roles in pursing the development of a CIS system. First, it has acted as a coordinator of different players around a common vision working through a national task force and with 'champions' in each bank. Second, it has used support for further legislation on mandating full file sharing as a means of mobilising and focusing the industry. It secured consolidated feedback on shaping regulation and moving this quickly to finalisation (taking less than two years to gazetting – relatively fast!). Third, it managed the process of developing an industry association (the CIS Association of Kenya) and defining its role – as an advocate and regulator (with delegated authority from the CBK) - and its *modus operandi*. Fourth, it began to develop new services that were considered important for a successful CIS system such as alternative dispute resolution mechanisms.

By 2015, the development of CIS still faced a number of challenges such as how to extend beyond banks to other credit providers and addressing lenders capacity to use information to make decisions (rather than simple blacklisting). And the Association had also to consider how to improve its services to its members, to ensure its own sustainability. It is not possible to assess yet whether the new CIS system is reducing risk and the cost of credit but, as a first indicator of effectiveness, use of the system - demand for information reports from CRBs – is one useful proxy. This shows that monthly demand for credit reports had grown to 200,000 from less than a third of that figure four years earlier. Its targets are for a further doubling by 2017.

It is premature to be citing the CIS system as a success. However, there is a relatively clear vision of the future – not simply of how the Association will function but how the system as a whole will work and be funded. Thus far FSD Kenya has funded the development at a cost of $1.6 million between 2008 and 2014 and has been the main driver of the process. It is doubtful if the existing level of progress would have been achieved otherwise. The level of stasis and dither around CIS meant that making progress here was not simply a matter of 'donor funds' but of active facilitation, coordinating tasks that are essentially one-off interventions. Now that the nascent system is there it has to be paid for and FSD Kenya's support to the Association is on a declining scale and the project coordinator is now an Association employee. FSD Kenya has played the key technical and coordinating role thus far but the finance industry has an incentive to make this work – and there are clear indicators in place to test this commitment.

Interoperable payments system (the 'Switch')

FSD Kenya began discussions with CBK around payments in 2008-09 when the potential implications of M-PESA were beginning to emerge and a concern growing that its first-mover advantage was shifting to a de facto monopoly position. FSD Kenya led a scenario development process to raise the industry's awareness of the significance of payments systems. This was followed by a study that recommended improved industry co-operation and allowed economies of scale in payments. Working with KBA to consider options with respect to payments, FSD Kenya identified a strong business case for the industry to create an interoperable national retail payments system. The National Payments System Act of 2011 also made clear that CBK supported collaboration between providers in the development of payments systems.

From this starting point – a shared vision of the future – when the scale of the task became clear, FSD Kenya seconded a staff member to KBA to work full-time on the development of the Switch. FSD Kenya's engagement has had a number of related strands.

- Bringing industry players together: this meant not only regulators and banks but also representatives from MNOs. Given the competing interests (and corporate ethos) among the different players, this involved understanding the different parties' perspectives while keeping their focus on the mutual interest and the public goal (endorsed by government) of the project. Managing organisations on the 'collaborate-compete continuum' was not a straightforward task, and much of it based on personal relationships. According to one participant *"FSD Kenya was always getting beaten up! Not being a player, people were asking whose side are you on? What authority do you have?" But it was recognised that not only was this role necessary* "This won't happen without someone making it happen" but that this coordinating role could only be done by a neutral party with credibility - and FSD Kenya was the only candidate who fitted this description.

- Raising awareness: study tours to South Africa and the UK were organised for cross-sectoral groups of – banks, MNOs and government – and proved very useful (*"They were fantastic – made it practical". "It was a rare opportunity to come together. And agree"*.). Where required, specific studies were undertaken – for example on non-bank interoperability.
- Specific working groups: once the process moved forward smaller working groups were established, with clear agendas, milestones and regular (weekly) meetings.
- Development of a new organisational architecture: this included a National Payments Association and a Mobile Money Association for non-bank members, work which involved an initial study, agreement on constitutions, and securing legal advice. As the Switch moves to being operationalised, more detailed management structures will be required to be set up.
- Contracting the design and commissioning of the Switch itself

Although still a work-in-progress, the payments platform initiative has progressed. FSD Kenya's facilitation role has been critical – certainly the pace of progress would have been much slower (a matter of years) had they not been present and with the requisite qualities – knowledgeable, neutral, engaged, flexible. FSD Kenya's input has been around $1.5 million up to 2015. But given the incentives the banking industry has to make the Switch successful, their joint investment of $10 million and the scale of the potential commercial gains - it is expected that the structures and mechanisms developed will continue without support.

Regulations

There is an established process laid down in Kenya governing the path through which policy and regulatory reform take place. For policy, this typically has a number of elements (and for regulation a slightly abridged version):

- initial idea and concept development – drawing typically on the agenda raised in government's main overarching strategy (currently the Medium Term Plan [MTP] (2013-17) for the Financial Services Sector, part of the Government's Vision 2030 national planning framework)
- task definition to develop a background or policy paper – such as writing terms of reference
- identification and contracting of specialist personnel, and production of paper
- consultation with stakeholders (through websites, workshops, presentations etc) and changes in the light of this process
- drafting of policy and move to Cabinet, Parliament and the political realm

Where does FSD Kenya fit into this? From its early days, FSD Kenya has played an advisory role to key parts of government – especially the CBK and National Treasury. Much of this has been relationship-based advice as much as formally structured advice and inputs. Latterly, however, since 2013, FSD Kenya's input has been through a Policy Support Facility, a 3-year $1.6 million project which sought not only to provide support/advice but also to do so in a more formalised responsive manner that would help develop the capacity of the regulation/policy-making system.

However, in practice, following initial concerns over delays from the government side, FSD Kenya has assumed a role that is more pro-active and involved than ever. This includes initial idea generation and concept note development - which it is well-positioned to do from its knowledge of the industry and of the MTP (a document which it helped to write); writing terms of reference and, from its networks, identifying suitable consultants (usually international); contracting them quickly (lack of bureaucracy helps here) and managing their inputs; and coordinating inputs from other stakeholders, including liaising between government departments.

FSD Kenya is engaged throughout the process. Government organisations are, of course, still in charge but for them – frequently overstretched and under-capacitated - the kind of flexible, supportive, formal and informal technical resource offered by FSD Kenya is ideal. And this differs markedly from the way in which support facilities offered through other donors, such as the World Bank, operate which tend to be more restricted in subject matter, slower and less responsive.

FSD Kenya has played a role in facilitating a number of major regulatory changes. Of particular note is their role in developing the batch of e-regulations required to put the provisions of the National Payments Act (2011) into practice, including helping to organise a concluding workshop between the CBK and the private sector in Mombasa. In 2015 other processes have begun in relation to important issues such as banking competition and leasing.

There's little doubt that, being as close as they are to the regulatory reform process, has allowed FSD Kenya to exert constructive influence on the technical detail and direction of regulation. Ten years after starting, FSD Kenya is more embedded 'in' the system than ever – and to this extent the system is more reliant on them than ever.

Aware of the obvious downside of this involvement, with respect to sustainability and dependence, FSD Kenya has (in 2015) initiated a new training and professional development programme for financial sector policymakers. This has involved coordination between the 'demand-side' – seven public regulatory agencies, headed by the Treasury and the provider of the programme – the (private) Strathmore Business School in association with the (public) Kenya School of Monetary Studies, and a hands-on role in the programme's design. The programme consists of five modules and combines classroom teaching with on-the-job mentorship spread over a 4-month period, and is for two batches of 30 government staff. FSD Kenya is financing the first, pilot programme. The programme fits with the strategic objectives of Strathmore and a need that government recognises. If the programme is successful it would appear that incentives are aligned to support its continuation – assuming that government is able and willing to pay the relevant fees.

Learning and discussion points

- Objectives – after many years of engagement, FSD Kenya has achieved partial success through its intervention. Both CIS and the Switch, using the power of government signals to press industry players to collaborate for mutual interest, may be on the path to sustainable solutions. But in relation to regulations, FSD Kenya has inputted successfully to much regulatory change without developing a more sustainable system.
- The benefits of a longer period of engagement - while it might be argued that both CIS and Switch engagements could have been done more quickly, pushing the pace of change would risk undermining ownership and thus the success of the intervention. Change has to matter to partners; until there is an incentive to change, change processes are likely to be someone else's (a donor's) agenda.
- The multi-facetted nature of institutional change - developing public institutions is inherently a longer-term task but also one which combines political, personal and organisational elements. It is, by its nature, a long way from the 'technical short-term fix' emphasis of many standard development interventions.
- Sustainability and a future vision - for CIS and the Switch a future picture without FSD Kenya is emerging. For CIS, a system managed by a CIS Association, paid for by users and supported by CBK regulation. For the Switch, a system with oversight from a National Payments Association and operational control by a management company established by/paid for by users (banks). Sustainability therefore has taken a tangible, understandable form. But for regulation FSD Kenya's role has focused on direct advice and, while being successful in improving regulation, the absence of a clear, shared future vision raises questions on 'where this is going'.

4.5 MINI-CASE 5: SERVICE MARKETS – STILL A CHALLENGE

Significance

All FSD Kenya's strategy documents have recognised the importance of business service markets for finance. These cover a range of functional areas such as market research, information systems, business strategy, and management and financial processes. Typically such services are offered on an individual, one-to-one basis or – for more generic knowledge and skills – in training.

For FSD Kenya they have been a recurring focus, with some projects consciously aiming at developing services markets. Intervention here therefore has the objective of developing the skills and capacity building function in the market system and building this as service markets, with finance providers buying services (consulting and training) from a range of sources.

In 2005, there was sparse information on the development of these markets but they were recognised to be weak and to be infused with sporadic donor subsidy and intervention. By 2015, though there is still patchy information on services markets, they are still generally felt to be undeveloped, but with more activity in evidence.

The impact of FSD Kenya on the development of services markets directly has been limited. What explains this experience? Examination of its work in three different projects – Microsave (focused principally on services for MFIs), GrowthCap (aimed at services for banks in SME finance) and SACCOs (broad-based management development) – throws light on the underlying reasons for this.

The story

Microsave, in its third phase of funding, was supported by FSD Kenya (and other donors) over a 3-4 year period from 2004 to 2007. Its aim was to enhance the capacity of the financial sector but also to develop providers of technical services to finance organisations. It did this through three related components: (1) working directly with providers (action research partners (ARPs)) in in-depth collaborations to change their systems and products, (2) using this experience to develop 'tool kits' which could then be applied to other ARPs and were available as a general resource and (3) mentoring and training (and certifying) a number of service providers and individual consultants.

Microsave, as a whole, was seen to be very successful but this was mainly in relation to the direct positive impact on MFIs/banks who were its partners. With respect to impacts beyond this, according to the project completion report, *"the influence on the local technical service market is less certain"*. Some individual consultants supported then are still active in the market – particularly in 'softer' market-facing tasks such as customer research rather than harder 'boiler-room' functions related to, for example, credit processes - but they have limited influence.

FSD Kenya sought to replicate the Microsave experience in GrowthCap – a project focused on improving SME finance and the development of SME finance consultants to banks. While GrowthCap in 2015 is still working directly with three partner banks, it has had minimal success in developing service markets. It sought to follow the same activities as Microsave, namely a combination of working directly with partners, learning through this process, and applying this learning to partners and in the development of written materials that would have a wider use including for new service provider consultants. Consultants would also be mentored and trained intensively.

An external review pointed out a number of specific reasons for GrowthCap's failings, both conceptual (a misinterpretation of the Microsave experience) and operational (weak management resources). From this, two general, operational criticisms emerged. First, weakness in specifying 'the offer'. Facilitation of service markets requires being able to deal with different players and being able to offer them *something of use* – information, advice, expertise, contacts, finance. And to be able to do that the facilitator has to understand their situation well and be able to answer basic M4P operational questions – what's stopping the supply-side from offering appropriate services?; why doesn't the demand-side invest in services?; what constraints need to be addressed through interventions? Second, understanding the centrality of incentives. Understanding why markets work, or don't work, requires that the underlying incentives are understood. Incentives shape behaviour in markets and interventions have to be aligned with them.

This importance of incentives in service markets is especially relevant in in explaining the lack of progress with FSD Kenya's work in SACCOs (see 4.1 above). Through direct demonstration pilots, active measures to develop providers of consulting services, and the development of training programmes, FSD Kenya sought to develop a training and consulting market for SACCOs. This was based on the assumption that SACCOs, pressurised by impending regulation and aware of the need to improve performance, would see the need for training and consulting, and were prepared to invest in these. SACCOs didn't (and don't) – the demand-side of the putative training market was fatally weakened by the different incentives shaping SACCOs' behaviour.

Similar reasons to the above explain the failure of FSD Kenya to develop training services in relation to SME finance. Initial weak understanding of the market – on demand-and supply-sides – meant that its offer was correspondingly vague. Moreover, with training another incentives/rules issue undermines the market. Banks are accustomed to see training as an investment to be undertaken with caution knowing that – if it's seen to be any 'good' – it will result in a considerable proportion of staff being lured to other competitor banks. Until this unofficial rule is addressed underinvestment in personnel is likely to continue. In such a situation, there would seem to be a strong rationale for a coordinated response but there appears to be little interest in this (suggesting that it doesn't matter enough to banks – at least not yet).

Learning and discussion points

- Objectives – this has been largely unsuccessful. This lack of success in developing service markets in a general sense can be attributed to weakness in operationalising the M4P approach. However, three broader factors have contributed to this which may explain some of the gap between stated intention and actual practice.
- The meaning of 'service market' in finance. Referring to these services as a market helps to bring definition to them. Like any market, there is a demand- and supply-side and for this to work there has to be mutual benefit for both parties. However, FSD Kenya has commonly referred to this as being part of the meso-level. Although this may be correct descriptively and is a much used phrase by funders, it is a more oblique and ambiguous term. In particular, it can give credence to the view that, actually, services for providers should not really be seen as a market at all but as a donor-supported function. For example, an external impact assessment of FSD Kenya in 2009 praised Microsave for its "hugely successful" work at the meso-level. But this was actually about the free direct delivery of technical assistance to banks; the review did not assess – because it was deemed too difficult – impact on the development of services.
- The influence of the continued flow of donor funds. While direct subsidy for the delivery of financial services has long been disapproved of in official guidance for donors, there has (until recently) been equivocation around services. In practice, this has become one of the main areas of funding focus for donors. In this context, of course, expectations on demand- and supply-sides are influenced and it becomes more difficult

for a market to develop. While doubtless funders can find justification in the 'need' of recipient organisations, this also reflects their own need to disburse 'support' – a fact of which stakeholders in Kenya, not least those in the finance sector are completely aware. It is of note that Microsave, a much bigger organisation than in the past and with a strong reputation as a direct provider of services to finance providers, is still donor-supported for most of its work.

- The nature of service market development. What consultants bring to any situation is themselves - manifested in their personal attributes and their experience base. Training, information, networks ….all may be useful and supportive but none is a substitute for pertinent experience. More specialised experience in finance exists outside Kenya than in Kenya currently and international consultants will continue to predominate for some time. However, more Kenyan consultants will emerge in specific technical fields from banks eventually. Global experience shows that this is the sequenced pattern of development for most business services. But before that 'good practice messages' will be spread by recruitment/ poaching – a trend already strongly in evidence. This factor does not invalidate intervention in service markets, but it does have implications for when and how facilitators should intervene.

4.6 MINI-CASE 6: MATCHING INCENTIVES AND 'OFFER' IN ENGAGING WITH THE REAL ECONOMY

Significance

Finance impacts on the lives of poor people in several ways. Most directly, poor households are consumers/users of financial services, and much of the effort in financial inclusion initiatives is aimed here. But finance also influences the lives of poor people in their capacity as employees/labourers and as entrepreneurs; as people in the 'real' economy. Financial services that work better for the poor must also work in this bigger economy, in particular in the world of agriculture and business.

In Kenya, much of the real economy is agriculture. 75% of people earn at least part of their living from agriculture, agriculture accounts for 25% of the economy and poverty is overwhelmingly a rural phenomenon. Moreover, while in the financial services field there is tortured debate over the links between poverty reduction and access to services, in agriculture the position is much less contentious, with evidence indicating a strong relationship between productivity growth and poverty reduction, higher than for growth originating in the rest of the economy. Beyond agriculture, SMEs – as opposed to microenterprises – are also increasingly important, recognised to be a key

Savings group table banking: Finance impacts on the lives of poor people in several ways. Most directly, poor households are consumers/users of financial services. But finance also influences the lives of poor people in their capacity as employees/labourers and as entrepreneurs; as people in the 'real' economy.

source of growth and employment in dynamic economies, a factor which has particular relevance for Kenya, as a low-income economy.

FSD Kenya has always recognised this broader importance of finance. Its second strategy identified rural/ agriculture and SME finance as two of its three priority themes. Interventions here sought, in agriculture, to develop a new product/service, value chain finance (VCF), and develop a service provider to provide this, and in SME finance, to build the capacity of a number of finance providers so that this would stimulate the wider market.

There is very little substantive change to report from interventions in these areas. Of course, it is the case that 'normal' household finance does percolate into business – M-Shwari for example is popular with agriculture traders – but overall FSD Kenya has had comparatively little impact on the real economy. Its work in agriculture, particularly in value chain finance, has seen little success, this in a national context of declining proportion of total credit going to agriculture (from 8.7% in 2000 to 4.9% in 2012). Similarly, while SME finance is now a higher proportion of total lending (22.6% in 2013 from 18.2% in 2009), it is not clear how any of this can be attributed to FSD Kenya. After eight years of work, it has still not produced noticeable change. What accounts for this and what can be learned from these relatively unsuccessful engagements with the real economy?

The story

Agriculture

FSD Kenya's main intervention, initiated in 2009, was aimed at the development of agriculture VCF targeted at small-holders. The rationale here was that VCF is a potentially useful way of extending finance effectively to different players throughout value chains, enhancing the performance of the value chain as a whole and not just individual players within it. However, VCF requires rigorous quantified analysis of the value chain and of the financial needs/flows within it, and this was an analytical approach that was new for finance providers.

The idea behind this action-research project was to instigate a number of pilot processes of detailed research that would lead to VCF product development. This would be applied in four value chains and would be used to develop appropriate products and establish the basic 'proof of concept'. Once done, the project envisaged working with finance providers to develop a specialised and sustainable VCF information support service. The project was implemented jointly with a USAID programme that was already working in the agriculture finance sphere, and was seen to be the main technical resource.

In an initial pilot, FSD Kenya had approached eleven finance providers who'd expressed an interest in the project and selected four with whom it signed memoranda of understanding (MoU), defining objectives and responsibilities. FSD Kenya's offer to these banks was essentially technical assistance in nature. Detailed surveys were undertaken with each of the banks in the geographic areas in which they were working and pilot protocols signed with three.

Four value chain studies were planned but only two were undertaken and one of these was abandoned on realisation that the research was not being rigorously done. Since the research was the foundation of the whole project, in its absence all the other activities fell to the side. The project therefore did not succeed in meeting its key targets and testing new VCF products let alone developing a supplier of services. Similarly, its plans to develop learning resources – briefing notes and 'how-to' notes on VCF – did not materialise.

The project, costing $0.7 million, failed to gain traction and achieved limited learning. Why was this so? Two issues undermined FSD Kenya's efforts. First, the project was seeking to "establish a source of technical expertise" in an advanced research-oriented field, and therefore had to be technically-led. But in practice it wasn't. External consultants were used but technical leadership from FSD Kenya was very thin. Its offer therefore – what it brought to the table in discussions with providers, more than simply the detail of written agreements but what was said and who was saying it – lacked credibility. Meanwhile the implementation arrangements crumpled with the USAID project who were to be the 'bringers of expertise' (in such a specialised field, all of this had to come from outside Kenya) shifting their focus to other activities. FSD Kenya committed to undertake a technically-challenging task, and recognised this, but was left unable to deliver.

Second, the implicit assumption in the project was that the key 'problem' with finance providers was technical capacity. In reality, however, as important here was that agriculture wasn't really a major priority for most finance providers – and their commitment lukewarm. For example, in the pilot phase, of the three partner institutions only one devoted dedicated staff to the process; in the others staff were only partly available because they were engaged in other business units. FSD Kenya were therefore over-optimistic on partners' incentives, may have underestimated the extent to which donor funding had seeped into the incentives DNA of the sector, and did not craft an offer to them that tested their commitment adequately. Which leads – weak incentives or weak offer –is a moot point, but both were problematic for FSD Kenya here.

SME finance

FSD Kenya's work on SME finance has several continuing strands. This includes its work in developing a CIS system, which has made considerable progress (see 4.4). But one key thrust is related to (see 4.5) building banks' SME finance capacity and to business services dealing with this. The approach here was to (a) provide relatively intensive technical assistance to a select number of suitable banks in action research projects (b) use this experience to lay the basis for development of providers of SME finance consulting services.

In 2015, after several years of discussion and sporadic activity with several banks, three pilot projects with banks had at last started, each of them concerned with supporting change within banks with respect to systems, products, and people. In each project there is a 50% cost share agreed around direct technical assistance costs. The idea of developing a local service market has been de-emphasised.

Progress in developing banks SME finance capacity has been much slower than expected, several years behind what was envisaged. Why has this happened? As in agriculture, two overarching reasons stand out. First, reforming banks to improve their performance in relation to SME finance requires a significant change process throughout the organisation and across different departments and is not a matter of discrete one-off pilot projects. In this context, FSD Kenya struggled to articulate what it was offering and why this was needed. Its stretched management resources and the sometimes variable quality of technical inputs from consultants meant that relationships with potential partners were mixed and FSD Kenya's offer was weak

Second, FSD Kenya over-estimated banks' enthusiasm and readiness for SME finance. Superficially at least banks did display interest in SMEs and for some this is a logical step to a less price sensitive and potentially higher margin market. However, in general, their understanding of what a commitment to SME finance would mean in practice – and the depth of change required - was partial. As this became clearer so their incentive to change reduced. Banks' level of commitment has been inconsistent; it hasn't mattered enough.

Learning and discussion points

- Objectives – little impact has been achieved. The VCF intervention in agriculture largely failed while the SME finance work, though still ongoing, has struggled to gain traction with participating banks.
- Recognising the problem (1) – is there an incentive to change? Finance providers who have been partners in change processes have shown, overall, varying commitment to invest in developing services aimed at the real economy of agriculture and SMEs. Ascertaining commitment in large organisations means going beyond specific individuals to understand corporate decision-making structures. In this context, interventions need to be crafted in a way that tests and builds partner commitment – without this, technically-focused intervention is unlikely to succeed.
- Recognising the problem (2) – is there facilitator capacity to bring change? If there is partner commitment ('want to change'), and the key barrier to change is organisational/technical know-how ('don't know how to change'), facilitators have to be able to access and provide appropriate technical competence to have a useful offer to partners. In the absence of this, interventions cannot be successful.

4.7 MINI-CASE 7: PLURALISM AND CROWDING-IN: SEEING INFORMAL FINANCIAL SERVICES THROUGH A MARKET SYSTEM LENS

Significance

In 2005, savings groups were increasingly seen, globally, as serving an important purpose in enabling poor people manage their finances and their lives. However, in Kenya they were relatively undeveloped. From the FinAccess survey (2006), with almost three-quarters of the population excluded or reliant on informal finance, FSD Kenya knew that a more inclusive finance market could not simply rely on formal finance providers; other sources, such as savings groups, potentially had a key role to play.

FSD Kenya regarded existing standard approaches to developing savings groups as expensive and overly dependent on external, donor support. After a protracted period of negotiation, working with NGO partners, primarily CARE and Catholic Relief Services (CRS), FSD Kenya initiated a process of project design, experiment, and innovation that spanned eight years and three main phases. Intervention here therefore was aimed primarily at developing training/group formation – a supporting function with a public character – and on this basis enhancing digital information resources and links with banks. In doing so, a better environment would be established for the successful operation of savings groups.

By 2015, through FSD Kenya support, approximately 400,000-450,000 people had been organised into 15,000 new savings groups. More important, a range of new, efficient approaches to savings groups formation had been developed which held substantial promise in terms of further scale and sustainability, and a wider roll-out in the country.

FSD Kenya's savings group story is not finished. New challenges are being confronted as the potential to integrate savings groups with mainstream formal providers, using digital finance technology, is explored. But, even at this stage, some lessons are emerging on the implications of applying a market systems framework.

THE STORY

From its inception, FSD Kenya has sought to pursue a broad and pragmatic approach to financial inclusion. While recognising the need to advance the frontiers of formal finance provision, it has also understood that a healthy inclusive financial sector is one which is 'pluralist', which offers choice for consumers of different sources of finance. In particular, for hard-to-reach, poorer people, non-commercial sources of finance are important.

In 2007, FSD Kenya began discussions with CARE over a potential savings group project. CARE had responded to an advertisement calling for proposals on innovative ways to improve the poor's access to finance. At that time most of CARE's work with groups in Kenya was in the context of broader livelihoods programmes where savings groups – following a familiar NGO group ethos - were a means to an end, and often a way of soliciting contributions to, for example, community water infrastructure. Elsewhere, notably in Mali and Zimbabwe, CARE had developed an approach to developing savings groups which was not tied to livelihoods activities and this had been introduced in a small way in Kenya. It was this approach that CARE initially suggested should be followed. This approach emphasised the central position of CARE staff in organising, training and managing the group formation process, and was commonly regarded as international good practice.

From FSD Kenya's perspective, the problem with this standard approach was that it was sourced in a view of small-scale expensive donor-NGO delivery rather than facilitation of change aimed at unleashing potential for larger-scale, more sustainable impact. For that to happen, not only did the cost of forming groups have to be substantially reduced, but the function of group formation had to be more embedded in the norms and practices of rural society – rather than be one which only (external) NGOs could do. Prolonged discussions took place with CARE on alternative ways of forming savings groups, much of it focused on the cost of training per group member. In traditional approaches this ranged typically from $20 to $100. FSD Kenya's view was that this had to be reduced to less than $10 if the potential of scaling-up savings groups was to be realised.

After almost a year of sometimes robust interaction with CARE, FSD Kenya's view[13] prevailed and the first phase of the project commenced with $10 as the target, less than one-fifth of CARE's initial position. More important than the specific quantitative target, however, were the questions and the analytical lens that lay behind them that FSD Kenya - here as an informed funder of facilitation rather than a facilitator themselves – were asking. How can the process of developing savings groups be placed more into the community? How can the system of group formation replicate itself with little (or no) external support? Are the inevitable quality compromises that will arise from reduced NGO control – and the emergence of market norms - acceptable?

FSD Kenya's engagement has proceeded in three phases:

Phase 1 (2008-2010, $1.3 million)

This phase tested a range of different channels for delivering groups, in particular faith-based organisations and franchisees (local entrepreneurs). The cost target provided the framework within which CARE could innovate. FSD Kenya also provided technical assistance to support CARE in the process.

After two years the project had reached 115,000 new members in more than 4,000 new savings groups. For CARE themselves the outcome was revelatory: *"We reached the largest number of people we'd ever reached! This is the only programme I'd been involved in that was self-sustaining"*.

13 As the *de facto* donor in this relationship, FSD Kenya obviously had extra weight in this discussion

Phase 2 (2011-2013, $2.3 million)

The main purpose of this phase was to further refine and develop the savings groups models by testing different approaches – with CARE and CRS - in different regions. This included remote, northern areas with more nomadic populations where a different approach was required, one with a reduced, but more focused training component. One challenge here was to change preconceptions of people who were accustomed to relief from NGOs (*"some of if given by CARE"*!). After two-and-half years the project had reached 210,000 new members.

A number of important findings emerged from detailed research undertaken at this time. While channels that were more expensive produced the best 'quality' groups, *"savings groups in all channels are having positive impacts on members' livelihoods*"; groups were reaching the *"middle class of the poor",* there was considerable 'spillover' from savings groups projects with, on average, 2.5 groups forming spontaneously for every project group; and through the different models applied and the local derivations emerging from these savings groups of great diversity had emerged, not one standard model.

Phase 3 (2013-2016, $2.6 million)

As well as further savings group formation, the main focus here was on developing and testing of digital technology-based aids. This included:

- An e-recording app to allow digitisation of group rules (the constitution) and transactions.
- An e-kit of training materials to be used by non-trainer supported groups themselves or by trainers
- M-linkage products that link groups with banks, either simply as a safe storage/saving facility or to access other savings and loan products.

These are all in varying stages of development, with the e-recording app closest to practical application. The step of linking savings groups with formal providers is arguably the most ambitious step being considered now. Bringing together disparate parts of the existing market system, narrowing the formal-informal divide, would potentially be a major step to meaningful inclusion but depends critically on whether this represents a feasible business model for banks.

Learning and discussion points

- Objectives – FSD Kenya has achieved partial success in developing the group formation/training function with momentum created in embedding this into the market context. It is clear that substantial further outreach depends on public/donor resources – but a research base to guide this has been established.
- Seeing traditional roles in a market systems context: the initial step of putting savings groups into the framework of market systems has been

most valuable. Group formation can be seen as a legitimate one-off, public good – an investment in social capital – but considering it in this frame rather than seeing it as an aid-funded deliverable instigates a series of questions which interventions should seek to address. Much of this revolves around 'right-sizing' group training so that there is more scope for groups to develop as an embedded (if informal) institution rather than a slightly artificial external creation.

- Developing a vision of the future: after eight years of intervention and \$6.2 million invested, having made the step to place savings groups into a market system framework, and undertaken research on the efficacy of different channels, an important question with savings groups (as in any M4P context), is to consider the future vision towards which intervention is proceeding. For example, how can groups be linked with Kenya's formal finance providers? This is especially important to avoid the familiar trap of development support for endless group formation.

4.8 MINI-CASE 8: THE INFORMATION AND KNOWLEDGE BASE - YES, IT'S GOOD, AND IMPORTANT ... SO WHO'S GOING TO DO IT?

Significance

In 2005, financial access and inclusion were new terms for Kenya and for many in the financial sector. While there was some interest, especially from the CBK, stirred by the UN's declaration of 2005 as the International Year of Microcredit, these were terms that still represented vague aspiration rather than a 'tight' subject to be defined, analysed and pursued through specific actions.

From its inception, FSD Kenya recognised that developing an information and knowledge base through research was a key part of its task. This was necessary to raise stakeholders' awareness and understanding of financial inclusion – what it meant and what its implications were. But also, as a key tenet of its market systems approach, FSD Kenya's interventions had to be analysis-led, shaped by a knowledge of the underlying causes of market failure and exclusion.

Research is a defining feature of FSD Kenya. The objective of interventions has been to develop the research and development supporting function, primarily as a public role, feeding into financial provider performance but also policy and regulation. Intervention has taken both the specific form of instigating regular FinAccess surveys on financial inclusion – with three already undertaken and the fourth due in 2016 - and more generally producing a range of research-based outputs, some being of a more fundamental 'knowledge' character such as the Financial Diaries case studies and others that are issue-based and inform or are derived from other FSD Kenya work.

In 2015, financial inclusion is embedded significantly in the financial sector's consciousness and discourse. It is one of the three core objectives of the CBK, features in the corporate communications of the main players in the sector, and is highlighted regularly in the media. FinAccess is a respected fixture on the financial landscape and FSD Kenya research is known widely. But notwithstanding the quality and value of the research undertaken, ten years after initiating its first research activities, FSD Kenya (in its own words) is still *"playing a key role in the management (and funding) of FinAccess"*, and the same broadly applies to the wider research role. Self-evidently, FSD Kenya is the principal funder and provider of research. What's happened here and what can be learned from this?

The story

The need to define and measure financial inclusion was recognised as an early priority by FSD Kenya and, as in other countries (especially South Africa), a national survey (FinAccess) was required in order to establish basic data on the existing position. This covered data on access and usage broken down by four different types of provider (formal prudential, formal non-prudential, formal registered and informal) and sub-divided further by demographic (education, gender), geographic and other criteria. FinAccess takes the form of a written publication and presentations. It also contains the series of datasets that comprise the raw material for the main surveys and which can be further analysed. The first FinAccess was launched in 2006, followed by one in 2009 and then again in 2013. Later versions of FinAccess have added more supply-side data but it is primarily a demand-side survey.

FinAccess, now in its fourth iteration, is an acknowledged part of the finance scene in Kenya and it is not possible (now) to isolate its 'impact' on inclusion. Familiarity with it inevitably dilutes appreciation but most observers in public and private sectors recognise its value. As one ex-CEO of a major bank put it *"For the industry as a whole the greatest thing [from FSD Kenya] has been FinAccess. It has made it [inclusion] real. Everyone believes it"*. Use of the 2013 survey was tracked by FSD Kenya and showed almost 8,000 downloads and 24 media mentions. Anecdotally, it is valued and used, though how much it is used is less certain. Nonetheless, the first test of the survey's utility – that it is technically valid and trusted – has been passed.

FSD Kenya initiated and has taken the lead role in managing and financing FinAccess from the first survey but has done so in conjunction with other organisations in the official managing structure, the Financial Access Partnership (FAP). Division of the many different responsibilities for organising FinAccess -such as questionnaire design, agreeing on sample frame, conducting pilots, identifying and contracting research companies, project managing researchers, data entry and analysis, and publication - is divided up between different partners. CBK and the Kenya National Bureau of Statistics (KNBS) have been the principal technical partners. Other individual organisations from public and private sectors have also been involved as FAP members. However, their input has been variable in depth and usefulness, to the extent that the FAP ceased functioning around the 2013 survey, primarily because the private sector stopped engaging. In practice, the responsibility for management and coordination of FinAccess still lies with FSD Kenya.

The financial contribution of partners to the costs of the survey offers one indication of where real ownership lies. FSD Kenya financed the first survey (at a total cost of $0.25 million) but determined that sustainability should be given more consideration for the second ($0.67 million) – which secured some (modest) contributions from CBK and the three individual banks. By 2013 ($0.85 million), one third of the direct survey costs (ie excluding analysis, interpretation, and project management costs) were being provided by CBK. FSD Kenya believes that the contribution for the fourth FinAccess will be higher but for now it does and pays for most of FinAccess.

Notwithstanding the quality and relevance of the survey, ten years after its inception, FSD Kenya still faces basic issues over FinAccess – inter-related questions which are not dissimilar to those it faced from the outset:

- who is it for primarily? (the public sector?, the private sector? both?),
- what is it (a 'minimalist' view focused on the main survey output or the survey plus access to data sets plus secondary analysis?) and
- who owns it? (the public sector [CBK], a private sector entity or an association?).

None of these are straightforward questions to answer, especially in the context of mixed signals from CBK on its own commitment. In practice, FSD Kenya's approach to these has wavered over the last few years. For example, private sector interest was cultivated at one time but an attempt to sell the datasets to interested parties after the 2013 survey produced no buyers, suggesting a substantial disconnect between the survey and private sector interests. FinAccess still takes a considerable proportion of research staff time. After the first survey, FSD Kenya's own assessment commented on their surprise and disappointment at how time-consuming the process had been – and this is still substantially the position.

FSD Kenya's research role beyond FinAccess is broad and takes different forms:

- Commissioning and publishing think-piece studies (by specialist consultants) that complement other work – for example, on the case for a new asset registry or proposed mechanism for dispute resolution in credit information sharing.
- Short insight pieces on new trends and developments – for example, digital finance breakthroughs.
- More detailed impact-oriented research into FSD Kenya work – for example, surveys and case studies on savings groups.
- Less applied, more research-oriented studies – most important here has been the Financial Diaries series of three hundred case studies analysing in detail poor households' management of money. But this category also includes occasional one-off research pieces and an e-book on financial inclusion in Kenya.

It is difficult is to assess the efficacy of this research effort. 90% of a stakeholder group tracked by FSD Kenya report awareness and satisfaction (a score above 3 out of 5) with FSD Kenya publications and while this is not the same as using research, it is a necessary step towards usefulness. There are other more qualitative clues indicating the value of research. For some activities which are dealing with specific policy issues, think-pieces are the start of the process of policy change – and there is a clear link between research and change. In other cases, the direct link with change in policy and practice is less evident but the work is seen to be influential – the work on Financial Diaries for example has been widely praised. It is also clear that FSD Kenya's general research orientation allows it to engage in different parts of the financial sector on the basis of a deeper knowledge of the issues. Knowledge is a key part of what FSD Kenya 'brings' as a facilitator – what informs its offer - and research, in turn, is central to this.

For all of these, FSD Kenya is playing the leading role as organiser and funder. And, unlike the other roles it plays, there is no partner or set of partners for FSD Kenya in this research role. This is inconsistent with the facilitator ethos and also puts FSD Kenya in an anomalous position. While FSD Kenya's general instinct and practice is to stay relatively in the background and allow partners to be more prominent it cannot do this here. But equally it is not comfortable with or oriented towards being an active, advocating voice in the market – this is not what facilitators are there to do - so it plays the research role in a relatively passive manner.

Learning and discussion points

- Objective – FSD Kenya has had success in establishing a research function in the financial sector. Its approach has been built on the belief that analysis precedes actions – it's what it's known for - and that information, knowledge and research are critical functions in a more effective and inclusive financial market system[14]. This holds whether market conditions have been favourable, as for the last ten years, or if they are less positive. This research effort has filtered into the market in a variety of positive ways.
- The research role in the future - the more pressing questions on FSD Kenya's research effort are concerned with the role that it is playing and what future picture this is leading towards? In its first strategy paper, in 2005, the need not just to do research but also to think of the research function in the longer-term was highlighted - there is "a need to consider how to institutionalise this research effort in the longer-term". If the task of facilitation is about doing but also critically about enabling others to do, FSD Kenya's research effort has been overwhelmingly focused on the former, de facto playing a public (if donor-funded) public research role. Local researchers may have benefitted from involvement in research tasks but these has been led by internationally-based researchers. Local capacity, if it has developed, has been through osmosis rather than through conscious effort. Notwithstanding the challenge of identifying partners, and the apparent systemic weakness of public research in particular, little progress has been made in addressing this issue.
- Accepting right-sizing on quality: with regard to FinAccess there is recognition of the challenge of developing a sustainable solution to producing the survey product, and discussion with stakeholders (CBK) on it. In doing so, in allowing genuine ownership to develop with others, compromises on quality and content are inevitable – but provided minimum technical standards of technical integrity are not breached, this may be the type of trade-off necessary for FSD Kenya to begin to exit.

14 International research products in financial inclusion, provided for example by CGAP, while valuable, don't play this role.

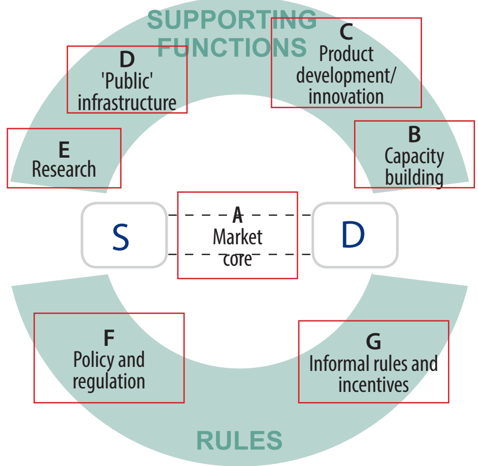
Chapter 5

MARKET IMPACT: WHAT DIFFERENCE HAS FSD KENYA MADE TO THE FINANCIAL MARKET SYSTEM?

This section considers changes that have taken place in the market and FSD Kenya's role in contributing to these. Changes at the core of the market – the supply, demand and use of services and their impact on poor households – are summarised. It then focuses on the underlying 'causes' of market change; the supporting functions and rules. For FSD Kenya to have a lasting, significant impact on the market and on the poor, it has to bring influence here. From this analysis, likely future trends emerge.

After ten years, has FSD Kenya's approach been successful? Has it worked? What changes have taken place in the financial market system and to what extent has FSD Kenya contributed to these? These questions are best considered in the context of the overall financial market system and the different functional elements within this (Figure 6), each of which can be seen as systems in their own right[15]. Changes in the core of the market (A in Figure 6) can be regarded as a consequence of changes in the wider market (B-G in Figure 6).

Figure 6: Finance market system schematic – the main functions



15 This is not an exhaustive list. Supporting functions in particular could be subdivided into further, related functions – such as information, advocacy, specific business services etc. But the categories given here capture the main, generic functional areas.

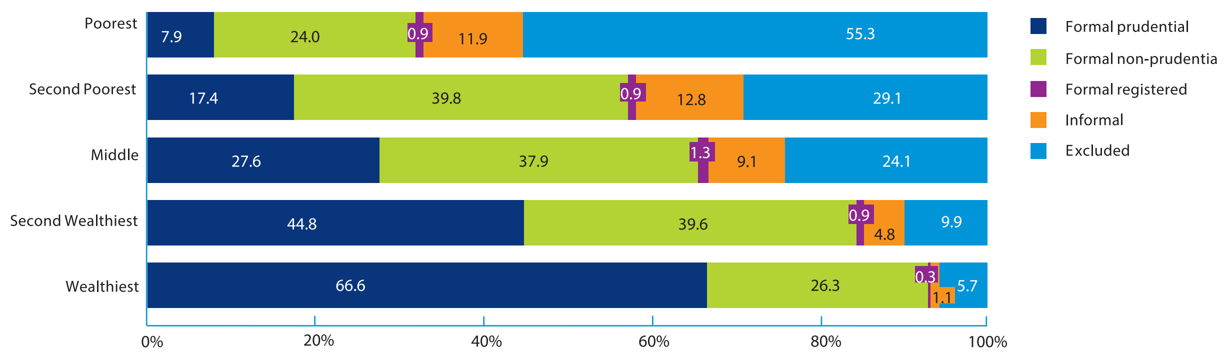
- The market core: the transactions between the supply and demand-sides of the market and the benefits derived from these.
- Capacity-building/process development: services and investment in organisational change and development, including staff skills and knowledge
- Product development and innovation: services and investment in developing new services.
- 'Public' infrastructure: shared public mechanisms and services that bring a collective benefit to the industry, especially CIS and payments services16.
- Research: data analyses and research that provide information and insight on trends, impacts and emerging issues
- Policy and regulation: the formal rules shaping the market, usually from government
- Rules and incentives: the underlying informal rules that shape the behaviour and incentives of key players and feed into every aspect of the market

5.1 CHANGE IS THE MARKET CORE: A MARKET THAT WORKS BETTER FOR THE POOR ….. BUT MUCH MORE FOR OTHERS

Changes at the core of the market can be assessed with respect to access and use of services, benefits from services and wider supply-side changes. From FinAccess data (Figure 2), there has been a major increase in access to formal financial services, especially through banks and M-Pesa. The figures on use of services show similar trends. Financial exclusion, whether measured by access or use, has declined significantly, in Kenya more than any country in the world. However, as Figure 7 shows, inclusion is lowest among low-income groups, with over 50% of the poorest quintile being financially excluded and, though there is no trend data on access by wealth, it seems likely that the advance of financial services has been greatest in higher income groups.

16 This also includes the group formation function in relation savings groups

Figure 7: Access strand by wealth: the poorest are more likely to be left out



What change has this reduction in financial exclusion brought in the lives of the poor? Overall in Kenya there are no up-to-date authoritative trend figures on poverty. It is expected that the national 2016 survey will show some reduction in those below the poverty line but the scale of this is a matter of speculation. And wider evidence is ambiguous. For example, land ownership among the poorest quintile appears to be declining more sharply in Kenya than in other African countries and other studies suggest that economic growth is not translating into poverty reduction.

A number of qualitative studies, however, have thrown light on the changes that increased inclusion have brought. Greater use of M-Pesa's money transfer service for example has strengthened existing informal interpersonal transfers that are used for a range of purposes – such as consumption-smoothing, social obligation (gifts, assistance), economic livelihood activities. A similar spread of use is seen in savings groups, with payment of school fees the largest use. More is now known about the complexity of poor people's lives and of their financial management strategies – balancing investment and liquidity needs – from the Financial Diaries studies. Much of the benefit of the new level of access for poorer people appears to be concerned with helping them manage their lives better. This of course is positive, but it is likely to be a marginal improvement rather than one which is transformational. Moreover, reflecting the international experience, in Kenya there are no quantitative studies to 'prove' the relationship between access/use of financial services and reduction in poverty.[17]

The impact of M-Shwari on the poor is also likely to be, at this stage, limited. While the combined savings and loans product was inspired originally by the Portfolios of the Poor research, the demographics of M-Shwari customers show them to be skewed towards wealthier groups, although this may be changing.

Beyond direct use of services, a more inclusive financial system would also reach poor people through providing more income-earning opportunities and access to useful goods and services. Have changes in the financial sector allowed this to happen? With respect to finance for the real economy, there is little sign that this is the case, with lending to agriculture (the main livelihood source for poor people) actually reduced. For finance for specific goods/services – for example in energy, health and education – there has been some change, such as the M-Kopa solar energy product (effectively a form of asset finance), but the users of these (initially at least) are primarily not the poor.

So while poor people have been touched by the overall surge in access, the main customer group that have witnessed most benefit are those above the poverty line. Not only do they use the range of M-Pesa services but an increasing choice of services from banks is available to them.

17 Impact research is being undertaken by FSD Kenya but has not yet thrown much light on this issue.

If the poor have not been the principal beneficiary of FSD Kenya efforts, it is important not to dogmatically see this achievement somehow as 'anti-poor'. Kenya has an extremely skewed wealth distribution. Recent research[2] in Africa (including Kenya) shows that the proportion of the population who are 'middle-class' and above – with a daily income of above $10 – is smaller than media excitement on Africa's consumer spending growth might suggest[3], and may be less than 10% in Kenya. This means that a large proportion of the population are either poor or near poor, and potentially vulnerable to sliding into poverty.

In viewing change in the core of the financial market, the supply-side should also be considered. And here change has been dramatic, especially for banks. The number of people with bank accounts has increased (to more than 6 million) and banks returns on capital and assets have also grown. Average return on assets for example has increased from 3.04% to 4.57%, with the performance of the top six even greater than this. Banks are bigger, more visible, with a large marketing presence, new premises (for many), greater numbers of better paid staff (given the competition for good quality people), and, for those (a growing number) who are locally-listed firms, paying higher dividends to shareholders.

Overall, in the last ten years it is clear that the financial market has become relatively more inclusive, with more poor people accessing and using services. In this sense, it is a market which, in M4P parlance, is working more for the poor. But the benefits for poor people are primarily in terms of allowing them to manage their financial lives better rather than improving their opportunities. The biggest beneficiaries have been the customer group immediately above the poor, where choice and value has been expanded, and stakeholders on the supply-side (management, staff and owners) whose rewards have grown substantially. So the financial market is working more for the poor – but its working even more for others.

5.2 CHANGE IN UNDERLYING CAUSES – A MIXED PICTURE

The above picture of the core of the market reflects underlying changes in the wider market system, in its supporting functions and rules. To understand the nature of the change that has taken place – and the difference FSD Kenya has made (if any) in terms of the scale, importance and sustainability of change – it is necessary to consider each of these functions in turn.

B – Capacity-building and process development

Finance provider capacities – internal systems, people and organisation – appear to have increased over the last ten years, especially with banks. In some cases investment has received donor support, especially the 'soft' capacity in people and systems rather than hardware (which companies usually invest in). Donor support for capacity-building is still prominent – and driven as much by donor-push as demand-pull factors – and because of this, unlikely to diminish in the short-term. Capacity-building has also taken the form of recruitment of new staff and, through limited, internal training. The emergence of Equity and the growth of digital finance have been key drivers of change.

There are signs of an emerging supply-side in consulting and training. This includes low-level training and consulting, often with local consultants, and at the other end of the spectrum, specialist strategy and management consulting. Some of this capacity is emerging as the Kenyan market has grown. McKinsey and Co. set up a Kenyan office in 2014 and other international companies are beginning to follow. Indeed, reportedly, many of the major banks have hired McKinsey to work on their strategy – and, in time-honoured manner, have used this as a chance to rationalise management. Indeed one of the most striking symbolic indicators of the change in the Kenyan financial sector is that, ten years after they were supported by FSD Kenya (and Microsave and Swisscontact) in a major collaborative process to develop and implement their strategy, Equity, recognised leader in the new banking era in Kenya, employed McKinsey to develop their new strategy. It is not yet clear whether other, more operations-focused consulting firms will become active in Kenya or not, but the business services environment for banks does appear, in some ways, to have moved.

In relation to training, this remains underdeveloped. Equity has been the industry's training workhorse – and has reluctantly accepted the substantial leakage of staff that follows from this (which can mean many, sometimes most, of those trained will leave within a short period) – but is hopeful that a position of greater stability has now been reached. There are some new developments in the training field – for example the donor-supported Helix Institute of Digital Finance and the Strathmore Business School's programme aimed at policy makers in the financial sector (FSD Kenya-instigated). There are no indications that the industry – unlike its collaboration on payments or CIS – has the appetite to collaborate on the common challenge of training.

In seeking to facilitate more capacity building, FSD Kenya has played different roles. It has undertaken capacity-building efforts directly and achieved greatest impact through the broader market stimulation arising from Equity's spectacular growth and banks' commercial imperative to build capacity. However, some of the 'Equity effect' is likely to have happened with or without FSD Kenya. Other efforts to develop business services through demonstration and consultant development have yielded limited results – with some limited achievements in relation to the first Microsave work counterbalanced by little impact elsewhere.

The position now is that there is some sustainability in capacity-building activity. The need to invest in this – either themselves or by accessing (still present) donor-support to do so – is more recognised by finance providers. A supply-side of recognised firms is not in evidence yet but may begin to develop and this is likely to be added to as senior staff from banks 'liberate' themselves to join the ranks of consultants. FSD Kenya's role now is much diminished from its earlier days. With incentives and capacity emerging that can support the development of a market, the challenge now may be to ensure that the information available allows this market to address inclusion issues.

C – Product development/innovation

The palpable 'buzz' around financial innovation takes a variety of forms. Spurred on by M-Pesa – still the single biggest driver of change – there have been other tangible product development achievements, with M-Shwari being the most significant. A range of new ideas in digital finance are at various stages of development. Around innovation a jumble of new activity and collaboration are happening – with hubs, labs, impact investors, and donor schemes in evidence. Banks, not usually associated with embracing 'the new', talk enthusiastically – "*innovation is in our DNA*", "*innovation is the name of the game*" – and there are now a sprinkling of bank research and innovation departments. More innovation is taking place even if some might be seen as superficial *"bathtub"* innovation rather than building on the researched needs of potential customers, especially from low-income groups. For some, this all shows that a finance 'innovation ecosystem' is evolving in Kenya.

Certainly there is more happening in innovation. And there is more opportunity – according to one industry player, *"If Silicon Valley is the best place to be sitting if you're developing apps, Kenya is the best place for mobile money and financial inclusion".* But the efficacy of this activity is still open to question. 'Ecosystem' is an increasingly used term in innovation circles but beyond being an assemblage of innovation 'stuff' this is a rather empty descriptive term, lacking analytical definition[18], and not useful in considering the development challenge: what does an innovation system that supports financial inclusion *look like*, for example with respect to key functions and the roles of different players? In the absence of this, the danger is that all activity is deemed good since it is all part of an amorphous 'good' ecosystem.

It is not currently the case that innovation emerging from this ecosystem has an especially 'pro-poor' character. At this point the influence of M-Shwari isn't clear. Most of its 11 million account holders are not poor – but new account holders increasingly are. It may be that, much like M-Pesa, poor people will be the last group for this innovation to reach – but that they will embrace it enthusiastically once its benefits become clear. Its first imitator, however, from KCB is even less oriented to low-income customers. Banks' interest in innovation has not readily translated into substantial investments in understanding poor customer needs and shaping products around these. The new innovators still, apparently, seek quick returns.

In this context, FSD Kenya has played several roles in developing an environment more conducive to innovation. It has helped to develop the

18 It doesn't for example appear to reference the considerable literature on innovation systems let alone M4P

enabling regulatory space for M-Pesa (see 4.3), through FinAccess it has provided a quantifiable basis for financial inclusion efforts, and it has sought to support specific new product ideas. This last form of intervention has produced mixed results but, in the form of M-Shwari, FSD Kenya has successfully 'nudged' CBA to a development that is vast in scale and, potentially, strongly impactful through its wider demonstration influence on the market. FSD Kenya therefore has contributed importantly to creating more and better innovation. This innovation momentum is set to continue with or without FSD Kenya. However, given the prevailing incentives, it seems less likely that the innovation system that is developing will deliver – will sustainably deliver - product development that is focused on the poor and the mass market, stretching the frontiers of inclusion.

D – 'Public' infrastructure

Two of the most important 'pieces' in the public supporting functions of the finance industry are a CIS system and a shared payments platform. Both are essential to reduce transaction costs by lowering risk and improving the integration of major retail channels. FSD Kenya has played a pivotal, coordinating role in the story of their development in Kenya, a process which has taken 6-8 years of varying levels of intervention.

In both cases FSD Kenya is still engaged actively and playing a leading role, both in 'doing' and in funding. However, in both there are realistic, discernible paths ahead for FSD Kenya's withdrawal and for the future sustainability of the management and delivery arrangements of these services. In neither case has FSD Kenya's work yet resulted in material change in financial services offered. Yet in both there are realistic expectations of substantial impact being felt within a short period. Use of the CIS system is increasing and, as it does, this should begin to reduce risk and the cost of credit.

The impact of the new interbank Switch is likely to be more immediate. Competition in the market is increasingly fierce and its proposed pricing structure - approximately half that of M-Pesa – is likely to prompt a price reduction from M-Pesa. Given the volume of transfers taking place daily in Kenya, and given that these cost poorer people (transferring smaller amounts) proportionately more, the net effect of this is likely to be a major saving, de facto, a large transfer of funds to consumers, including poorer people. This is also likely to act as a boost to innovation by offering new lower cost options in reaching consumers.

The impact of these changes is likely to be very substantial and sustainable – and, to a large degree, attributable to FSD Kenya. It is very unlikely that either of these would have progressed to their current state, in the given time scale, without the facilitation endeavours of FSD Kenya, a view readily expressed by stakeholders. The logic of the finance industry collaborating for mutual shared benefit as well as for the public good has always been compelling and, as one respondent noted, "is the kind of thing a maturing industry should do". However, irrespective of their rationale, changes such as this often do not simply happen – countries/industries can become paths of underperformance - without an FSD Kenya-type organisation to make it so, and certainly this is the case in Kenya.

A third and different public function relates to group formation for savings groups. This is more embedded in the market system than before and sufficient learning has been achieved to allow a major scale-up – but is still substantially reliant on donor/FSD Kenya funds to initiate scale-up of the process.

E – Research

FinAccess is the main regular research product related to finance and inclusion. It played an initial critical role in defining and establishing inclusion in Kenya, and it is still known and valued for this. Other research on inclusion takes a variety of forms – some being specific policy issue-related papers, others serving a more fundamental knowledge-generation purpose, such as the Financial Diaries. Assessing the efficacy of public research is particularly difficult, although FinAccess in particular elicits considerable interest.

FSD Kenya is the main player engaged in research around financial services – acting as a funder and implementer. It instigated FinAccess and other research being undertaken. This role has not changed significantly throughout its life – it leads, shapes and funds. Most of its research partners are internationally-based. FSD Kenya makes limited use of local researchers in finance. These are known to be relatively few in number and weak in terms of capacity - although there may be more interest and resources emerging through organisations such as KBA (who have a new research department), through researchers who have been involved in undertaking commissioned research, as well as through more Kenyan-based consulting operations.

FSD Kenya's achievement here has been primarily to establish a research function on inclusive finance – effectively to create it - one which impacts on the sector in a range of ways. For the future, discussions on the future of FinAccess have taken place without a consensus being reached. But for the wider research role, while FSD Kenya has deliberated on this issue, it has not developed a considered view on how this important function can be undertaken in a sustainable way. Or take measures in pursuit of a future vision.

F – Policy and regulation

The process through which policy and regulation is made – from idea to policy paper, consultation, and drafting – has not changed but the policy and regulatory environment has evolved in a manner that has encouraged innovation and change in finance, especially in relation to digital finance. From the CBK's initial 'no objection' approach that gave the regulatory space for M-Pesa to the e-regulations related to the National Payments Act, the regulatory environment has moved regularly. And this will continue to be the case.

FSD Kenya has played an important role throughout. Its role in creating the initial M-Pesa opportunity was critical. More recently, through its policy support facility it has been exerting considerable influence throughout the policy process, much of which is shaped by the Government's Medium Term Plan for the Financial Services Sector, which FSD Kenya was involved in writing.

FSD Kenya's direct role in the policy and regulation process has allowed it to exert influence but this has also meant that there is more reliance on it than in the past. The question this raises is not about the sustainability of the regulatory process – this of course will continue - but rather about the sustainability of the quality of the advice and analysis guiding the process. Developing a professional development programme for regulators in financial services may be a starting point for addressing this but won't fill many of the roles FSD Kenya is currently playing.

G – Rules and incentives

The final element in the financial market system is the least tangible but also one of the most important, namely the rules (formal and informal) that shape the incentives and behaviour of market players; the underlying reasons explaining why organisations do what they do. The financial market system has developed over the last ten years into one which is working better for the poor but working even better for others. Some of the factors lying behind this are technical in nature – for example, the normal trajectory of innovations is to start with the easiest customer segments and then spread to more difficult groups. But another set of factors stems from the motivations of providers. Several issues should be borne in mind here.

First, inclusion, as commonly interpreted in Kenya, and indeed reported on in FinAccess, follows the internationally accepted definition. Its headline metrics are around access and use of services. This provides a neat, quantified position which is easily understood and reported on. But, as mentioned above, it also presents a narrow view, a promised land of inclusion as simply one where everyone resides in the safe hands of the banks with a bank account. This is a restrictive interpretation of inclusion that neglects consideration of the role of finance in, for example, providing economic opportunities and goods/services for poor people. Critically, it deflects discussion on what the role of finance should be, of what 'good' financial services are that can bring significant benefits to poor people. The limitations of this view of inclusion has prompted some debate on the "need to raise the bar" for defining financial inclusion[4].

Second, mainstream providers in Kenya are commercial organisations, with commercial objectives, and accountable to shareholders. For publicly-listed companies – such as the two largest banks – this means scrutiny of results on a quarterly basis. Banking in Kenya is, in relative terms, very profitable – more so than the industry is in many other countries. Throughout the last ten years, as the industry has taken on board the inclusion message and as previous reasons cited for high profits (such as high levels of NPLs have diminished, profits and returns have continued to increase (Figure 5). Political controversy over the apparently high-level of bank profitability has ebbed and flowed since a political attempt to impose a cap on interest rates (the so-called Donde bill) in 2001 failed but the issue is not (and won't be) extinguished. Ideally, it might be argued, a more competitive market will reduce margins and as the market system becomes more efficient – for example, through better information – this would be expected to happen. However, as yet, it hasn't and the sector as a whole is short-term in orientation; banks are criticised for chasing quarterly profits with some saying MNOs, seekers of "instant gratification", are worse.

Third, the debate over rewards for banks in Kenya should be seen in a wider international context of discussion on the role of the financial sector in modern economies[5]and of 'financialisation', the process through which the financial sector has gained a dominant economic role. There has been considerable critical commentary on the inherent short-term-ism of "quarterly capitalism", while a more fundamental critique of finance has emerged, led by the Chief Economist of the Bank of England. The key argument here is that publicly-listed businesses (including banks) have become too driven by shareholder concerns, giving a higher proportion (6-7 times higher that forty years ago) of profits to dividends than in the past, so reducing their ability to invest. Banks, more generally, have neglected their proper, longer-term purpose of serving the broader, real economy and society.

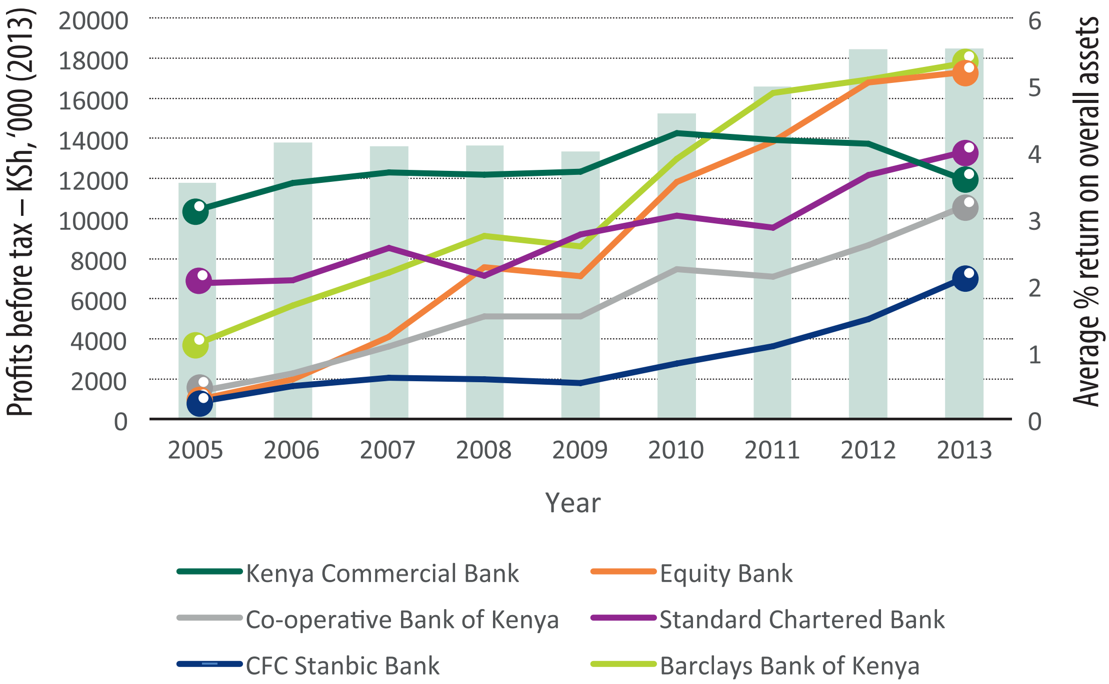
In the different context of Kenya, there are more thoughtful, if quieter voices in the banking sector itself that suggest that the current position is not tenable and that the existing characteristic high returns will/should reduce. Quite how this happens is not clear. A more efficient market structure to allow more competition would help doubtless but others hint that something more may be required, *"as an industry we will need to reach out and sacrifice something"*. This of course might be translated into the gesture of more corporate social responsibility work – a new feature of banks in Kenya is the high profile they accord to this 'giving back' charitable work. Or it might be that a more fundamental revisiting of their role is required[19].

Although there are clear differences between the UK and Kenya, these analyses share common ground; namely that in considering the role of financial services, it is necessary to consider the question of what it is there to do? And in Kenya, is it realistic to expect financial markets to develop in a manner that has a significant effect on poor people's lives when the informal rules and incentives around them are so apparently driven by the compelling needs of the short-term?

Consideration of such questions inevitably takes analysis into the domain of political economy. FSD Kenya's work is led by analysis, including an understanding of political economy issues and their implications for market

19 In relation to this, discussions in Kenya are beginning on the development of a market conduct authority, part of whose remit should be concerned with minimum ethical codes of conduct.

Figure 8: Banks keep on growing: real income growth in top six banks, 2005-13 ('000 Ksh - 2013)



performance. But its work has been primarily technical in orientation – enhancing capacities, developing new functions, providing better information. These have changed in the last ten years but incentives and the political economy haven't. FSD Kenya has not sought to bring influence to this different but important aspect of the financial market system.

5.3 FINANCIAL INCLUSION AND FSD KENYA – WHERE WE ARE …. WHERE WE'RE GOING

Where we are

Table 1 summarises the main points from the above examination of change in the Kenyan financial system, and the effect FSD Kenya has had upon this. The key points are the following:

The financial system is bigger, more dynamic, more profitable and more innovative than ten years ago. And it is more inclusive, even if poor people are not the biggest beneficiaries. FSD Kenya has contributed significantly to this change. How significant is a matter of speculation and the subject of endless 'what if' scenarios but at minimum it has helped push inclusion issues more quickly and practically into the functioning of the Kenyan financial sector.

It has played a quiet but hugely effective role in developing a policy and regulatory environment that is conducive to digital finance and the new level of innovation stemming from the M-Pesa-age. Its research has percolated into the thinking and workings of the sector and made inclusion real and tangible. Without FSD Kenya these changes would have been significantly reduced, impeding the performance of the whole sector.

Its work directly with companies has provided a strong push to the momentum of corporate growth, capacity-building and inclusion. Most notable is its contribution to the Equity phenomenon and to M-Shwari – both of which have had a major crowding-in/catalytic impact on the market system. While both of these would have developed without FSD Kenya, their wider impact would have been lessened.

While its work in developing key public functions, building blocks of the market – CIS and payments systems – has had no impact thus far, after years of sometimes difficult engagement, this is on the edge of converting into substantial improvements in the efficiency of the sector which will have far-reaching impacts for consumers, including low-income groups. Without FSD Kenya this would not have happened in the same time frame, perhaps not for many more years.

These positive examples of impact create a story of FSD Kenya which, in aggregate, is one of considerable success, and is a vindication of its distinctive approach and its organisational structure (see Section 6) – and a commendation of its key resource, its people.

Table 1: Summary of market change and FSD Kenya impact

Function	Has there been change?	Has FSD Kenya had an impact?	Is FSD Kenya's impact likely to be sustainable?
Core			
Core	Bigger, more innovative and inclusive, but poor not main beneficiaries.	Yes – from combined effect of improved supporting functions and rules	Mixed, partial picture – some continued dependence on FSD Kenya
Supporting functions and rules			
Public infrastructure	Limited change yet. But impact likely to grow quickly	Not yet from CIS and the Switch. But change likely to be significant. Limited from group formation	Not yet but good prospects given players' incentives Group formation processes continue but growth funder dependent.
Policy and regulation	Yes, change has enabled market growth and innovation	Considerable – formally and informally	No, dependence on FSD Kenya to ensure good 'quality' on inclusion issues
Research	FinAccess and regular, varied other research outputs	Considerable generally – but limited application for specific purposes	No, FSD Kenya leading, doing and funding
Capacity building/ process development	More investment in capacity-building. Beginnings of service market. How 'pro-poor' is open question.	Ripple effect from demonstration (Equity). Low impact from service market interventions	Capacity building more entrenched, but considerable donor-funding still evident.
Product development / innovation	Much more innovation activity - not necessarily 'good' innovation	Mixed impact from direct interventions – potentially large from M-Shwari. Role in M-PESA regulation – trigger to digital innovation.	Not clear if inclusion-focused innovation is embedded in market
Informal rules and incentives	Incentives in market unchanged – short-term orientation	Limited impact from FSD Kenya – not the focus of the programme	

However, market facilitators, like FSD Kenya, can only prod the different functions and players, with their different capacities and incentives, which make up a market and do so in a way which analysis suggests will lead to a better, more inclusive market system. Facilitators are not all-powerful social engineers; they push, cajole, inform, instigate and stimulate; they don't control, not everything can work. So, this story needs to be balanced with recognition of limitations and failures.

- The policy and regulatory system is still considerably reliant on FSD Kenya inputs. The research function in the market has been created and is largely funded by FSD Kenya. In both, FSD Kenya present a pro-poor voice – this voice would be silenced at least partially without FSD Kenya.
- Interventions with individual companies have failed as much as they have succeeded. Efforts at developing supporting service markets largely haven't worked – although some of this may be happening now anyway.
- What an innovation space that works for the poor in financial services means – beyond being a (slightly) nebulous ecosystem - isn't clear. How to engage here in a way that is more than the hit and miss of support for specific ideas isn't clear.
- There has been limited attempt to engage with the underlying incentives which affect every aspect of the market. This is more political territory – at its heart being the question 'what should be the role of finance in the economy?' – but is a central issue which will not (should not) disappear.

Where we're going

On the basis of these trends and FSD Kenya's performance to-date, what further changes might be anticipated in the market? What might happen in the future if FSD Kenya weren't there? This is in the realms of conjecture but a number of trends seem likely.

- The development of the CIS and Switch systems will increase efficiency and competition, reducing costs for consumers, and opening up new possibilities for new and better services.

- The existing momentum behind product development and innovation will continue. Some of this will reach the mass market/poor but much will be focused on the easier near-poor segments rather than the poor and the real economy.
- Some research and information (particularly FinAccess) and policy and regulation processes will continue but, with a diminished informed voice of the poor, will be less focused on inclusion. Beyond FinAccess, there will be little public research.
- The essential incentives and rules shaping behaviour, and the primacy of short-term imperatives, will be unchanged.

As a result of the above, in the near term, it seems likely that the market will continue on its present path, to exhibit some growth, innovation and expansion to the mass market and the poor. But, as just now, benefits are likely to be much greater for others. Does this matter? Is this - broadly the existing pattern of development and distribution of benefits projected into the future - 'good enough'? The mainstreaming of financial inclusion as a concept allows for broad interpretation, so this might be seen primarily as a moral as much as a technical judgement. But certainly a continuation of current trends does not match the original poverty-reducing ambition of FSD Kenya, or indeed of the M4P approach.

Chapter 6

FSD KENYA THE ORGANISATION: HAS FORM MADE A DIFFERENCE?

This section considers the extent to which FSD Kenya's distinctive organisational form - a trust – has contributed to its performance, from both an operational and a strategic perspective.

FSD Kenya has of course changed over its ten-year life. Table 2 outlines its growth in terms of budget and people. This is reflected in the range of activities in which it is involved. Much of its initial work was focused directly on retail providers but its work in 2015 is divided into five different theme areas, and includes work on SME finance, CIS, payments systems, regulatory reform, informal finance, digital finance innovation, knowledge generation and research. Its internal structure also reflects this growth and spread of activities. FSD Kenya's organogram shows a structure grouped under its five themes supported by a range of administrative, logistics and finance functions. This has developed but the change, irrespective of its form, is much as would be expected given its growth.

What hasn't changed in the last ten years is the approach that underpins FSD Kenya's work. FSD Kenya exists to stimulate pro-poor change in the market system. FSD Kenya is a facilitator, not a market player per se. FSD Kenya does not intend to play a permanent role, its role is catalytic. FSD Kenya is guided by the same principles it set out in its first strategy. It is under the leadership of the same Director.

What also hasn't changed is FSD Kenya's organisational status and its overall governance and management structures (see Figure 2). FSD Kenya was established as an independent trust because this organisational form was seen to give the best chance of successfully implementing its M4P approach. This was, and still is, an unusual organisational form in the international development world and is a distinctive feature of the FSD Kenya experience. What can be learned about the efficacy of this organisational form from the last ten years' experience? Do the reasons cited for establishing it as a trust, rather than as a conventional project, remain valid in practice? This can be considered at an operational and strategic level.

Operational

A number of positive, operational features were, it was hoped, likely to be conferred on FSD Kenya by its trust status.

- Flexibility – this would manifest itself in being able to act quickly in response to new opportunities and in being relatively free to shape its activity – its offer to partners – depending on the situation.

  To a large degree, this has occurred. For example, FSD Kenya's work with CBA on developing the M-Shwari product combined research and information provision with technical assistance and financial guarantees. FSD Kenya's offer fitted the context, and changed as the engagement with CBA developed. In practice, TA and grants may be the most common type of intervention from FSD Kenya but it has the strategic and operational space – the mandate, procedures, decision-making structures etc. – to intervene in a range of soft (non-finance) and hard (finance) ways, and to act quickly and flexibly. What it offers is not determined formulaically in advance.

- Credibility – this would manifest itself in the perceptions of stakeholders and in the development of trust-based relationships.

  There are some minor complaints about perceived FSD Kenya bias towards particular organisations or partners, but this is not surprising given that some activity has been with market leaders serving a demonstration purpose. Stakeholders commonly perceive FSD Kenya to be a neutral and trusted third party, with clear lines of communication with both private and public players. Although known to be funded by donors, FSD Kenya is not seen as 'another' donor project – but as an entity that is more Kenyan and grounded in the Kenyan context. Individual intervention agreements with partners have a formal written form but it is the strength of the informal understanding that shapes the functionality of the relationship.

Table 2: The growing organisation – Change in FSD Kenya (people and resources)[20]

	Budget	Personnel
Strategy 1: 2005-2007	$38m	6-8
Strategy 2: 2008-2010		8-22
Strategy 3: 2011-2015	$45m	22-42

20 Budget figures exclude funding from DFID for the Hunger Safety Net Programme. This is a grants disbursement – electronic cash transfer payments – programme, which is passed through FSD Kenya and inflates the budget figure artificially, hence its exclusion here.

- Longevity – this would manifest itself in a willingness to undertake difficult, longer-term tasks in the greater credibility provided by being more than a fleeting presence.

  Collectively FSD Kenya has an institutional memory greater than most in the sector and this memory is an asset in engaging with different partners. The knowledge that it has a longer-term perspective has allowed FSD Kenya to 'take on' more challenging constraints – such as CIS – that are inherently more protracted, where there is no neat technical-fix, and that require coordination and mediation, and to do so in a process that allows others to take ownership. It has been allowed to intervene in 'next step' interventions that become possible sequentially after initial work has laid appropriate foundations. For example, the development of a training programme for regulators became possible because of previous/ongoing work in regulation.

- Efficiency – this would manifest itself in for example being able to allocate resources more effectively and in reduced transaction costs in managing funder relationships.

  The second of these is more difficult to examine[21] but in the former there is hard evidence that the trust model, without the normal contractor overhead, is more efficient. A recent study commissioned by FSD Africa[8] assessing the relative efficiency of trust versus contracted-out organisational forms showed that in FSD Kenya 88% of all spend was on programmes with the remainder, 12%, for overheads (fiduciary, strategic and management costs). Comparable figures for contracted-out models were 60-70% on programme activity and 30-40% on overhead costs.

FSD Kenya's work on the payments platform offers a useful example of these characteristics in combination. It's *credibility* and *neutrality* has allowed it to engage with different (competing) market players, its *flexibility* has allowed it to adopt different activities, including placing a full-time project manager in a partner organisation (the KBA), and its *longevity* has allowed it to stick with a sometimes frustrating process (over a period of 6-7 years) in a way which has allowed partner ownership to develop. As a consequence of these qualities, the resulting impact of this intervention is likely to be significant – and perhaps dramatic (see 4.2).

The evidence suggests therefore that the theoretical benefits of FSD Kenya's structure are being realised in practice and that this is contributing to its effectiveness. However, it would be simplistic to ascribe its performance as a facilitator to this fact alone (or chiefly to it). Facilitation is a people-intensive task and FSD Kenya as an organisation is, to a great extent, comprised of the sum of the talents and qualities of individual people. Where FSD Kenya works, as repeatedly pointed out by stakeholders, this is because of the people involved. FSD Kenya's Director in particular – who has led the organisation since its inception (and this following another ten years of work in the sector), is widely respected for his insight and knowledge of finance – and the FSD Kenya experience cannot be separated from his own characteristics. The role of other staff and consultants is also highlighted frequently. Conversely, however, when FSD Kenya has not worked well, weak staff capacity has often been a contributory factor.

The fact of FSD Kenya as an independent trust does not guarantee a high quality human resource. The bigger question is: does a trust enhance the chances of attracting and developing good people? There are reasons to suppose that this is the case – trusts offer a platform (timeframe, opportunity, scope, rewards[22]) for 'good work' for 'good people' that is theoretically better than in standard projects. But in themselves they are empty shells –empty shells that theoretically are more conducive to good facilitator performance, but empty nonetheless.

In this context, irrespective of whether a facilitator is a trust (or a contracted-out project) it has to not just recruit but develop personnel with the right attributes (skills, knowledge etc.). Weaknesses in FSD Kenya's operationalization of the M4P approach can often be attributed to the organisation's lack of investment in staff's understanding and ownership of the approach[23]. The hard reality of skills constraints has imposed an equally harsh lesson on FSD Kenya. In considering intervention options, as well as considering criteria such as potential for systemic change and large-scale, FSD Kenya needs also to consider the more pragmatic question: do we have the people resources to intervene effectively?

Strategic

At a strategic level, the key question is more open: to what extent is FSD Kenya's position as a trust implementing the M4P approach allowing it to better influence the longer-term direction of the market? More specifically, is FSD Kenya's recent growth trajectory (in terms of people and budget) compatible with a strategic objective (facilitators as temporary catalysts) which, ultimately, implies that, as an organisation, it doesn't exist? Definitive conclusions are neither possible nor appropriate here. But two contrasting perspectives can be put forward.

Perspective 1: FSD Kenya has grown appropriately to fill a strategic need.

FSD Kenya's growth represents a natural, necessary response to new strategic opportunities that have emerged as the market has developed – for example in relation to innovation.

21 The author's observation here is that FSD Kenya has to devote comparatively less resources/time to managing funder relationships and accountability than in contracted-out projects.

22 With more resources available (less being diverted to overhead costs) trusts have the ability to offer higher rewards if required.

23 Recently FSD Kenya has increased its investment in skills and knowledge, for example through participation in FSD Africa's 'Making financial markets work' programme

The largely unforeseeable rapid developments in the market demanded a quick entrepreneurial response, or the moment would be lost.

Moreover, to ensure that substantial initiatives that have been started are 'seen through' to have a chance of fruition, proper resources are devoted to their analysis and implementation. This might reflect an initial underestimation of the scale and complexity of tasks but this is not surprising given that there are few models (none!) for FSD Kenya to draw on.

In any case, one key aspect of FSD Kenya's unique selling point is its ubiquity, its involvement with many different parts of the market system. It is this all-round knowledge and experience that gives it its different credibility and offer.

FSD Kenya's growth has allowed a stronger organisation to emerge fit for new, emerging challenges in an evolving and more sophisticated market.

There are many challenges now emerging in the market that can be met by FSD Kenya precisely because its earlier work has laid the foundation to do so. And as a facilitator it has to see this through with partners.

FSD Kenya's burgeoning development is a vindication of the light touch status and role of the PIC, and recognition that FSD Kenya staff and the Director in particular are the key drivers of the programme.

Perspective 2: FSD Kenya's growth reflects strategic drift and lack of discipline.

Moving out of work areas of limited success/failure could have been done quicker. This in part reflects a culture which is inclined to give partners another chance, where a predilection to optimism has been diffused with indecisiveness and allowed the organisation to stay engaged in activities that, even without the wisdom of hindsight, weren't working well (and weren't going to).

The logical flipside of investigating new opportunities is to move out of others (the former has happened; the latter less so).

Growth sometimes appears to have happened rather than to have been consciously planned – at the start of the current strategy period the plan was to peak at 22-26 staff (now there's 42) – and to have gathered its own momentum without consideration of whether this is appropriate.

Lack of strategic clarity has encouraged a tendency to overestimate technical capacity, and not to consider whether the organisation does have a serious offer in different spheres of work.

FSD Kenya's growth and new size has meant that, like many other development initiatives before it, one of the tacit priorities for the future is the organisation's continuation; the organisation is a stakeholder; the means to an end is becoming the end.

There are many challenges emerging in the market – and there always will be – but it is the role of stakeholders in the market (public and private) to address these. And of FSD Kenya, ultimately, having intervened in the market, to leave them to it.

FSD Kenya's development suggests a lack of a suitable, informed 'challenge function' within the organisation; ie there is insufficient searching internal debate on FSD Kenya's appropriate strategic role.

These two perspectives lie at either end of a continuum. Both are, in their own way, straw men created here for the purposes of comparison - but in reality some elements of both may hold true for different aspects of the organisation's work. This case does not offer a definitive view on the organisation's strategic direction – and these are offered as discussion points. The wider learning consideration is that FSD Kenya – as with all organisations engaged in market facilitation – has to regularly review the consistency of its work in practice with its overall strategic vision and role.

Chapter 7

LEARNING: WHAT DO WE GET FROM THE FSD KENYA EXPERIENCE?

This section draws on the specifics of FSD Kenya's experience and its impact to highlight the key learning points emerging from examination of its performance over the last ten years. These are grouped under the headings of strategic, operational, future challenges in Kenya, and wider dilemmas.

Ten years on from its commencement, what can be learned from FSD Kenya's experience? In particular, what should other organisations – funders and facilitators – take from this in seeking to pursue their shared objective of large-scale and sustainable poverty reduction, whether operating in finance or in other sectors?

Learning can be categorised here under four headings, each having more or less relevance for different stakeholders.

- **Overarching and strategic:** getting the big things right: this is of relevance to funders and facilitators and deals with the main facilitator attributes that determine performance.
- **Operationalising the approach:** technical issues in implementation: this is of most relevance to facilitators and focuses on more technical challenges in implementation.
- **Future challenges in Kenya:** this focuses specifically on financial inclusion in Kenya and sets out priorities in considering its future path. This is of most relevance to FSD Kenya and Kenyan stakeholders.
- **Discussion and dilemmas:** of relevance to all, this deals with more intractable issues which emerge from the case where there is no definitive, simple answer and which highlight the limitations of interventions.

7.1 OVERARCHING AND STRATEGIC: GETTING THE BIG THINGS RIGHT

This relates to the overall characteristics of a facilitator and its strategy is important in fostering success. Although running the risk of stating the obvious, the essential truth of these comes through when looking at FSD Kenya. Where FSD Kenya has had a positive impact on the market it has been because it possesses these general attributes. These form a set of general considerations for funders and facilitators alike.

1. Function matters – the importance of taking a systems approach: FSD Kenya's experience, not universally successful but overall very positive, is a vindication of the market systems approach. This provides an appropriate framework and guidance for intervention, and sets a level of ambition (changing market systems) that matches the high ideals of international development. A narrower, more prescriptive, more delivery-oriented remit would have greatly reduced FSD Kenya's impact. FSD Kenya's experience reaffirms the essential validity of the market systems approach.
2. Form matters – but is not a panacea: to a large degree, the original reasons for setting up FSD Kenya as an independent trust have been endorsed. The different hypotheses advanced for example in relation to benefits from programming flexibility, incentives alignment, longevity and efficiency, have largely been realised in practice. And while it might have been possible to implement FSD Kenya's programme with a different structure, it would have been much more difficult than as a trust. Form is clearly not a panacea; it does not ensure success. For example, it does not guarantee finding and developing the right personnel. And inherent within it, funders have to be relatively more removed from implementation – this is a key tenet of its rationale – and accept this position, which does not mean an abandonment of accountability but does mean less involvement and control. But a form such as a trust, in comparison with conventional contracted-out arrangements, offers more scope for successful intervention.
3. Good people: facilitation is a people-intensive task and people are FSD Kenya's biggest resource. When FSD Kenya works it can be linked back to them – repeatedly stakeholders emphasise this point. Facilitation requires a range of attributes – such as technical knowledge, market awareness, empathy and enterprise – which don't have to be vested in one individual (and usually aren't) but to be available to the facilitating organisation. Of particular importance in relation to people is leadership. The strengths and weakness of facilitating organisations is often personified in those of its director/general manager[24] and this is certainly the case with FSD Kenya. Good people are thus a necessary but not sufficient condition for facilitation to be successful. This reality places an onus on organisations to find and, as important, to develop appropriate people.
4. A culture and practice of being close and engaged: many of FSD Kenya's most important interventions have occurred when they have been responsive to an emerging situation (for example M-Pesa regulation and M-Shwari). This is more than serendipity. It is a function of developing the right relationships with stakeholders, of being sufficiently informed about specifics and the general situation in the market, and of knowing 'who' as well as 'what' in relation to market players. Facilitation always involves engaging with others; it can't be done by facilitators themselves.
5. Flexibility in programming: the dynamic and unpredictable nature of market change means that being able to adapt quickly to new situations arising from the public or private sectors is important. This does not mean a 'blank page/open to all' position, rather it means allowing operational space within areas of strategic interest. FSD Kenya's planning, budgeting and decision-making structures offer it considerable flexibility, which a more rigid organisational format would not permit.

24 There are parallels with owner-managed businesses – 'know the owner-manager and you know the business'

6. Neutrality and independence: while part of the current financial landscape, FSD Kenya is recognised for not being a market player per se. This 'third party' status allows it to manage multiple relationships with different organisations and to be perceived as acting for a bigger national/developmental interest. In turn this enables it to for example coordinate different (competing) players to cooperate for mutual/public interest. And to engage with different individual companies on the basis of trust over confidential matters. Acquiring this status is a result of conscious effort – reinforcing the message of what the purpose of facilitation is, and emphasising that individual partnerships do not preclude other arrangements or imply 'being in the pocket' of a particular firm. In contested markets this neutral status is tested regularly but is critical to be able to engage constructively with different players.
7. Analysis and knowledge-led: what facilitators do – and who they do it with - need to be shaped by a good understanding of market context and market constraints. Market knowledge and insight is a crucial part of what facilitators bring to individual discussions. This in turn is related to where facilitators intervene; FSD Kenya's work in one area (for example regulation) is often informed by what it does elsewhere (for example research or innovation) and these learning synergies are valuable. Strategically therefore, from the outset, facilitators need to be committed to structure themselves appropriately to be analysis-led.
8. Longevity: FSD Kenya's ten-year existence has allowed it to address issues which are inherently long-term in nature, such as facilitating coordination for shared/public functions, where the pace of change is to some degree dictated by market players. Not being seen as a short-term package of pre-defined activity (a conventional project) allows new possibilities to emerge and to be pursued. Particularly in complex/large-scale markets, the scope of facilitation is greatly enhanced if more time is available.
9. Credibility: this emerges from what facilitators do and from the perceived value they are seen to offer – it is not a quality that is created on its own. FSD Kenya's experience illustrates how once developed – for FSD Kenya manifested in technical competence, market knowledge, informed analysis, and independence – more intervention possibilities emerge but also how poor quality/unsuccessful interventions can quickly damage and limit the scope for intervention. Although not commercial in their objectives, facilitators have to act in a business-like way, and, like businesses, have to consider what they (and their brand) mean to different players.
10. An informed voice: if facilitators are to be successful in 'making markets work for the poor', it is important that their voice in pursuit of this is not that of hectoring pressure group. Loud advocacy may be an important market function but it is not that of the facilitator. Rather, in order to engage with different players and address different constraints, the voice has to be considered and deliberate.

7.2 OPERATIONALISING THE APPROACH – TECHNICAL ISSUES IN IMPLEMENTATION

FSD Kenya's successes can be attributed broadly to the above general qualities and to the positive interventions that have stemmed from these. But its experience has not all been one of unremitting achievement. Many of its less successful interventions also constitute a useful source of learning for facilitators. In these instances, the main issues usually relate to weaknesses in operationalising the M4P approach.

1. Applying the same analytical framework to interconnected systems: while all FSD Kenya's projects are articulated in the context of market development, in practice a gap can develop between intentions and implementation reality. One reason for this is that individual parts of the overall market system – interconnected systems - are not viewed through the same rigorous lens as the overall market. FSD Kenya is aware that, for example, business services, regulation, research and innovation are all systems in their own right, but they have not always been viewed through the same lens as would be applied to finance as a whole.

   Taking the same systems framework to specific parts of the financial market system means more detailed analysis of sustainability. FSD Kenya always does consider sustainability in designing and planning its activities but if this is not considered in the context of a system – and of functions and players and 'who does and who pays' – sustainability analysis is not made real, it can be a superficial, intuitive exercise rather than one that guides actions.
2. Delivering directly within the facilitation process: facilitators experience a tension between 'waiting' for market players to respond to signals and incentives and kick-starting activity directly25. Inevitably, the more FSD Kenya does, the less space and incentive there is for others. This is especially so when there is a feeling that 'things have to be done' – such as FinAccess or policy advice. In practice, this 'delivering- versus-facilitating/pragmatic-versus-principled' intervention dilemma is one that facilitators encounter frequently.

   Resolving this tension requires that facilitators make a distinction between operational tactics and strategic goals. Major one-off actions to kick-start activity, or in response to an immediate opportunity/need, for example to engineer a market shift, can fit coherently within an M4P framework. However, if delivery is the only activity undertaken or this is repeated (with the same or another partner) or there is little sign of impact beyond what is achieved directly, then there is a danger that immediate needs take precedence over longer-term strategic goals and ultimately the purpose of facilitation is neglected. FSD Kenya's work in the regulation space illustrates this risk. Intervening to create a better

25 As expressed succinctly by one respondent - "What are we supposed to do? Stand on the sidelines and cheer?"

regulatory space has undoubtedly been successful, but doing so in a similar way over a number of years suggests that delivering is not now – on its own - serving a facilitation purpose.

3. Demonstrating – but sparingly: a specific example of the 'delivering within facilitation' challenge relates to providing TA support to individual firms. The rationale for engaging directly with companies is ultimately about the wider demonstration effect from this. FSD Kenya's experience shows that this can work – but equally that it may not. However, too much donor-fuelled support to defray innovation risk can, paradoxically, make providers more risk averse – and this is a concern in Kenya. It is seductive for facilitators to 'get in there' and 'do business' whilst offering 'demonstration case' as thin justification. But this is not the only way to stimulate systemic change; there are other, less invasive intervention options, including information, linkage development, and research.

   One secondary argument for engaging directly with business relates to the facilitator's learning and culture, namely that it keeps them close to provider practicalities. There is some validity here but ultimately it is not sufficient in itself to justify intervention.

4. Putting incentives at the centre of analysis and action: FSD Kenya's learning curve on the importance of incentives has been relatively slow (as it has been for many in international development). In particular, its first five years26 focused primarily on capacity-building with variable consideration of incentives. But misalignment between incentives – of specific partners and the wider market - and intervention objectives has been very problematic in a number of instances. Understanding incentives is integral to understanding markets, to selecting partners, and to shaping the design of interventions.

5. Sequencing intervention as possibilities open up: as markets develop, including in response to initial interventions, new possibilities may emerge. For example the benefits of bank industry collaboration – say in CIS – may open industry eyes to the potential of other shared initiatives. As the horizon of possibilities is stretched, market system change often occurs in this iterative, sequential manner – not all at once. Intervention therefore needs to be cognisant of this dynamic nature of markets and rather than replicating the same intervention activity should adapt creatively to new realities, which may well involve multiple and different activities.

6. Successful facilitation needs a menu of activities: the flipside of being analysis-led is that facilitators should have flexibility to respond appropriately to constraints revealed through analysis. FSD Kenya has few limits over what it can do with partners – what matters is not the specific intervention choice (technical assistance, grants, guarantees, cost-sharing arrangements, research etc) but that this fits the constraint being addressed. Good facilitation means not having facilitators' hands tied when it comes to intervention.

7. Being realistic on intervention capacity: the breadth of analysis in M4P, especially in a market such as finance, can lead to identification of a range of constraints that may be 'valid' to consider for intervention. But analysis should only lead to intervention, especially in technically advanced areas, if facilitator's have a realistic chance of accessing competent intervention capacity. FSD Kenya's experience shows that there can be a tendency to be overly-optimistic about this and that damage that can be caused by 'bad' implementation.

8. Ensuring a strong transactional element in interventions: making relationships work with partners is about crafting an arrangement that offers something useful but also tests partners' commitment, allowing them to develop ownership over process and outcomes. This is not a formulaic task - neither a matter of simple percentages nor of providing technical assistance without considering what the other party gives in return. Particularly with commercial companies, it is always relevant to ask what is being given in return – even if this is a new idea or pilot project. This requires clarity, not just in terms of the written form of an agreement but more important in terms of shared understanding and ownership. Where FSD Kenya has shaped its intervention with partners so that there is clarity over what each party is contributing, and over the goals and the end point for interventions, this provides the basis for a successful engagement. Where this hasn't happened – and FSD Kenya has not always tested the commitment of partners sufficiently in arrangements with them - misunderstandings and lack of delivery can undermine the deal and relationships linger unproductively.

9. Investing in people: there is an alluring but misleading simplicity to M4P, to its rationale and to its objectives, all helped by the sense of all-encompassing worthiness of its title "Making markets work for the poor". This can encourage facilitators to believe that anything they do related to markets and the poor – which is pretty much everything – is M4P in practice. However, M4P is more than a title or a slogan. It is an approach which has disciplines and frameworks to guide it and which challenges facilitators to make sense of it in their own environments. From FSD Kenya's experience, for example, knowing about financial markets is not the same as knowing how to apply M4P in financial markets. Learning doesn't just happen – it requires conscious planning.

10. Clear strategic vision: market development is not the result of one intervention only – there is never one quick-fix panacea - but takes a range of activity aimed at different constraints which are complementary in their effect. The portfolio of interventions undertaken by facilitators therefore has to fit with an overall future vision – one which recognises that the role of facilitation (and facilitators) is not a permanent task. And this requires regular review and challenge around basic questions:

26 FSD Kenya's first strategy paper did not use the terms incentives once!

where do we envisage the market being x years from now? Without this discipline market development can slide into multiple pockets of separate activity which each have a justification but which together miss the bigger strategic goal.

7.3 FUTURE CHALLENGES IN KENYA

Focussing on financial inclusion in Kenya specifically, what are the broad implications of the case analysis? With a financial sector, at least outwardly, transformed in the last ten years, what are the main strategic challenges lying ahead? The preceding analysis suggests a number of important issues but five major priorities, all of relevance to FSD Kenya and concerned with the supporting functions and rules pertaining to financial inclusion, are highlighted here.

1. Reconsidering the social contract for the financial sector: the last ten years has resulted in important benefits for poor people, helping them to manage their finances and lives better, and these are likely to increase as the market becomes more efficient. But benefits for the poor have been far exceeded by those for other consumers and especially for stakeholders on the supply-side – banks, their managers and their owners. The analysis emerging from the FSD Kenya experience suggests that this situation is unlikely to change meaningfully unless there is a new, shared consensus in Kenya – an implicit 'social contract' - on the role of the financial sector – and particularly of formal finance providers such as banks. And this should be to serve the needs of wider society and the real economy, including the needs of the poor, so that the financial sector is more genuinely inclusive. Such a change, manifested in the rules (formal and informal), would encourage a change in bank incentives and behaviour towards new, different services and reduced emphasis on financial returns.

   This kind of change is not a matter of legislative diktat but is in the realms of the social and political requiring debate and analysis among a broad set of stakeholders in the industry, government, the media and civil society. Although discussion on the financial sector's social contract is not widespread currently, there are a number of converging voices and trends which make this an opportune moment for this discussion. Among these are moves to create a market conduct authority, banks own (quiet) realisation that their conspicuous growth and success (and high margins) do not sit comfortably in a still low-income/poor economy, and international concerns over 'financialisation' – the role of finance in economies. The social contract on finance in Kenya is not an issue to be considered lightly and of course is challenging. Progress in addressing it would neither be quick and easy. Initially this might include steps to raise debate such as research/discussion papers (e.g. banks' financial performance relative to other sectors and international comparisons); review of legal frameworks, and scenario analysis on future options.

2. Developing a more sustainable and robust regulatory process: there has been significant progress in developing an appropriate regulatory context for financial services. However, especially in the digital finances field, there will be a continual need for update and revision. The challenge here is to develop a better, more sustainable system of policy and regulation. Currently, this process relies to some degree on external inputs, especially from FSD Kenya. As a starting point, the system as a whole needs to be assessed and future vision developed for how this could work more effectively.

3. Building a research function as part of the market: research on different aspects of financial inclusion has been created as function by FSD Kenya in the last ten years. This research (FinAccess and a range of subject-specific studies) has fed into decision-making in private and public sectors, and in doing so enhanced sector performance. But this essentially is a function funded and delivered by FSD Kenya – and this is not a healthy position for the financial sector to be in. The challenge here is to move away from this dependence. This might involve, as a starting point, developing a future vision of how a research system could look in the future. This would be concerned with both FinAccess (where discussions have started) and also the broader research function related to financial inclusion and include a candid assessment of different future options, the capacity and incentives related to these, and the realistic role of FSD Kenya for each.

4. Seeing through the process of developing public infrastructure: after a long (6-7 years) and sometimes difficult process, tangible progress on both the CIS and the Switch has been made. The potential gains in terms of market efficiency, innovation and inclusion from successful development of these two (different) functions are very significant. Though FSD Kenya involvement remains important currently and will be in the near-term, a future for these important market functions operating well without FSD Kenya involvement is in sight.

5. Developing a coherent innovation system: there is considerable activity and excitement in the innovation space in Kenya, especially in digital finance, much of it aiming to find good (disruptive) ideas. Kenya is seen to be a leading location for fintech, especially in Africa. There is an assortment of 'soft' funding available but the substance of innovation as opposed to the appearance is not yet completely clear. In this context, the challenge is first to consider what an innovation system that can develop 'good' innovations – ie that can impact positively on poor people – looks like, for example in relation to research, information and skills. And second, given this, to consider what needs to be done to develop such a system.

For FSD Kenya, this set of priorities is a combination of seeing through promising activity already started, recalibrating towards an enabling rather than delivering role, focusing on what's important (and away from what's less), and raising ambitions with respect to addressing the underlying incentives 'elephant' that sits in the financial services space. Across all of these areas, it also means clarifying FSD Kenya's future vision on how the different parts of the financial market system can work in the future.

7.4 DISCUSSIONS AND DILEMMAS

FSD Kenya's performance – both positive and negative – can be explained with respect to the above points, and together these form a set of broader lessons. Within these, however, are a number of more open, intractable issues, to which there are no straightforward answers that provide neat closure, and which touch on the limits of what development interventions can do, and with which FSD Kenya – and funders and facilitators – need to wrestle. Three are highlighted here.

1. The facilitator's dilemma: facilitators that have success in playing particular roles in a market may create an expectation of 'more'. Yet 'more' often leads to a more permanent presence, and to reliance on them growing rather than others being drawn in to play that role. FSD Kenya, to a large degree, faces this challenge in relation to its research and policy and regulation roles.

   This dilemma arises as a result of not developing a clear vision of 'where we are going', of how it is envisaged a market system will work in the future and how intervention can contribute to this. Without this, a void develops that allows 'direct delivery' to take precedence over facilitating others to do, and a drift to apparent permanence. The longer this continues inevitably the more entrenched the facilitator becomes. Developing a clear view of the future is the starting point to addressing this issue and to outlining options - but compromises in terms of sustainable service quality are inevitable.

2. The 'how much is enough' challenge: this refers to a situation where further progress in developing the market requires that fundamental constraints are addressed relating especially to institutional capability. For FSD Kenya, running into formidable 'buffers' on for example public sector regulator and research capacities, these are real issues.

   Again, addressing these involves first developing a view of the future – or different scenarios – that outlines intervention options. This might include for example advocating on the issue with industry stakeholders and government. Doing so will also identify what can't (and can) be done with limited facilitator resources – including the task of turning round public sector institutions – and the inevitable trade-offs in quality in considering sustainable futures.

3. The political economy challenge: political economy exists in every market context but in some the constraints emerging from this on developing the market for the benefit of the poor are particularly severe. Although some development practitioners may perceive that power/politics issues have less validity and relevance for them than technical issues – with which they are more comfortable – from an M4P perspective following the approach does mean identifying the main constraints no matter their nature. And focusing on the poor – the 'P' in M4P – is often inherently political. More challenging however is the question of whether facilitators should actually engage in seeking to bring change to the political economy and the incentives that stem from this? The critical issue here, as with all interventions, is whether facilitators have the right mandate, skills and organisational capacity to do so, and if they don't, can meaningful change be brought about by engaging solely on technical, capacity, information and other non-political questions?

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