FSD KENYA IMPACT ASSESSMENT
SUMMARY REPORT

JANUARY 2010

FSD Kenya
Financial Sector Deepening

This report was commissioned by FSD Kenya on behalf of its Programme Investment Committee. The summary report has been compiled by Robert Stone, Susan Johnson and Janet Hayes. A copy of the detailed annexes is available on request from FSD.

OPM

Oxford
Policy
Management

CDS BATH
Centre for Development Studies

FSD Kenya
Financial Sector Deepening

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). In addition to the Government of Kenya, funders include the UK's Department for International Development (DFID), the World Bank, the Swedish International Development Agency (SIDA), Agence Française de Développement (AFD) and the Bill and Melinda Gates Foundation together with the Government of Kenya.

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Abbreviations

AFD	Agence Française de Développement
ASCA	Accumulating Savings and Credit Association
ASAL	Arid and Semi-Arid Lands
ATM	Automated Teller Machine
CBFO	Community-Based Financial Organisation
CBK	Central Bank of Kenya
CDS	Centre for Development Studies
CSP	Certified Service Provider
DCED	Donor Committee for Enterprise Development
DFID	Department for International Development (UK)
DFS	Decentralised Financial Services
DTM	Deposit Taking Microfinance Institution
FLSTAP	Financial and Legal Sector Technical Assistance Programme
FSD/K	Financial Sector Deepening/ Kenya
FSA	Financial Services Association
G2P	Government Payments to People
GDP	Gross Domestic Product

Abbreviations

HSNP	Hunger Safety Nets Programme
IA	Impact Assessment
JTL	Jitegemee Trust Ltd
KIPPRA	Kenya Institute for Public Policy Research and Analysis
KPOSB	Kenya Post Office Savings Bank
KWFT	Kenya Women's Finance Trust
M&E	Monitoring and Evaluation
MFI	Microfinance Institution
MIS	Management Information System
MSME	Micro, Small and Medium Enterprise
NGO	Non-Governmental Organisation
OPM	Oxford Policy Management
OVC	Orphans and Vulnerable Children
OVI	Objectively Verifiable Indicator
PIC	Programme Investment Committee
PIC PAR	Programme Investment Committee project appraisal report
PRA	Participatory Rapid Appraisal
QA	Quality Assurance
RCT	Randomised Control Trial
ROCSA	Rotating Savings and Credit Association
SACCOS	Savings and Credit Co-operatives
SAM	School of Applied Microfinance
SIDA	Swedish International Development Agency
SME	Small and Medium Enterprise
WOCCU	World Council of Credit Unions

EXECUTIVE SUMMARY

This impact assessment of the Financial Sector Deepening Trust in Kenya (FSD) has been undertaken on behalf of FSD by Oxford Policy Management, in association with the Centre for Development Studies at the University of Bath. The objective of the assignment is to undertake a rapid analysis of the impact of the FSD programme over its four years of operation, and to make pragmatic recommendations for strengthening of the impact measurement of the programme in the future. Work on the assignment took place between September and December 2009, including field work in Kenya in October and November.

FSD - measuring its impact

FSD provides a multi-faceted programme of support to the financial sector. It uses a systemic market development approach that seeks to use interventions at three levels - policy and regulatory (macro), sector support services (meso) and retail capacity (micro) - to catalyse and achieve impact throughout the financial sector, with the ultimate goal of generating sustainable improvements in the livelihoods of poor Kenyans. This final impact on the livelihoods of poor Kenyans is therefore envisaged as arising through two routes: first, through the direct impact of projects on the capacity and operations of the financial sector; and secondly, through complementarities in its interventions that generate change in the sector as a whole. These indirect effects - produced through competition, innovation and demonstration - are the 'crowding in' effects that a market development approach hopes to achieve.

FSD has a diverse portfolio of projects and, to date, had not implemented an impact assessment strategy. Given the complexity of the programme as a whole and the scope of this exercise, the aim was therefore to test the available evidence that demonstrates whether the programme theory is functioning as expected.

Methodology

The methodology for the work involved a combination of document review and semi-structured interviews with key partners, stakeholders and financial service users. It focused on a selection of projects across the three levels of the market development approach. It sought to identify evidence of the direct impacts at the level of each project, while also looking for wider evidence of 'crowding in'. The enquiry also sought to identify areas of unintended or unplanned impact from interventions. The main approach taken to attribution involved a discussion of hypothesised counter factual scenarios with the informants.

Findings

The OPM team considered the direct impacts achieved at each of the levels of FSD activity. At the policy and regulatory (macro) level, we concluded that FSD's work has contributed in a significant way to the development of an improved enabling policy and regulatory environment. At the (meso) level of support services, the programme has helped to build significant capacity in the support service market and has also contributed to the shift to a market that is more client-oriented. The direct impact this has had on institutional viability is hard to measure at this early stage, but it is evident. At the (micro) level of retail capacity, FSD's support has helped to enable the transformation and institutionalisation of key providers within the sector, while facilitating the survival of institutions that were under threat. Again, while the impact of this on institutional viability is hard to assess and attribute, there is strong evidence that the support has sustained and enhanced the outreach of more client-focused services.

The team also examined the final impact on the ultimate goal of generating sustainable improvements in livelihoods of poor people through reduced vulnerability to shocks, increased incomes and employment. In theory, all levels of FSD activity can ultimately lead to this goal, with additional pathways needed for the macro and meso levels to achieve it. At the macro and meso levels, it is necessary for the enhanced environment and the improved support services to result in expanded provision of appropriate and affordable services. There is some strong evidence that these impact pathways are operating and, in particular, that the culture of the market has changed to become more focused on reaching poorer clients. However, the evidence is more mixed in terms of patterns of access and use of services at by poor people. The evidence suggests that there are some improvements in outreach to socio-economic groups previously under-represented in the profile of clients of banking and microfinance institutions, but greater clarity is needed over the poverty profile of who is able to access the services. In terms of the final impact on the incomes and vulnerability of poor Kenyans, it is not currently possible to derive firm conclusions.

The evidence of impact on increased incomes and reduced vulnerability for the range of respondents that we were able to interview is, at best, preliminary and so can only be indicative of areas for further research. The evidence appears to demonstrate a limited and mixed range of impact on improved incomes. There is also a suggestion of impact on indicators that have not been identified explicitly in the FSD goal, such as children's access to education. It was not apparent from the evidence we gathered that new, more flexible savings and loan products are being used to protect actively against shocks and vulnerability: informal financial mechanisms are still extensively used to achieve this protection.

Nevertheless, we regard the culture shift in the financial market as a whole to be highly significant and consider that there is convincing evidence that FSD has played a significant role in achieving that shift. It is clear that there has been a shift in service availability and products. But it is also evident that further innovation will be necessary to generate a level of access and transactions costs that make services - especially savings - appropriate and affordable for poor people handling, at most, a few hundred shillings a day.

We also consider, however, that there is evidence that the market development approach has produced strong synergies across the three levels of projects. This has been achieved both through the ways in which different projects have inter-linked at different levels and as a result of FSD's enhanced ability to work at the level of policy development: FSD's policy role has benefited from a deep and detailed engagement at the micro level, which has provided the necessary knowledge, understanding and credibility to enable it to participate effectively in policy discussions.

Future FSD impact assessment work

FSD intends the impact assessment (IA) work within the programme to be of an 'improving' nature: it will seek to 'develop better solutions' over time. FSD needs to develop an IA framework that allows it to retain the flexibility and responsiveness that has been an important feature of its work to date. Thus, it needs to set up an approach within which decisions are systematically made about which projects are to be assessed and how. It is not necessary to include a full assessment of every project, but the framework should capture the key components of the programme, particularly those that operate on a larger scale, while providing some guidance on the assessment of smaller projects.

Given the diverse nature of projects in FSD's portfolio, the first step in developing an IA framework will be to distinguish between types of projects, by delineating groups of projects with respect to the similarities of their impact pathways. The current FSD approach effectively does this by categorising projects at the micro, macro and meso levels, with sub-groups/themes within each of these. A further distinction should be made between projects implemented by FSD itself and those that are implemented through partners. This distinction for macro level projects will also help to recognise the active policy dialogue and facilitation role that FSD undertakes. This distinction highlights the need to take into account the points at which indicators are defined and data collected, since FSD is dependent on partners for much of the necessary data.

The proposed framework would have two components. First, IA work would focus at the three levels of the programme, each of which would have a different strategy for data collection. The main aim would be to trace the direct impact that the sub-group of projects is expected to have, by establishing clear impact pathways. A combination of quantitative and qualitative strategies is likely to be appropriate. Secondly, the links between the direct impacts and the final impact on poor Kenyans would be tested. A number of assumptions are made about the link between direct and final impacts for macro and meso level interventions. This component would examine the causal pathway that is captured by those assumptions and would also seek to capture the wider impacts on the market system that are operating as a result of aspects of the programme. This is to capture the 'crowding in' effect that a market development approach seeks to precipitate. At this level, therefore, FSD would essentially be monitoring the role of the financial sector as a whole in meeting the needs of poor Kenyans, and seeking to understand its own indirect contribution to that process. An important component of this monitoring is already in place through the FinAccess surveys, but it needs to be developed further and complemented through additional research to explore the impact pathways at work.

The proposed framework will require reliable information from the outset. The overall IA framework must be firmly held and managed within FSD for it to be successfully focused on an 'improving' agenda, and must be responsive to the future development of the programme over time. Given the complexity of IA, a dedicated cross-cutting role should be introduced, rather than making this an additional responsibility of project managers. FSD will need to have the expertise in-house to plan and implement a range of approaches to IA. The detailed research, however, would be carried out through commissioned studies.

Adopting appropriate time frames is an essential consideration in addressing and assessing the final impact of the intervention on poor Kenyans. The effects of the FSD interventions can be expected to build up over time, but will not necessarily do so in a linear way. The purpose of monitoring impact pathways is to better understand how these effects are occurring and to help adjust intervention strategies in the light of this.

Chapter 1

INTRODUCTION

Oxford Policy Management (OPM), in association with the Centre for Development Studies at the University of Bath (CDS), has been contracted by the Financial Sector Deepening Trust in Kenya (FSD) to undertake an impact assessment of FSD.[1]

Work on the assignment began on 28 September 2009 with a review of core FSD documents and relevant impact literature. Following discussion of a draft inception report indicating the proposed methodology and timetable for the assignment, a final inception report was submitted on 23 October, and field work was undertaken in Kenya from 26 October to 13 November.

Since its establishment in 2005, FSD has provided a multi-faceted programme of support to the financial sector. It uses a systemic market development approach that seeks to use its interventions at the macro, meso and micro levels to catalyse and achieve impact throughout the financial sector - that is, on its enabling environment, support services and retail capacity - with the ultimate goal of generating sustainable improvements in livelihoods of poor households. The impact of the programme is therefore envisaged as arising from both the direct impact of its projects and also from the complementarities in its interventions that generate change in the sector as a whole, extending beyond the specific impacts of FSD's projects - 34 of them to the end of 2008. It was recognised from the outset of this assessment that it would be a difficult challenge to capture the impact of FSD on the various parts of the financial sector while, at the same time, establishing indicators of impact across the full range of the projects that are supported by the Trust. Hence, a sampling approach was defined and agreed.

Following a summary in section 2 of two contextual issues - the current status of the financial sector in Kenya and the role of FSD, section 3 describes the methodology adopted for this impact assessment. As explained in section 3, it was a major challenge to identify the broad 'programme theory' underlying FSD's market development approach and relate this to its top-level goal, which is 'to generate sustainable improvements in livelihoods of poor households through reduced vulnerability to shocks, increased incomes and employment'. Section 3 therefore includes an explicit attempt to establish and spell out the programme theory itself, before explaining the methodology for testing this theory and FSD's success in addressing it.

Section 4 summarises our major findings about the impact of FSD at the micro, meso and macro levels, and also the overall impact of the programme. Section 5 makes recommendations on how impact assessments can be embedded into the future work of FSD.

This summary report reproduces the main part of the report submitted to FSD in January 2010: the full report can be found on the FSD website, www.fsdkenya.org. The full report includes annexes that set out in detail a review of FSD's programme theory and impact pathways, an assessment of impacts at the micro, meso and macro levels and recommendations for future impact assessment for FSD.

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[1] The team consisted of Robert Stone and Janet Hayes (OPM) and Susan Johnson (CDS). The team was supported in the field work and in the analysis of the Kenyan context by Jacob Chege and Moses Njenga of the Kenya Institute for Public Policy Research and Analysis (KIPPRA).

Chapter 2

THE CONTEXT

2.1 THE FINANCIAL SECTOR IN KENYA

The Kenyan economy enjoyed a remarkable improvement in its performance between 2002 and 2007, achieving high rates of GDP growth that culminated at 6.9% growth in 2007.[2] This successful period followed two decades of erratic performance and stagnation of the economy. The projected growth of 2008[3] had been even more impressive at 7.8%. This figure was not achieved, however, due mainly to the violence that followed the presidential elections of December 2007. Despite this setback, the economy is now slowly regaining macroeconomic stability, though with much reduced GDP growth (only 3% in 2008)[4] and continuing political uncertainty in the context of the uneasy coalition government. Growth in the period since 2002 has been achieved largely through increased domestic demand. Growth in exports, however, has continued to be slow as a result of a lack of diversification, low value exports and supply-side constraints related to the investment climate. High food, energy and transport costs have also contributed to higher rates of inflation since 2005: inflation reached 27% in 2008.[5]

The Kenyan financial sector is composed of the banking sector, microfinance institutions (MFIs), Savings and Credit Cooperatives (SACCOs), money transfer services and the informal financial services sector. The regulator is the Central Bank of Kenya (CBK). There is a widespread consensus that there is still limited access to financial services for the majority of Kenyans, though in reality the situation has improved markedly in recent years. According to the FinAccess Survey 2009, 22.6% of the adult population now have access to formal financial services through banks, compared with 18.9% in 2006. A further 17.9% are served by other formal institutions (MFIs and SACCOs) compared with only 7.5% in 2006. The proportion of adult Kenyans that depend primarily on informal financial service providers has declined from 35.2% in 2006 to 26.8% in 2009. Overall, the proportion of adult Kenyans that are excluded from accessing financial services and products shrank from 38.4% in 2006 to 32.7% in 2009.

The banking sector has for some years faced several inter-related challenges, including high interest rate spreads, high overhead costs and relatively high profit margins.[6] One factor in this has been the lack of credit information-sharing, which is seen as one of the several reasons for the high incidence of non-performing loans - but here, too, there has been great improvement since 2002. Further factors are the deficiencies in the legal and institutional framework that limit the range of assets available to banks as acceptable collateral. There has also been periodic uncertainty in the policy environment relating to the control and regulation of interest rates and related bank fees. The current government in 2007 published its strategy for financial sector development in its document entitled Vision 2030.[7]

Technological innovations have transformed the Kenyan financial sector landscape in the years since 2002, by helping to extend financial services to millions of poor people at relatively low cost. For example, since 2006, automated teller machines (ATMs) have become a major feature of the landscape, with 1,510 ATMs in the country by December 2008.[8] Mobile telephone money transfer services have also emerged, allowing mobile phone users to make financial transactions or transfers across the country conveniently and at low cost. M-PESA, a mobile phone-based payment system, was launched by Safaricom in 2006 and has experienced phenomenal growth since then. By the end of 2008, M-PESA had over five million users, making it the largest single supplier of financial services in Kenya.[9]

Competition at the lower end of the market has clearly intensified also because of the expansion of microfinance into rural areas. Having realised that microfinance is a potentially profitable activity, a number of mainstream banks have started to open branches in rural areas (in some cases, having closed them only a few years earlier) and to downscale the design of some products to provide microfinance services - either on their own account or by looking for strategic partnerships to do so.[10]

The microfinance sub-sector was, until recently, regulated under several different acts of Parliament.[11] The 2006 Microfinance Act has provided a much more comprehensive and consistent regulatory environment for MFIs. It has been designed to promote the performance and sustainability of deposit-taking MFIs (DTMs) while, at the same time, better protecting depositors' interests. The Act also enables MFIs to provide more complete financial services to the Micro, Small and Medium Enterprise (MSME) sector. Savings and Credit Cooperative Societies (SACCOs) are well established in Kenya: the Ministry of Cooperative Development and Marketing estimates that there are some 10,800 registered SACCOs, serving an estimated 6.19 million members.[12] In the last 15 years, they have expanded their membership by expanding their common

2 World Bank: Kenya at a Glance factsheet (http://devdata.worldbank.org/AAG/ken_aag.pdf).

3 KIPPRA (2009), *Kenya Economic Report 2009: Building a Globally Competitive Economy*, Nairobi, Kenya Institute for Public Policy Research and Analysis.

4 World Bank: World Development Indicators Database, April 2009 (*http://ddp-ext.worldbank.org/ext/ddpreports/ViewSharedReport?&CF=1&REPORT_ID=9147&REQUEST_TYPE=VIEWADVANCED&HF=N&WSP=N*).

5 World Bank: World Development Indicators Database, April 2009 (*http://ddp-ext.worldbank.org/ext/ddpreports/ViewSharedReport?&CF=1&REPORT_ID=9147&REQUEST_TYPE=VIEWADVANCED&HF=N&WSP=N*).

6 Beck, T. and Fuchs, M. (2004) 'Structural Issues in Kenyan Financial System: Improving Competition and Access', World Bank Policy Research Paper, 3363, July.

7 Republic of Kenya (2007), *Kenya Vision 2030: A Globally Competitive and Prosperous Kenya*.

8 Annual Report of the Central Bank of Kenya for the Fiscal Year 2008–09.

9 Annual report 2008, Financial Sector Deepening (FSD). The FinScope 2009 survey, for which the field work was undertaken in February 2009, indicates that 27.9% of the population (5.2 million) were registered users and 13.0% (2.4 million) were unregistered users. By November 2009, Safaricom indicated that the number of registered users had increased to over 7 million, nearly 40% of adults in Kenya.

10 For example, Equity Bank, Family Bank, K-REP Bank and Co-operative Bank.

11 Including the Non-Governmental Organizations Co-ordination Act; the Building Societies Act; the Trustee Act; the Societies Act; the Co-operative Societies Act; the Companies Act; the Banking Act; and the Kenya Post Office Savings Bank (KPOSB) Act.

12 It is difficult to know how accurate this estimate is, but there are undoubtedly numerous SACCOs in the country, with millions of members.

bonds and developed 'front office' services to offer flexible savings accounts to their members (and, in some cases, to non-members). For a time, their growth was largely due to their presence in rural markets when banks were becoming increasingly costly or closing their branches. Nevertheless, that growth has been inadequately regulated, especially given the lack of deposit protection. The recent 2008 SACCO Society Act now offers an improved framework for the effective supervision of SACCOsand especially those providing front office services - by the new SACCO Societies Regulatory Authority.

Kenya also has many thousands of Rotating Savings and Credit Associations (ROSCAs) and Accumulating Savings and Credit Associations (ASCAs) that are a source of savings and credit services. Some 29% of the adult population use ROSCAs, while some 5% use ASCAs. These associations are found in both rural and urban areas, either as registered social welfare groups or as unregistered groups of friends and family members. These informal providers mobilise savings and offer credit while also providing important social networks and forms of support in times of difficulty or crisis.

2.2 FSD KENYA

FSD was established in 2005 to support the development of financial markets in Kenya as a means to stimulate creation of wealth and the reduction of poverty. FSD operates as an independent trust under the supervision of professional trustees, with policy guidance from a programme investment committee (PIC). Funding is provided by a number of development partners working with the Government of Kenya, including the UK's Department for International Development (DFID), the World Bank, the Agence Française de Développement (AFD), the Swedish International Development Agency (Sida) and the Bill and Melinda Gates Foundation.

Working in partnership with the financial services industry, the purpose of FSD is to expand access to services among lower-income households and smaller-scale enterprises to a significant degree. FSD's current strategy is based on a market development approach that seeks to stimulate change at three levels of the financial market system.

- **Macro**, the enabling environment, primarily focuses on policy and regulatory regimes - this includes projects developing laws and regulations as well as important data- gathering projects like FinAccess.
- **Meso**, sector-wide development, concentrates on sector support and business services, market integration and information flows - this includes projects such as the development of MicroSave, which provides training and support services for the microfinance sector.
- **Micro**: retail capacity development, focused on retail service providers, and product and delivery channel development - this includes support for banks like Equity bank, microfinance institutions like Faulu and informal institutions like Group Savings and Loans Associations.

These three levels, in turn, involve three intersecting areas of focus, or 'themes': the core financial system, rural finance and finance for growth (Growthfin). Within this framework, the total number of projects (completed or ongoing) can be classified as shown in table 2.1.

Table 1: Categorisation of FSD projects by level and theme (numbers of projects), as at the end of 2008

Process undertaken	Core financial systems	Rural finance	Finance for growth	Total
Macro: enabling environment for finance	4	0	0	**4**
Meso: sector-wide development	9	3	5	**17**
Micro: retail capacity development	3	6	4	**13**
	16	9	9	**34**

Chapter 3

METHODOLOGY

3.1 OBJECTIVES AND CHALLENGES OF THE IMPACT ASSESSMENT

The objective of the assignment is to undertake a rapid analysis of the impact of the FSD programme over its four years of operation, and to make pragmatic recommendations for strengthening of the impact measurement of the programme in the future.

The most rigorous approach to measuring FSD's impact would require a series of specific impact studies examining the results of all the many projects supported by FSD to date. These studies would seek to identify the extent to which the results to date can be attributed to FSD's involvement, and then relate this to FSD's overall mission and objectives. However, as indicated in the ToR, this comprehensive project-based approach entails several difficulties. The principal problem is simply the level of resource that would be required in order to measure impact rigorously across a portfolio of over 30 active projects. Methodologically, a single approach is also unlikely to be appropriate, given the great variation in the types of project supported by FSD. Furthermore, much of FSD's activity involves investing in work that is expected to take several years to produce the intended impact on market development. Finally, the market development approach to the financial sector means that FSD's overall impact can be expected to be greater than the sum of the impacts of individual projects.

In this section, we explain how the methodology for the assessment has sought to meet these challenges, beginning with establishing the 'programme theory' - that is, the underlying logic of the programme's orientation in terms of achieving its desired impacts (and therefore its goal and strategic objectives) - and the 'impact pathways' that implicitly underpin this logic.

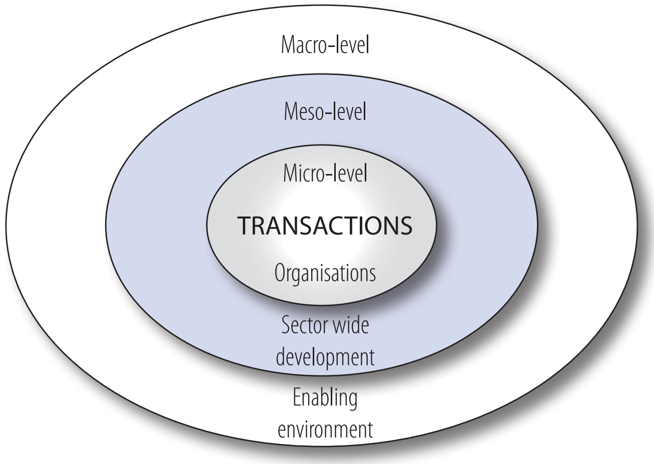
3.2 ESTABLISHING THE PROGRAMME THEORY

FSD takes a market development approach to the financial sector. This approach conceptualises three aspects of a market (see Figure 3.1). These are the enabling environment at the 'macro' level, the infrastructure of the market in terms of support services at the 'meso' level, and the retail capacity that provides services at the 'micro' level. FSD's support to the sector has operated in all three of these domains.

FSD's top level goal is: *'to generate sustainable improvements in livelihoods of poor households through reduced vulnerability to shocks, increased incomes and employment.'* Its ***strategic objective*** *(typically known in logical framework terminology as the 'purpose') is: 'to deepen the capacity of Kenya's financial sector to meet the financial needs of poor Kenyans and micro, small and medium enterprise on a sustainable basis.'*

However, it has been a challenge to link the broad programme theory underlying the market development approach as articulated above to the goal of the programme: FSD's own strategy documents do not currently detail this link adequately. The market development approach effectively stops at the level of transactions that link to the intended purpose; but those that link to the overall goal are not clearly specified.

Figure 1: Levels of support for financial sector development



Source: FSD Strategy Paper (2005–2007).

Indicators relating to the goal level have not been specified by the programme. The objectively verifiable indicators (OVIs) that are identified are at the **strategic objective level**. These are:

- The proportion of the total adult population that uses the services of formal financial institutions;
- The number of accounts in the financial sector;
- The proportion of the total adult population that is financially excluded;
- The amounts of credit extended to the private sector as a percentage of GDP; and,
- The interest rate spread between the lending rate and the average deposit rate.[14]

It can be seen that this specification involves five sector-wide variables that, together, aim to capture the characteristics of a 'deeper' financial sector. The first three indicators relate to access and inclusion, and so can demonstrate in principle that the programme aims to increase formal inclusion and reduce overall exclusion. These three OVIs allow for increased inclusion in both the informal and the formal sectors. The second OVI relates to the overall size of the formal sector, measured by the number of accounts. However, this indicator seems to overlap to some degree with the first indicator, which relates to the proportion of the population using the services of formal financial

[14] FSD does not have a formal logical framework: these indicators are taken from the M&E frameworks in the PIC 2005–08 and 2008–10 strategy papers.

institutions.[15] A key point about all three of these indicators is that the issue of for whom access and exclusion are improved is not defined, even though the strategic objective explicitly states that it is the needs of poor Kenyans that should be met.

The final two OVIs at the strategic objective level reflect alternative perspectives on financial sector development. The fourth indicator, a 'credit–GDP' measure, is often used to analyse the role of the financial sector in the economy as a whole. While it could be expected that the improved delivery of credit services to the excluded, and to micro and small businesses would result in increased credit in the economy, this indicator seems to refer to an alternative definition of financial deepening to that used for the first three indicators; that is, one that is grounded in access and inclusion. The final indicator relates to interest rate spreads. This captures the programme's desire to help achieve improved efficiency in the financial sector with regard to intermediating savings into credit. While these two indicators have been incorporated to align FSD with the government's wider sector policy objectives through the Financial and Legal Sector Technical Assistance Programme (FLSTAP), the route by which these outcomes are expected to be achieved from FSD's activities is unclear, as is how it is to be linked to the ultimate goal.[16]

With a market development approach, the routes by which impact reaches the overall goal are extended in both time and complexity, and can also require a greater number of stages than are captured by FSD's current approach. An alternative approach is to distinguish between the direct (or intermediate) impact that the project is seeking to achieve within the market development framework approach, and the final impact on the livelihoods of poor Kenyans. The full impact pathway for this approach is illustrated in Figure 3.2 (with an example taken from market linkage activities at the meso level). The direct and final impacts are linked by assumptions. For some components of the programme, the final impact is the same as the direct impact; but these cases are few in number - comprising only those components that either operate at the micro retail level and offer new products and delivery channels, or directly seek to expand service provision through, for example, registration under the Microfinance Institution Act. Interventions at the macro level are aimed directly at producing an improved policy environment conducive to innovation and outreach. It is only when intermediaries have responded to such an environment by providing more appropriate and affordable services that poor people can use these services to improve their livelihoods.

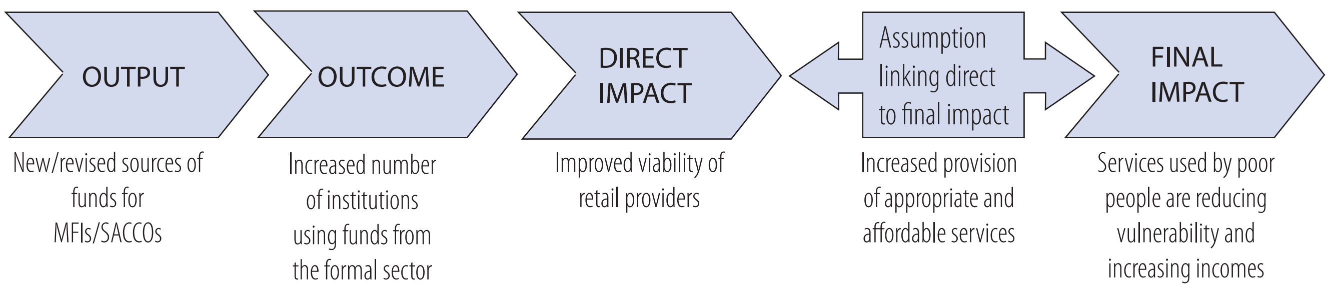
Moreover, the adoption of a market development approach means that the strategic approach of the programme towards the sector as a whole could be expected to be more than the sum of its parts. Such an approach endeavours to create synergies between components such as the development of appropriate regulatory regimes, improved sector infrastructure and improved retail capacity. FSD also plays a key role in policy dialogue in the sector. This important role, which is also implicit in the market development approach, especially at the macro level, is not effectively captured in the existing programme theory.

3.3 TESTING THE PROGRAMME THEORY

The FSD programme has not undertaken any impact assessment (IA) work to date and, hence, did not have either a baseline defining the pre-project condition of its intended beneficiaries, or project-level impact assessment material that could be reviewed to establish the impact of the programme as a whole. The key objective of this present IA exercise was therefore: '*to test the available evidence that demonstrates that the programme theory is functioning as expected.*' [17]

The methodology for the work involved a combination of document review and semi-structured interviews with key partners, stakeholders and financial service users. The aim of the interviews was, first, to establish the theoretical programme impact pathways and, second, to obtain evidence that can substantiate (or refute) the effective functioning of these pathways in practice.

Figure 2: The FSD impact pathway, with a market linkages illustration



[15] FSD management have commented that the use of the second OVI was motivated by having a second easier-to-measure supply side-based measure that could be tracked more often than the demand side one. They recognize, however, that the relationship between the two is not linear, and so complicates matters. Another take on the issue is that the first indicator captures coverage, and the second the size of the financial sector.

[16] Implicitly, improved efficiency reduces costs for users - but this would only happen in a sufficiently competitive environment.

[17] *OPM and CDS–FSD Kenya: Impact Assessment Inception Report*, 23 October 2009.

Work focused on the three levels of the market development approach: macro, meso and micro. The selection of projects employed two criteria:

- Projects should have been in operation for a sufficient length of time to ensure that their services are being delivered and that indications of impact could therefore reasonably be expected to be seen;[18] and,
- The selection of projects focused, wherever possible, on clusters of initiatives around a similar theme. In terms of market development, it can be expected that projects operating in this way will have synergies within the sector and be more likely to lead to wider dynamic impacts on competition, innovation and demonstration effects. The benefits of a portfolio approach to market development projects would be missed if only projects with a unique focus were selected.

Further, the programme theory of a market development approach can propose pathways at the level of individual projects. However, the programme as a whole could be expected to have overall impacts that go well beyond the sum of its parts; for example, by producing synergies and catalysing developments in the sector. Our inquiry therefore also probed for wider impacts in areas such as competition, innovation and demonstration effects, as well as for impacts on the policy process. Additionally, our enquiry sought to identify areas of possible unintended or unplanned impact from interventions, whether positive or negative.

3.4 ISSUES OF ATTRIBUTION

The key question for any impact assessment exercise is how the effects identified can be attributed to the programme. This requires establishing appropriate counterfactuals. However, this is a particularly challenging task for the FSD programme, not only because of the lack of IA work to date, but also because of the nature of its intervention in the sector as a whole. This means that there is no possible counterfactual at the sectoral level. Moreover, in many areas of FSD support to specific projects or initiatives the counterfactual is also hard, or indeed impossible, to establish. For example, had FSD support not been given to the Equity Building Society to transform itself into a bank, how would Equity have approached the task of transformation and what difference might this have made to its eventual development? There is no definitive right answer to such a question. Instead, the approach to establishing counterfactuals in such cases can only be through informed opinion in the light of the close examination of objective evidence regarding specific trends and contextual factors. The approach taken to attribution therefore involves a discussion of hypothesised counterfactual scenarios with key informants.

At the client level, the field research undertaken for this exercise did not seek to establish specific measures relating to improved incomes, employment or reduced vulnerability. Given the limited time and resources available, and also given the lack of a baseline and the associated difficulty in establishing an appropriate sampling frame, a somewhat simplified approach was called for. Specifically, the field research was used to test the programme theory by obtaining indicative evidence, first, about patterns of 'access' and 'use' that could triangulate the information from available FinAccess survey data and, second, to understand whether and how respondents themselves attributed changes in their livelihoods to the use of these services.

3.5 FIELD WORK

The field work for this assignment took place between 26 October and 13 November 2009. The team visited Nairobi and carried out semi-structured interviews with a wide variety of FSD partners and stakeholders at macro, meso and micro levels.[19]

The team also carried out field research in Busia and Kitui districts, involving interviews with the users of five of the financial service providers supported by FSD (Equity Bank, Faulu, Kenya Women's Finance Trust, Kenya Post Office Savings Bank and K-Rep Fedha Services). These two districts[20] were selected, first, as they are ranked in the bottom 20 in the country for the proportion of the rural population in absolute poverty[21] and, second, as a result of discussions with FSD in order to capture as wide a range of the service providers as possible. Field work was undertaken within the towns of Busia and Kitui, and also in rural market centres that were between 20 and 25 km from these towns.

The approach to the field work had four components:

- Interviews were conducted with officers and managers of the five main financial providers that FSD has funded. Where possible, the findings were supplemented by interviews with managers of other banks and institutions. This helped establish the key changes in provision at the local level over the previous three years;
- Participatory Rapid Appraisal (PRA) for microfinance tools was used with MFI groups to achieve an overview of financial service provision in the area;
- Members of these institutions were interviewed. In Kitui, the findings were supplemented for PostBank and Equity by carrying out semi-structured interviews with clients encountered in their banking halls; and,
- In order to establish a perspective that went beyond the clients of the institutions themselves, the local administrations in these locations were approached to identify individuals in their areas for interviews. The aim

18 We have only selected projects described by FSD as 'ongoing' or 'completed'.

19 Generally, micro-level interviews were conducted by Susan Johnson and two interviewers recruited through MicroSave, meso-level interviews by Janet Hayes and macro-level interviews by Robert Stone. Jacob Chege and Moses Njenga conducted interviews relating to SME finance.

20 Based on the pre-2005 district map.

21 Kenya National Bureau of Statistics (2007) 'Basic Report on Well-being in Kenya (Based on Kenya Integrated Household Budget Survey 2005/6)', Kenya National Bureau of Statistics.

of this exercise was to expand the respondents well beyond those in the client base of the institutions.

3.6 QUALITY ASSURANCE

The team had internal quality assurance (QA) and management policies in place to ensure that the process and products of the assessment met international evaluation principles and standards, especially the OECD/DAC standards.

The quality assurance and management processes included internal review of key outputs by Anne Thomson - Principal Consultant at OPM and Board Director who is OPM's focal point for monitoring and evaluation - to assure the quality of the main outputs.

The QA plan was designed to provide an appropriate mechanism to ensure the competent delivery of the consulting services from the team. The aim was to ensure that these services came together as a coherent set of activities with consistent outputs. All QA activity was documented through 'tracked changes' and related emails. An outline of the QA plan is presented in Table 3.1.

Ethical standards regarding the collection of data from respondents were established and maintained. All respondents were informed of the purpose of the exercise, and their consent to the interview requested. Responses are reported anonymously in the final report, unless specific attributed responses are necessary and are also agreed with the respondent.

Table 2: Quality assurance plan

Activity	Responsible	Timing	QA documentation
Daily QA	Team leader + team	Ongoing	E-mail, documents
QA review of draft inception report, and all preparatory and inception phase activities	QA manager + team	3 weeks after commencement	'Tracked changes' and related e-mails, written notes
QA review of draft report, including review of the entire material used for preparing the draft report	QA manager + team	1 week before submission of report	'Tracked changes' and related e-mails, written notes

Chapter 4

THE IMPACT OF FSD KENYA

In this section, the findings about the impact of FSD at the micro, meso and macro levels are summarised and an assessment offered of the overall impact of FSD.

4.1 MICRO-LEVEL IMPACTS

Here, we review the effect of FSD support to the development of micro-level retail capacity. This part of the assessment focused on five projects:

- Support to Equity Bank to transform itself from a building society to a bank;
- Support to Faulu and the Kenya Women's Finance Trust (KWFT) for transformation under the 2006 MFI Act;
- Support to Kenya Post Office Savings Bank (KPOSB) to introduce a new business model; and,
- Support to K-REP Fedha Services to commercialise and make available sustainable management services to Financial Service Associations.

4.1.1 Service providers

Equity Bank

The growth of Equity and its transformation to a bank has had a huge impact on the financial market in Kenya, both in terms of its actual direct outreach and through the demonstration effect this has also had in the market, locally and internationally. Equity has increased its deposit account numbers from 586,000 in December 2005 to 3.2 million by the end of 2008. FSD's support with regard to Equity's transformation continued the support provided by DFID that preceded the establishment of FSD. The support was the funding of technical assistance that led to Equity's legal transition to bank status in 2004, and also to leverage support from several other donors and partners in the sector.[22] While Equity would have transformed even without DFID support, as it had outgrown its building society status, DFID's support was 'beyond money', as it put its own reputation behind Equity and this, in turn, leveraged political will within the Central Bank of Kenya (CBK), which had previously regarded Equity with some scepticism. The transformation was completed within six months.

This phenomenal growth of the transformed Equity Bank has reflected a shift to a client- and market-driven approach rather than a product-driven approach,[23] which has had a wider impact on the culture of the market. This has occurred through innovation - especially the introduction of transactions accounts with no ledger fees - and demonstration effects. One banker reported that 'people have seen the value at the bottom of the pyramid . . . [the] magic of Equity is that it has shown that geographically, by product, by different customer profile that you can build a market there'. FSD has undoubtedly been a key contributor to this success, both in its direct involvement and in bringing in other development partners (especially Microsave), and is seen as such by competitors. 'It takes assistance to figure out the model as it is a low margin business.'

Faulu and the KWFT

FSD's assistance to Faulu and the KWFT with regard to undertaking the necessary transformation to meet the requirements of the Microfinance Act was expected to improve their institutional viability in the long term, primarily through their ability to mobilise savings. This transformation is a high-cost exercise, given the significant regulatory requirements of the CBK. In the longer run, it is expected significantly to develop the market for services for poorer clients. Faulu had successfully converted by May 2009, but faced some erosion of its profitability in the short run. The KWFT has not yet fully met the licensing requirements but has continued to grow at a rapid pace during the transition.

It is still too early for a full assessment of the impact of these transformations on the long-term market positions of the two institutions; neither can their status be seen as entirely secure, given the new dynamics of the Kenyan financial marketplace. However, transformation is a costly and in-depth process that requires skilled advice and guidance. While both the KWFT and Faulu would have undertaken the transformation without FSD's assistance, the financial support provided by FSD has speeded up and smoothed out the process, leaving both organisations stronger financially than would otherwise have been the case had they had to fund this transition from their own reserves. It is not evident from our interviews that any other donors were readily available to provide funding.

KPOSB

FSD's support to PostBank was with regard to the development of the bank's 'new business model', which involved inter alia the shift to an automated card-based system. Prior to this, the bank's market position was being rapidly eroded as its limited automation and slow service meant that clients no longer perceived the institution as a bank, and certainly not as a good bank. PostBank funded the hardware and software, while FSD funded the technical assistance needed to implement the new system, which went live in October 2008. PostBank estimates that the three years that it took to undertake the transition would have been significantly longer - as many as six years - without the highly professional technical assistance that the FSD support provided.

The impact of this support on client outreach is difficult to establish because PostBank does not systematically report on dormant accounts. However, it is clear that the shift has enabled PostBank to remain a player in the deposit

[22] This support was begun by DFID under its financial sector deepening programme and taken over by FSD when it was established as a Trust.

[23] Coetzee, G., Kabbucho, K. and Mnjama, A. (2002) *Understanding the Re-birth of Equity Building Society in Kenya*, Nairobi, Microsave.

account market and prevented an important public asset from becoming an anachronism. Given its past outreach to low-income clients, this is an extremely important contribution. However, PostBank's long-term competitive market position remains to be seen, as it is functioning in an aggressive market where the availability of loans is also a determinant of choice of savings institution.

KREP Fedha Services

FSD support to KREP Fedha Services has been to develop a financially sustainable model of management for the financial services associations (FSAs), which are a particular model of a small village bank. By 2005, the 70 FSAs faced significant challenges. Their performance was deteriorating, default rates were high and fraud was an almost daily occurrence. At the same time, ongoing donor grant support to the model was waning. Hence, the future of the existing model looked bleak, with the savings of local members in the form of shares (and, potentially, deposits) likely to be lost. The vision was to develop a commercial entity that would provide management services to the FSAs on a fee basis.

The vision, leadership and persistence of FSD's engagement with KFS has been critical in bringing a commercial focus where a culture driven by non-governmental organisations (NGOs) had previously existed. KFS is now at approximately 80% operational sustainability, with the FSAs, in aggregate, operating viably. This is a considerable achievement and a significant turnaround. However, the future is not yet secure. A remaining key challenge is automation, where the organization is still experiencing serious difficulties with design and implementation.

Overall, the support given by FSD to the transformations of Equity, Faulu and KWFT has undoubtedly contributed to the institutionalisation and growth of the microfinance sector in Kenya, as a whole. However, it is important to recognise that while the shift in the culture of the sector - precipitated, in particular, by Equity - is no doubt irreversible, rapid growth in client outreach over the period 2006–07 was underpinned by strong economic growth that has seriously slowed in the last two years as a result of the drought and then the post-election violence.

Some respondents criticised FSD for offering support to only a few selected institutions and for picking 'low-hanging fruit' in its engagement with those institutions, while giving them 'undue advantage' in the market. One response to such criticisms is that FSD's engagement with institutions such as PostBank and FSAs was challenging to take on and, while there are positive signs, they are clearly not, as yet, success stories. The critical perception of FSD is perhaps due also to its associating itself with institutions that are strong vibrant and high-profile, while other similarly significant projects are not nearly as well known. It would, however, seem that FSD's support has produced a level of institutionalisation of competition and growth for the low-income market from which competitors are clearly feeling the pressure.

4.1.2 Clients

Outreach

Bank usage has increased by 4.7 percentage points, from 16.8% of adults in Kenya to 21.5% over the period. The number of accounts at Equity has increased by 8.7 percentage points, more than tripling the proportion of people holding accounts there from 3.6% of adults in Kenya to 12.3%. It is clear from these figures, therefore, that the increase in coverage by Equity is not entirely due to new customers. PostBank's dealings have, on the other hand, more than halved, falling from 5.6% of Kenyan adults to 2.4%, which demonstrates how dramatically PostBank's custom has fallen off in this competitive market. The timing of the FinAccess survey in February 2009 was only six months after the new business model had been launched and, therefore, the full impact of the new business model in regenerating its customer base cannot yet be seen. MFI usage, as a whole, has doubled from 1.7% of adults in Kenya to 3.4%. KWFT's growth has been a key contributor to this expansion (growing from 86,000 to 242,000 clients),[24] and Faulu has also significantly expanded its outreach (from 58,000 to 98,000 clients).

The profile of each institution's clients was compared by location (rural/urban), gender, age, education and employment. Compared with 2006, we found that Equity had clearly more than proportionately increased its outreach to the rural population, women, younger people and the less-educated. It had also diversified its client base away from those in private sector employment. However, using a poverty indicator (based on 2009 data only), it has not clearly achieved outreach to a poorer clientele any more than has the rest of the banking sector.

Faulu has made a small improvement in rural orientation, shifting towards men, improving its profile with regard to the 18–34 age range and also those educated only to primary level; however, its poverty profile less deep than the banks. KWFT has improved its rural outreach, is now even more heavily biased towards women, and has shifted slightly towards older women; although its education profile has changed little. It does reach a poorer clientele than either the other MFIs or the banking sector but this profile represents the Kenyan population as a whole rather than being particularly poverty biased.

Both MFIs have diversified their clientele with respect to employment, such that the focus is no longer on those running their own businesses, and this no doubt reflects the wider range of products available. PostBank, in the light of its declining custom, has a clientele that is now more rural, slightly less female, older, and now less-educated than it was. However, it plays an important role in reaching a poorer clientele than other instiutions - similar to that of KWFT - and, hence, the investment in supporting its new business model is particularly justified from this perspective.

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[24] Figures for the period end 2005–end 2008. FinAccess data was collected in September 2006 and March 2009.

Impact

First, the eagerness with which respondents are opening the new wave of transaction accounts reflects a strong interest in saving, but the reality of active use of these accounts is somewhat different. This currently arises from a number of factors. First, the overall economic conditions of the last two years have been difficult; with post-election violence particularly affecting Busia and drought affecting both areas, but particularly Kitui, Most respondents reported that their standard of living had declined over the period. Respondents still, in the main, see these accounts as places where funds that are in some sense 'spare' - surplus to immediate needs - are put, in the context of difficult economic conditions. Currently, respondents indicated that they did not have any 'spare' cash to put there. Second, this raises the question as to why the accounts are not being used for active liquidity management. For the few who are on the doorstep of the banks or who are operating businesses in the towns, these accounts are providing this much needed service. However, for most of our sample, the transactions costs involved are still too high for the accounts to be used on more than an occasional basis - hence, they are still only appropriate for putting away funds that are not likely to be needed in the short term. It is not clear that the transformation of KWFT and Faulu into regulated institutions that are able to take deposits will substantially address these transaction costs problems. While KWFT currently has an impressive 171 field offices, the process of turning these into branches will be slow and costly; in the meantime, clients will have to use other mechanisms. Even where these services can be accessed through M-PESA, which could lower transactions costs due to the closer proximity of agents, the transactions costs incurred through this route are still significant relative to the amounts being managed.

The evidence on savings suggests that compulsory savings in MFIs have their purposes. These have been drawn down in response to emergencies and, for others, are seen as a long-term means of accumulation - especially by women - for their own security. The ongoing importance of 'merry-go-rounds' emphasises the role of the discipline that these mechanisms offer in savings when cash flows are 'low, irregular and unpredictable'.[25]

As has been found in a wide range of impact assessment research, the evidence here suggests that loans have had important positive impacts for some respondents. In this particular case, the key benefit has been that of enabling respondents more easily to pay secondary school fees.

Loans for agriculture are an important development in the portfolios of the financial institutions and this is certainly the case in these two areas, which are highly agriculturally dependent. While there is evidence that loans are being invested in agriculture (including loans that were necessarily designed for agricultural purposes), the difficult weather conditions of recent times have made this an even more risky business. As expected, investment of these loans in small-scale enterprises was also evident. The availability of loans had helped some to rebuild their businesses after they had been run down as a result of various shocks, as well as to develop new businesses. However, such experiences are, again, very mixed - while the loans are helpful, the environment inevitably produces risks for business and resulting difficulties in repayment.

It was notable that the timely repayment of loans taken up in rural areas was particularly assisted by the availability of remittances or transfers from other family members. There are two points to make here. First, it indicates the limited range of profitable investment opportunities that exist in these areas, and that reliance on these external funding sources is therefore necessary to support such investment. Second, M-PESA has made it cheaper and easier to be dependent on remittance income sources to manage regular loan repayments, and so has enhanced the viability of some borrowing.

However, a note of caution is perhaps necessary. The rural areas studied for this assessment have seen a quite aggressive MFI expansion into 'frontier' areas where poverty rates are high, people are heavily dependent on agriculture, and where there is low or, at best, medium-level economic potential. Alongside the pressing economic conditions more generally, this expansion carries the risk that clients who are not well-suited to servicing debts of this kind will be encouraged to borrow - possibly excessively. We encountered one woman dependent on farming and casual labour who had joined an MFI and was hoping to take up a loan, but for whom loan repayment on strict terms appeared to be a highly problematic strategy. On a more positive note, clients now have a wider range of loan products from which to choose and can be more transparent about the use of the loans for non-business purposes, instead of having to dress up consumer loans as business loans. There is also the welcome emphasis (in contrast to earlier approaches that stressed taking successively larger loans) on clients taking only what they felt they could repay, with many reporting loans of KSh 5,000 and KSh 10,000.

Finally, and significantly, there was little evidence that it was savings or loans products from these banks and MFIs that were being turned to in the face of shocks to livelihoods. Informal mechanisms clearly still dominated the response to this need.

4.1.3 Overall impact of FSD at the micro level

The analysis of outreach suggests that Equity Bank is reaching market segments that represent clients who have been less likely to use banking facilities in the past, with a greater proportion of those clients now being rural, women, younger or educated only to primary level. KWFT has been particularly effective at reaching women and poorer clients compared to other institutions. However, given that FSD's strategic objective relates to meeting the needs of poor Kenyans (and MSMEs), it is important to note that the poverty profile

[25] See Collins, D., Morduch, J. Rutherford, S. and Ruthven, O. (2009) *Portfolios of the Poor: How the World's Poor Live on $2 a Day*, Princeton and Oxford, Princeton University Press.

for Equity Bank is not dissimilar to that of the banking system as a whole, and neither is Faulu's. PostBank, by contrast, is reaching a poorer clientele than other banks, and this is a strong justification for the support given to PostBank to attempt to assure its long-term position as a deposit-service provider in an automated environment.

This overall expansion seen in the past few years of FSD's existence suggests that there has been an important turning point for the market as a whole. The culture change in the market has been substantial - almost all mainstream banks are now seeking to compete for a slice of this market. The newly competitive environment has also 'awakened institutional survival instincts, spurred innovation and a new desire for partnerships and linkages'. While one unexpected result is the new dominance of Equity Bank, it is clear that other competitors are fighting back. For example, the shift of KWFT and Faulu to deposit-taking MFI (DTM) status will offer new avenues of competition for deposit accounts.

At the client level, while there is a strong urge to save, the opening of transactions accounts (which are free to open) has, in part, responded to this, as well as to aspirations to acquire loans or simply to cash MFI cheques. This new outreach was therefore less evidently resulting in their active use for day-to-day - or short-term - liquidity management. While the new range of transactions accounts is accessible and appropriate to those located nearby with businesses generating reasonably significant revenues, they are clearly not being actively used by those in rural areas or by poorer clients. For this group, the need to 'push' and 'pull' funds out of cash management devices rapidly means that withdrawal fees of between KSh 25 and KSh 50 - even where there are no travel costs - are still very high. Hence, accounts remain places for funds that are not likely to be needed within days or weeks.

This means that it is difficult to discern whether these accounts are being used either to accumulate savings, or to better manage cash flows and respond to vulnerability. But it is clear that vulnerability in many households was, and still is, mainly being dealt with from income (where available), or from informal sources such as borrowing or assistance from ROSCAs,[26] sale of assets (land, bicycles, cows, goats, chickens), remittances/contributions, and borrowing from relatives (especially children) and neighbours and friends in cases of death and serious illness.

In terms of the impact of lending on client livelihoods, this has produced a range of experiences - both positive and negative - as we would expect, and especially in the difficult economic conditions of the past two years. First, the evidence showed that loans were being used extensively for the payment of school fees - a fact that was much appreciated by the beneficiaries. Second, loans that were invested in agriculture (even where not specifically designed for it) were often running up against the risks associated with such investments, especially in low-and medium-productivity areas. Third, there is also some evidence of new business establishment, and associated improvements in livelihoods and household assets for some.

In the rural areas, there is evidence of a strong dependence on remittances and transfer payments from relatives in employment or living in towns. This also suggests the difficulties of investing loan funds profitably in the local economy. As was also noted earlier, dependence on external income sources to help repay loans has been made much easier through M-PESA.

While M-PESA was not a key focus of the micro-level research, it is evident that its outreach has been one of the huge changes in the market in the last three years. According to FinAccess 2009 data, 27.9% of the adult population are registered users, while a further 13% are non-registered users. Respondents testified to its convenience and affordability for transferring funds, and it was clear that this has particular potential for reducing vulnerability that requires more detailed research. Overall, this evidence suggests that, while the expansion of financial services as a whole is to be welcomed, significant challenges to extended outreach still exist both geographically and in terms of the depth of poverty and vulnerability. There is still a need for safe and secure savings mechanisms at dramatically lower cost than the current formal services can provide even after the welcome expansion of the past few years. With regard to lending, there is still the major challenge of lending in poorer areas where profitable opportunities are few. The further development of lending in these areas requires the simultaneous development of the underlying infrastructure needed for smaller businesses and the productive base.

4.2 MESO-LEVEL IMPACTS

The focus of FSD at the meso level (sector-wide development) has been mainly on business services for retail providers and on market linkages, involving projects across all three themes: core financial systems, rural finance and finance for growth. These are provided through FSD's partnerships with a variety of other organisations. The research for this impact assessment focused on the activities provided through MicroSave, Decentralised Financial Services (DFS), Jitegemee Trust and SACCO Cap. These four components were selected from a longer list and exclude other activities where evaluation work has already been, or is already being addressed in other ways, or is not yet called for. Specifically, an extensive and detailed evaluation is already under way for the G2P project; FSD's consumer information programme has already been reviewed, the financial education programme is still in its very early stages of establishment, and the index-based weather insurance or warehouse receipts programmes are not yet providing services to users. Neither is GrowthFin included at this level, since a recent review (Gibson, 2009) indicated that it was too early to assess impact in this area, though some of the micro level impacts were taken into account in the analysis at that level.

[26] This can be gained in a number of ways: the group might allocate the pot to a member out of the pre-defined order due to need; or the group might raise additional funds for the member, either on a loan or grant basis.

All four of the organisations investigated aim to build the capacity of a variety of financial institutions that provide finance for poor people - including MFIs, SACCOs, banks with MFI programmes, FSAs and ASCAs. The first step in examining the associated impact pathway was to establish the extent to which FSD support to these institutions has improved their ability to provide support to financial institutions, and thus contribute to their increased provision of appropriate and affordable services.

As explained in section 3, it is difficult to trace impact pathways from work at the meso level to the increased provision of appropriate and affordable services, and virtually impossible to assess the indirect impact on vulnerability and incomes. The key focus of the investigation at the meso level was therefore on the direct impact of FSD on the service providers and linkages.

4.2.1 MicroSave

MicroSave's aim is 'to strengthen the capacity of financial service providers to deliver market-led financial solutions'. MicroSave started in Uganda as a donor-funded project in 1998 and MicroSave Africa became a self-sustaining, successful consulting company in January 2008. The core of MicroSave's approach has been the development of 14 toolkits, which have provided structured approaches to areas including market research, product development, delivery mechanisms, internal organisational processes and risk management. In addition, it has produced 60 briefing notes, four DVDs, several books and more than 100 other papers and notes. In Kenya, it has trained and mobilised 18 certified service providers (CSPs) in many of its toolkits. These CSPs have undertaken over 1,000 assignments in order to build the capacity of Kenyan retail providers. The organisation was also instrumental in establishing the School of Applied Microfinance (SAM), which is now run by an independent consulting company, J.M. Mantle. SAM has trained over 500 middle- and senior-level MFI managers, 90% of whom are from countries outside Kenya. MicroSave also initiated the DFS project, described in section 4.2.2.[27]

MicroSave's market-led approach has had a major effect in helping change the culture of the financial markets in Kenya away from a product-based to a customer-led approach. In working with Equity Bank over a sustained period, Microsave's support has also helped to develop services that clients needed and finds ways to deliver them effectively. MicroSave is widely seen as having played a critical role in Equity Bank's rapid expansion. This has had a huge catalysing effect on the market. In the words of a MicroSave Director, other banks have seen that 'Equity Bank makes profits by maximising the value of opportunity, whereas conservative banking is cost-structure driven and based on protecting loss.' MicroSave has worked with most of the major Kenyan microfinance banks,[28] plus Kenya's two largest MFIs,[29] both in building their institutional capacity through training as well as assisting with the development and launch of products focused on the low-income market, such as KPOSB's 'Bidii' account and Family Bank's 'Mwananchi' account. MicroSave also provided important inputs into the development and launch of M-PESA. Much of MicroSave's impact would not have been possible without the support of FSD, which afforded MicroSave space and flexibility to develop its approach over time.

4.2.2 Decentralised Financial Services (DFS)

The DFS project was set up by MicroSave in 2003 as a pilot action research initiative targeted at improving the outreach of financial services in remote and rural areas in Kenya. DFS aims to do this by developing and disseminating tools to strengthen the management and governance of community-based financial organisations (CBFOs). This strengthening aims to improve their performance in intermediating funds. The objective is to lower the costs of organisations working with DFS and, hence, improve the depth and breadth of outreach that can be achieved. The first phase of DFS had focused on developing and testing the tools to strengthen the management and governance of community-based financial organisations. Phase II began in 2005, and sought to demonstrate the impact of the tools in broadening and deepening outreach of financial services in rural areas.

By the end of Phase II of the project in 2008, high-quality tools and manuals[30] had been developed and used to train 225 groups, consisting of approximately 5,000 members.[31] Through this training, DFS has attempted to standardise the way groups are operating, in order to make the top-level management much easier and more consistent for the officers. For example, according to the 2008 review of DFS Phase II, DFS seems to have brought more transparency and consistency to the process of using sanctions. Working with the FSAs, these improvements have lead to enhanced efficiency, manifested in terms of a need for less management support from officers as group members take on greater responsibility. This has meant that the officers need to spend less time with each group and can therefore increase their caseloads. DFS's approach of working with groups started at a time when few other organisations were focusing on this area. DFS has developed some effective tools, and there is evidence that these are producing useful results in improving the efficiency and effectiveness of organisations working with such groups. There is some evidence that this is improving the viability of FSAs. As the major funder of DFS, FSD has provided DFS with a 'friendly critique', playing a key role in asking

27 MicroSave has also been able to launch MicroSave India which has, in turn, become a major microfinance technical service provider there, with more than 50 trained consultants. MicroSave has also started operating in Indonesia and the Philippines.

28 Family Bank, Equity Bank, K-Rep Bank and KPOSB.

29 Faulu and KWFT.

30 Forming a strong group; responsibilities and qualities of leaders and members of a community group; giving and collecting unpaid loans; recording group financial activities; making a group constitution; and, with older groups, the group well-being tool (Decentralized Financial Services Project II Review, p. 5).

31 Of the groups, 76 were trained by ASCA managers, 83 by individual service providers, 44 by FSAs and 22 by WPS SACCO ('Decentralized Financial Services Project II Review', p. 5).

critical questions to encourage DFS to think things through effectively: this, in turn, has increase the quality of their work.

4.2.3 Jitegemee Trust Ltd (JTL)

Jitegemee[32] Trust Ltd (JTL) was established in 1999, with support from the Dutch government, to provide wholesale loans to MFIs in Kenya. It is currently a company limited by guarantee and therefore has no shareholders. Until 2002, JTL supported one client, an MFI providing finance in the arid and semi-arid lands (ASAL) area. In 2002, JTL started supporting an additional client and, by 2005, had eight clients. JTL now supports both MFIs and SACCOs, with a total of 17 active clients, with three more approved and 12 potential clients in the pipeline. It now has a portfolio of KSh 523 million, which has been financed through seed funding received from the Royal Netherlands Embassy at inception plus an investment loan from FSD of KSh 157.2 million. The balance of the fund is invested in the money market and in liquid investments such as deposit accounts.

JTL's mission is to be 'a reliable wholesale provider of financial services to financial institutions that provide assistance relevant to individuals. JTL is committed to 'empowering low-income individuals in creating wealth by improving access to financial and business development services'. JTL provides wholesale finance to its client MFIs and SACCOs and also has a remit to undertake capacity-building activities with its client institutions. In practice, however, this area of work has stalled due to a lack of capacity and knowledge within JTL to undertake this work effectively. JTL is now in the process of refining its capacity-building product. There is also potential to link with other projects including SACCO Cap and SACCO Fund, although this has not yet happened.

By supporting these client institutions to grow (through providing finance) and become more efficient (through provision of technical advice) JTL aims to increase access to finance for economically active Kenyans. Through its support to its client institutions, JTL would thus potentially increase access to finance for 420,813 Kenyans. By providing wholesale finance to its client MFIs and SACCOs, JTL is enabling their growth and development and, therefore, potentially contributing to the development of the semi-informal sector.

JTL also provides some technical support to its client institutions through a critical review of their growth plans prior to investment and subsequent ongoing evaluation of their performance. JTL has also helped to mitigate the negative impacts of the post-election violence on three MFIs, lending a total of KSh 41 million to those institutions. Without this support, their future viability could have been undermined. By supporting its transformation into an investment fund, FSD is hoping to further increase JTL's impact. JTL would still be undertaking this transformation process without FSD's support but would have to pay for this itself, potentially reducing the levels of its support to its client institutions.

Although FSD's support to JTL has had some impact on improving service provision in the Kenyan financial sector, it is questionable whether the impact achieved to date has been sufficient to justify the amount of funding and technical support FSD has provided to JTL.

4.2.4 SACCO Cap

SACCO Cap was initiated by FSD in partnership with the World Council of Credit Unions (WOCCU), and is implemented by WOCCU. Its objective is to 'strengthen the capacity of the SACCOs sector to meet prudential standards, offer client-driven financial services and expand outreach through high-quality technical assistance provided on a sustainable basis by a strengthened Kenyan business services industry'.[33] Funded through FSD's SACCO Fund, SACCO Cap currently provides capacity-building support to eight SACCOs. Through this, it has helped equip them to meet the new regulatory requirements of the SACCO Act.

In particular, it has helped to introduce improvements to various aspects of their operations, including product development, MIS systems, governance and reporting. Furthermore, through the use of certain tools,[34] SACCO Cap has also enabled the SACCOs to understand more about their financial standing and helped them to improve their systems: this, in turn, helps them to become more efficient financial institutions. However, SACCO Cap's key role is its work to improve both the supply and demand sides of the market for SACCO support services.

FSD recognises that it can have only limited impact on the sub-sector through working directly with SACCOs: in order to enhance its impact, it needs to build a market for business services that can provide support to large numbers of SACCOs on a long-term basis. Progress has been made towards this aim: 49 service providers/consultants have now been trained in specific tools developed by WOCCU,[35] thus building capacity in the market. SACCOs receive support from SACCO Cap to identify and recruit appropriate consultants to take on the capacity-building tasks identified in the work plan, which is jointly developed by SACCO Cap and the SACCOs. SACCO Cap then reviews the outputs, and mentors the consultant, so that the SACCOs receive quality work and the consultants learn to provide high-quality services.

The assignments funded by the SACCO Fund operate as a training ground for the consultants employed to understand the SACCO sector and to receive

32 'Jitegemee' is a Kiswahili word for self-reliance, and stands for hard work and empowerment.

33 'This objective is cited from the SACCO Cap I PIC PAR. A simplified objective, to 'develop the capacity of SACCOs through development of a sustainable business services industry', is included in other FSD documentation.

34 Such as 'PEARLS', a tool that assesses institutions in terms of Protection, Effective financial structure, Asset quality, Returns, Liquidity and Signs of growth.

35 For example, governance, savings mobilisation, financial management, accounting, market research, process improvement.

feedback on their services from SACCO Cap. SACCO Cap management see FSD as 'a knowledgeable donor' that is very well-connected and provides SACCO Cap with good contacts, such as consultants that they have used.

4.2.5 Summary of meso-level impacts

In summary, FSD's work at the meso level has sought to build capacity in the business support services sector in particular. Its support has encompassed a wide range of approaches and services to support the full range of providers from those serving community groups, to banks, MFIs and SACCOs. MicroSave has been hugely successful and has helped precipitate the change in the market culture that is now evident and which has been commented on (in section 4.2.1). DFS is having a useful impact on institutional viability, particularly for FSAs. The impacts of SACCO Cap and Jitegemee are, to date, more limited. Despite the problems of assessing the operations of the impact pathways at the meso level, the substantial evidence from the projects investigated - and particularly those led by MicroSave - suggests that the direct impacts are such that they are likely to contribute significantly to the goal of FSD of reducing poor people's vulnerability and increasing their incomes.

4.3 MACRO-LEVEL IMPACTS

This section addresses the impact of FSD at the macro level - the impact that FSD has had on the enabling environment for financial services in general, and for improved access to finance in particular. FSD has four formal projects at the macro level, but as in any market development programme, the macro-level impacts of FSD extend well beyond the specific impacts of these four projects. The macro-specific projects themselves have inter-related outputs, outcomes and impacts, while many projects that are nominally at the micro and meso levels also have impacts at the macro level. As explained in section 3.2, the adoption of a market development approach means that the impact of the programme on the sector as a whole could be expected to be greater than the sum of its parts. Such an approach endeavours to create synergies between components such as the development of appropriate regulatory regimes, improved sector infrastructure and improved retail capacity. Moreover, FSD also plays a key role in national policy dialogue in the sector. This important role, which is also implicit to the market development approach - especially at the macro level - is not explicitly effective in the existing formulation by FSD of the programme theory.

Before beginning to assess the wider impacts of the FSD macro programme, account needs to be taken of the outputs and outcomes of the four specific macro level projects in which it has been engaged. These are: FinAccess (2006 and 2009); SACCO laws and regulations; microfinance regulation (I and II); and mobile banking regulation (I and II). In sum, the DFID Output to Purpose Review in 2009 found that all the OVIs for FSD at the macro level were on track or largely on track, and that the overall progress at the macro level was 'on track to be largely achieved by End of Project'. This earlier review summarised progress against output level indicators as follows: 'At the Macro level, [FSD] has continued to provide inputs on specific developments in policy, legislation and regulation. With its specific orientation towards access issues and its strong links to the industry, the [FSD] programme is judged to play an important complementary role to the Government of Kenya's Financial and Legal Sector Technical Assistance Programme (FLSTAP).'

To assess the direct impact of these projects and of FSD in general at macro level, the macro level implications of the investigation of the programme at the meso and micro levels was complemented by interviews with key respondents. Those key respondents were stakeholders who had been involved in the macro level projects, either because of their role in developing the relevant laws and regulations, or because the projects might be expected to have had an impact on them.

The responses given by these respondents strongly supported the conclusion that the impact of FSD at the macro level extends well beyond the impact of the four projects themselves, and into areas that are hardly touched upon in the existing FSD M&E framework and which are also understated in strategic and planning documents. These impacts relate to the enabling environment for financial sector reform and development in general, and to the political economy of financial sector policy and regulation in particular. Specifically, FSD has played a crucial role as:

- a source of evidence for evidence-based policy formulation;
- a source of information for innovators;
- a facilitator of dialogue between policy-makers, regulators, service providers and other stakeholders;
- a neutral but expert voice in the policy dialogue;
- a source of reassurance to policy-makers in relation to the risks and rewards of innovation;
- a source of technical advice delivered in an appropriate and timely manner; and,
- a crucial player in the introduction of some important reforms.

These roles are, of course, interdependent and mutually reinforcing. FSD's technical knowledge and neutrality give it a convening power that enables it to fulfil its role as a facilitator. This, in turn, gives it the credibility to advise on the risk profile of reform proposals and so forth. FSD's credibility is reinforced further by its intimate knowledge of financial sector issues, which results from its involvement in numerous projects at the micro and meso levels, as well as the macro level.

The scale of FSD's impact on the policy and regulatory process seems to have been significant. It appears that some very important reforms and innovations might not have happened in the absence of FSD, or might have happened more slowly. It is, of course, virtually impossible to establish a definitive attribution or a rigorous counter factual, for this conclusion, but the evidence from the key informants interviewed strongly supports the conclusion.

No contrary views were expressed by any interlocutor, though some interviewees did express the view that FSD tended to back winners who were going to win in any case - picking the 'low-hanging fruits.' Even those who made this point, however, acknowledged that FSD has been highly effective in those areas in which they were engaged and that, at the macro level in particular, the way in which the market development approach translated into engagement across all stakeholders has meant that FSD has made a significant contribution to the development of the policy and regulatory environment for access to finance in Kenya.

4.4 CONCLUSION: OVERALL IMPACT

This study set out to test whether there was evidence available to demonstrate that the programme theory is functioning as expected. The limitations of the exercise have been given. The evidence can be summarised as follows.

First, we have considered the direct impacts achieved at each of the levels of FSD activity. At the macro level, we have concluded that FSD's work has contributed in a significant way to the development of an improved enabling policy environment. The development of M-PESA is notable in this context. At the meso level, the programme has helped to build significant capacity in the support-service market and has also contributed to the shift to a market that is more client oriented. The direct impact this has had on institutional viability is hard to measure at this early stage but is evident, especially in the case of Equity Bank.

At the micro level of retail capacity, FSD's support has helped to enable the transformation and institutionalisation of key institutions within the sector, while facilitating the survival of institutions that were under threat. Again, while the impact of this on institutional viability is hard to assess, there is strong evidence that the support has sustained and enhanced the outreach of services that are now more client-focused.

Second, we have assessed the final impact on the ultimate goal of generating sustainable improvements in livelihoods of poor households through reduced vulnerability to shocks, increased incomes and employment. All levels of FSD activity, in principle, can ultimately lead to this goal, with additional pathways needed for the macro and meso levels to achieve this. From these levels, it is necessary for the enhanced environment and the support services to providers to result in expanded provision of appropriate and affordable services. There is some strong evidence that these impact pathways are operating and, in particular, that the culture of the market has changed to become more focused on reaching poorer clients.

However, once we move to the actual access and use of services at the client level, the evidence is more mixed. Two key issues arise here. The first is the extent to which these services are reaching poor Kenyans. The second is the question of whether this is generating improvements in incomes and reduced vulnerability.

Currently FSD provides no definition of the 'poor Kenyan' target group. The evidence reviewed here suggests that there are some improvements in outreach to socio-economic groups previously under-represented in the profile of banking and MFI access. Moreover, PostBank and KWFT have deeper outreach on a poverty indicator basis than do other institutions. The erosion of PostBank's customer base is, in this sense, a significant loss, due to the impact on its overall profitability. Although the erosion might now have been stemmed, PostBank's long-term viability is still uncertain. There is clearly, therefore, still a significant question to be addressed about the extent of the increased outreach to poor Kenyans. Without clarity over who is able to access the services, final conclusions on the extent of the impact on livelihoods for this group are impossible to derive.

The evidence of impact on increased incomes and reduced vulnerability for the range of respondents that the research for this assessment was able to interview is, at best, preliminary and so can only be indicative of the areas for further research. It appears to demonstrate a limited and mixed range of impact on improved incomes - either through savings accumulation or loan investment. This range is broadly what is to be expected on the basis of prior impact assessments in many other contexts. There is also a suggestion of impact on indicators that have not been identified explicitly in the FSD goal, such as children's access to education. It was not apparent from the evidence we gathered that the new range of more flexible savings and loan products is being used to protect actively against shocks and vulnerability; rather, that informal financial mechanisms were still extensively used to achieve this protection.

Nevertheless, we regard the culture shift in the financial market to be highly significant and consider that there is demonstrable evidence that FSD has played a significant role in achieving this shift. The relevant timeframe for assessing impact on the ultimate goal is difficult to determine. It is clear that there has been a shift in service availability and products. But it is also evident that further innovation will be necessary to generate a level of access and transactions costs that make services - especially savings - appropriate and affordable for poor people handling, at most, a few hundred shillings a day.

However, we also consider that there is evidence that the market development approach has produced strong synergies across the levels of projects. This has been achieved in a number of ways. First, it has been achieved through the ways in which different projects have inter-linked at different levels. The most obvious example here is the use of MicroSave inputs by other FSD supported institutions. It is questionable whether the same level of culture shift could have been achieved either by working only with retail providers in the absence of extremely strong business development services, or by providing the technical support without the avenues of interaction with providers. Second, the ability of FSD to work at the level of policy development has benefited from a deep and detailed engagement at the micro level, which has given FSD knowledge, understanding and credibility in national debates. Thus, for example, FSD's support for Equity Bank and M-PESA involved contributions at all three levels.

Success has many parents, and many institutions did indeed contribute to the success of these two institutions. But all the stakeholders we interviewed who were directly involved in these cases testified to FSD's crucial role. It is significant that this role was played at all three levels through, for example, the support for Equity to transform into a bank at the micro level, the important role of MicroSave in the development of both institutions at the meso level, and the support for the creation of an appropriate regulatory response to them at the macro level.

Chapter 5

EMBEDDING IMPACT ASSESSMENT IN FSD

The FSD 2008–10 strategy states an intention for the impact assessment work within the programme to be of an 'improving' nature; that is, it will seek to 'develop better solutions' over time. Implementing this for a market development approach to financial sector development that is focused on outreach to poor Kenyans and will impact on their livelihoods bridges two areas of recent and relevant international work in this area. The first is the work of 'improving' the impact assessment agenda in microfinance: this work has generated a range of approaches to social performance management and assessment. The second is the development of standards by the Donor Committee for Enterprise Development (DCED) for private sector development interventions that apply to value-chain and market development approaches.[37] This section discusses, first, the characteristics of an improving approach and, second, suggests an overall methodology for how this might be achieved by FSD.

5.1 THE M&E SYSTEM AND THE ROLE OF IMPACT ASSESSMENT

Improving approaches to impact assessment, first, prioritise the clarification of the goals of a programme, and then require the collection of evidence that can establish the basis for *links in the causal pathway* to that goal. This encourages feasible approaches to assessing programme effects and their impacts. Thus, it involves the clarification and testing of the programme logic; the accumulation of evidence about the functioning of the impact pathway; the assessment of impacts; and, finally, the systematic use of evidence to improve performance. It also treats this whole process as one that can be audited in the interests of ongoing improvement to the system of measurement and use of the data.

DCED's recent work to produce a standard for quantifying achievements in private sector development adopts a consistent approach that gives strong emphasis to the importance of identifying the results chain (i.e., the impact or causal pathway). It suggests, in particular, the need to identify particular indicators[38] at each stage, to have reliable systems for assessing them, and a clear approach to attribution. Additionally, it identifies the need to assess wider changes in the market, since this wider impact is a key feature of market development programmes. DCED further proposes consistent reporting arrangements and a clear approach to the management of the measurement system that is integrated into the programme. It also recommends that impacts be related as fully as possible to programme costs. Ultimately, then, the role of any external review is to establish how far these 'internal' standards are being met and to enable improved systems to be implemented. Approaches to attribution are similarly not expected to arise only from randomised control trials (RCTs) and quasi-experimental designs but, rather, to deploy an appropriate array of quantitative data and qualitative methods that offer a 'clear and reasonable approach to establishing attribution'.[39]

Hence, these approaches do not exclude the potential for using RCTs and other quantitative methods, but suggest that their deployment be used where appropriate within a wider strategy of impact analysis. RCTs, in particular, might not be possible or appropriate for some elements of the market development approach, particularly interventions at the macro and meso levels.[40]

In sum, there is a consensus in current approaches for:

- clarity over the impact pathway or results chain;
- identification and collection of indicators clearly related to the chain;
- a clear and transparent approach to attribution;
- reporting of results to stakeholders; and,
- attention to the management of the system and the use of information in order to improve performance.

5.2 RECOMMENDED FRAMEWORK FOR CONTINUING IMPACT ASSESSMENT

FSD needs to develop a framework to IA work that allows it to retain the flexibility and responsiveness that has been an important feature of its work to date. Thus, it needs to set up an approach within which decisions are systematically made about which projects are to be assessed and how. It is not necessary to include a full assessment of every project, but the framework should capture the key components of the programme, particularly those that operate on a larger scale, while providing some guidance on the assessment of smaller projects.

Given the diverse variety of projects in FSD's portfolio, the first step in developing an IA framework is to distinguish between *types of projects*. The key criterion here is to delineate groups of projects with respect to the similarities of their impact pathways. The current FSD approach effectively does this by categorising projects at the micro, macro and meso levels, with sub-groups/themes within each of these. Projects within the themes of the

[37] Donor Committee on Enterprise Development (2009) Quantifying Achievements in Private Sector Development: Control Points and Compliance Criteria, www.enterprise-development-org/page/measuring-and-reporting-results. For explicit market development approaches, see also DFID/SDC (2009) The Operational Guide for the Making Markets Work for the Poor (M4P) Approach, London, DFID/SDC. In particular, this emphasises the role of knowledge management and impact intervention logics.

[38] It suggests three 'universal' indicators for collection and aggregation across programmes: scale, net income, and net additional jobs created. These are more specific to enterprise development than microfinance programmes.

[39] Battle, C. (2009) 'Quantifying Achievements in Private Sector Development'. *Enterprise Development and Microfinance* 20(3): 205–19.

[40] As argued in a forthcoming paper, 'we must not let methodological purity determine which questions to try to address: just because a policy can't be randomised does not mean we should give up on trying to understand whether it is working or not. McKenzie, D. (forthcoming) 'Impact Assessments in Finance and Private Sector Development: What have we learned and what should we learn?', *World Bank Observer* (forthcoming).

core financial system and rural financial services operate with the aim of providing appropriate services direct to households. By contrast, those within GrowthFin operate with a focus on small and medium enterprises (SMEs) and impacts on employment. The projects within GrowthFin would operate as a sub-group, but one that also crosses the micro, macro and meso levels.

A further distinction to bear in mind is that between projects implemented by FSD itself and those that are implemented through partners. This, in the main, depends on the level of the project. Micro and meso-level projects are implemented mainly through other organisations, while macro projects are largely co-ordinated by FSD itself. This distinction at macro level will also help to recognise the active policy dialogue and facilitation role that FSD undertakes. It also highlights that the new approach must take into account the points at which indicators are defined and data collected, FSD being dependent on partners for much of the necessary data.[41]

The overall framework would have two components. First, IA work would focus at the three levels of the programme, and strategies for data collection would operate differently for each of these. The primary task would be to trace impact through to the direct impact the sub-group of projects is expected to have on the basis of establishing clear impact pathways. At the macro level, this means assessing whether policies are contributing to, for example, a conducive policy environment for innovation and outreach at this level. The approach is necessarily mainly qualitative in assessing the impact pathway. At the meso level, it would require a combination of quantitative assessment in terms of the changing scale and scope of support service provision, and qualitative assessment of service quality and the impact of using these services on the viability and performance of providers. At the micro level, the approach could involve RCTs, where they are appropriate, in assessing specific innovations, as is currently the case for cash transfers under the Orphans and Vulnerable Children (OVC) and Hunger Safety Nets (HSNP) programmes, for which the G2P project supports development of the delivery channel. However, a combination of quantitative and qualitative strategies is likely to be appropriate.

The second component would test the links between the direct impacts and the final impact on poor Kenyans. This component would have two dimensions: first, it would further examine the causal pathway that is captured by the assumptions that link the direct to the final impact for macro- and meso-level interventions. Second, it would seek to capture the 'wider' impacts on the market system that are operating as a result of aspects of the programme. This is to capture the 'crowding in' effect that market development seeks to precipitate. This crowding in might be occurring, for example, at the micro level through the demonstration effect of innovations with regard to insurance products or new delivery channels. At this level, therefore, FSD would essentially be monitoring the development of the financial sector as a whole in meeting the needs of poor Kenyans, and seeking to understand its own indirect contribution to it.

An important component of this monitoring is already under way through the FinAccess surveys, but needs to be developed further[42] and complemented through additional research to explore the impact pathways at work. This requires studies that analyse the changing providers and their products and services in the market, assessing their appropriateness and affordability, and linking this to access and use and the impact on livelihoods for users. These further studies would help in the identification and exploration of channels of impact from meso and macro levels, and also the wider competitive market system effects.

Adopting appropriate timeframes is an essential consideration in addressing and assessing the final impacts. The effects of the FSD interventions can be expected to build up over time, but will not necessarily do so in a linear way. The purpose of monitoring impact pathways is to better understand how these effects are occurring and to help adjust intervention strategies in the light of this.

The two components of the proposed framework will require baseline information from the outset, although they may differ as to the periodicity of monitoring. The overall framework for the impact work must be firmly held and managed within FSD for it to be successfully focused on an 'improving' agenda, and responsive to the future development of the programme over time. However, given the complexity of this task, this should be a specific cross-cutting role rather than an additional responsibility of project managers, although their work will actively feed into this assessment, especially through their ongoing monitoring, evaluation and review functions. It follows that FSD will need to have the expertise in-house to plan and implement a range of approaches to impact assessment focused on key areas from which the overall impact of the work can be brought together. The detailed research, however, would be carried out through commissioned studies.

41 It is disappointing that few Kenyan MFIs are taking an active social performance management approach. While KWFT undertook a social rating in March 2007, it is not clear that it is engaging in an ongoing way in this area.

42 In particular, the FinAccess survey has lacked indicators from which poverty outreach data can effectively be derived.

NOTES

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Financial Sector Deepening

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