

A Rapid Review of the Initial Impact of the Post Election Crisis in Kenya on the Microfinance Industry in Kenya and Some Potential Reponses

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A Rapid Review of the Initial Impact of the Post Election Crisis in Kenya on the Microfinance Industry in Kenya and Potential Responses

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Introduction: The disputed elections in Kenya on December 27th 2007 were the prelude to significant violence between Kenyan communities that resulted in significant loss of life, burning and looting of businesses and internal displacement. Violence continues at a lower intensity than before, but at a sufficient level to make a return to normal operations in many places, very difficult if not impossible at the time of writing.

This assignment has been to consider the impact of the current crisis on the microfinance sector and consider ways to support the industry which could include the establishment of a liquidity fund and investigate the role of MFIs in peace building. It has been conducted under the auspices, and with the assistance of the Association of Microfinance Institutions (AMFI) and has been financed by the Financial Sector Deepening Programme Kenya.

Organisation of this report: This report has been produced in two sections. In Part 1 there is a rapid review of the impact of the post election crisis on the microfinance sector in Kenya. This section includes consideration of the potential for different types of support mechanisms, which includes the case for donor grants and the potential for the creation of a local investment fund.

Part 1 is divided into five sections, Section 1 – A description of the current situation, Section 2 – Funding aspects, Section 3 – Financial exposure by institution, Section 4 – Peace building, Section 5 – Literature Review of Post Disaster Microfinance and its Implications for Recovery in Kenya.

Part 2: Conclusions and A Way Forward, briefly suggests a range of different actions including the broad design of a local investment fund, a guarantee fund, select technical assistance. It is anticipated that these financial mechanisms will need to be supplemented by initiatives aimed at counselling and peace building. The case for selective application of donor grants can only be determined at a later stage when more information on relative impact has been obtained.

¹ This study has been authored by David Cracknell, and represents opinions canvassed from the microfinance sector often through industry meetings coordinated by AMFI, and other key industry stakeholders, in addition to the author's own observations. However, there are differences of opinion within the sector and between the microfinance industry and its donors. It is not expected that this report will represent the views of every stakeholder. However, the proposed responses in no way are intended to exclude any other forms of assistance that may be available or may be deemed desirable by others. Errors of fact in a rapid situational analysis are inevitable and can be reported to the author for correction on david@microsave.org

PART I: A Rapid Review of the Impact of the Post Election Crisis on the Microfinance Sector in Kenya

Section 1: A Description of the Situation in January 2008

This section details the situation in the Kenyan microfinance sector as reported by microfinance institutions at the end of January 2008.

- 1. Impact on clients:** Client impact varies depending on location. Details are still be collected by AMFI. A significant number of clients have been displaced, and more have had their businesses burned. A few clients have lost their lives. Areas particularly affected include Kisumu, Eldoret, North rift valley, and in Nairobi – Kibera and Mathare. Trust between members of different communities has been significantly affected, with displaced clients not wishing at the moment to return to their residences. Even where clients have not been directly affected by violence, there are reported to be higher prices for inputs and supplies and lower demand for outputs.
- 2. Impact on liquidity:** There has been an immediate and widely reported impact on cash flow in affected areas, programmes with a regional focus are especially hard hit. Cash-flow impact has been reported as especially high, for example KADET which has been tracking receipts against expectations on a daily basis since the start of the crisis. It reports 50% cash flow. In another institution (Micro Africa) cash-flow has reduced by 40%. Temporarily institutions are managing cash-flow shortages through disbursements.

One respondent noted that a particular problem was the closure of bank branches in affected areas, or even when branches were open shorter opening hours. This was delaying payments from some clients.

- 3. Financial exposure:** Financial exposure (risk of loss) varies considerably depending upon operating location and methodologies, with group based, and rural microfinance appearing to be particularly affected. Estimates of financial impact continue to rise in most programmes. Total financial exposure across the industry may amount to several billion shillings. Details on an institution by institution basis have been provided in Section 3).

Reported exposure continued to increase throughout January, made worse by the spread of disruption around Kenya, for example, outbreaks of violence and disruption in previously safe, Molo and Nakuru in the week of 21st of January, and Nakuru and Naivasha in the week commencing 28th January.

“K-REP has been affected by the general situation, particularly in Kibera, Kisumu, Eldoret and in Eastlands. Our total exposure was initially estimated at Ksh. 500 million on the basis of a total portfolio of Ksh. 6 billion. Total exposure is increasing as time goes on and the situation fails to completely stabilise. Our current total exposure has been estimated at between Ksh. 500 million and Ksh. 1 billion.”

(Kimanthi Mutua, MD, K-REP Bank)

4. Difficulty in obtaining reliable information: One of the features of such widespread unrest and disruption is the difficulty in obtaining reliable information. Multiple factors make it difficult for microfinance programmes to collect reliable information at present which include:

- i. Disruptions to Wide Area Networks (reported by KADET)
- ii. Lack of transport in affected areas
- iii. Disruptions to staffing
- iv. Client banking through third party banks
- v. Groups making repayments through non standard mechanisms

5. Different mechanisms for estimating impact: Accurate assessment is difficult until assessors can travel around the country without impediment. As a result of the difficulty in obtaining reliable information, MFIs have used different bases for estimating impact. These have included:

- i. Impact at client level: Client deaths, clients displaced, businesses destroyed, this information is widely shared. For clients displaced or businesses destroyed there is a very high probability of loss.
- ii. Impact on cash-flow:
- iii. Number of groups not contactable

Organisations with better sources of information have understandably reported consistently lower impacts. Subsequent discussions in the AMFI meeting on February 19th 2008 showed that in many cases institutions that reported impact based on total portfolio in affected areas appear to have overestimated the total impact.

Factors in improved information appear to include information system, proximity to clients, and willingness to use alternative mechanisms – such as in the case of Faulu opening temporary offices closer to clients, or SISDO making phone calls to clients.

6. Areas of impact are consistent: Reports from four or five MFIs called provide great consistency on the areas of operation hardest hit. This provides some ability to cross validate claims of programmatic impact between different microfinance programmes, this should avoid the worst moral hazard.

7. Impact on Kenya's SACCOs appears moderate: While there are no figures for SACCOs, conversations with cooperative bank, and WOCCU suggest that impact appears to have been moderate but lower.

- i. Employment SACCOs: Impact has been moderate as most members in these large SACCOs are still in employment. The exception is the tourism industry, which has been affected by the large scale layoffs as a result of the rapid downturn in the tourism industry. Cooperate Bank already expects losses on loans to tourism based SACCOs.
- ii. Producer SACCOs: Impact depends upon the specific product. Industries with out-growers that depend upon large scale labour appear to have been affected. For example, tea workers have

been displaced. Ndenge Chai SACCO is only beginning normal operations (FSD Kenya). Some impact has also been reported by Cooperative Bank in the sugar sector with Mumias SACCO.

- iii. Localised SACCOs in troubled areas: Business oriented SACCOs located in troubled areas appear to have been badly affected. For example Cent SACCO, reported by MESPT to have only worked two days during the month following the elections.

Impact is also reduced as SACCO's tend to use the group methodology, less than NGO MFIs with individuals responsible for making loan repayments through the SACCO.

The Current Situation – Operating Difficulties

- 8. The impact on staff has been reported to be significant, especially in conflict areas:** Many MFIs are reporting significant impact on staff, especially those who have staff working across tribal boundaries. The MFIs reported to be most affected include KADET which has had to move 36 staff.

Most MFIs are reporting the need for counselling services throughout the institution and also at the client level. "Our first assignment is to bring people back to psycho-social reality. We need to have counselling processes for clients. We need to counsel our staff who can then on counsel. Group leaders also require counselling."

It is particularly hard for staff to ask for loans from clients who have been severely affected. "About 70% of clients in Eldoret town have been displaced. We can see them, but even when we do it is difficult for staff members to talk to our clients about their loans"

There are additional dangers in operating, in an uncertain environment, though these have not been widely reported. "We have had our staff threatened when they try to make recoveries often by thugs not wanting business as usual

- 9. Significant decline in group solidarity:** There have been significant declines in trust at group level. According to one MFI leader.

"Other impacts include the disintegration of group solidarity with groups which are cross tribal being particularly affected. We are watching this carefully, but there are already indications that we will have to reorganise groups. It is clear that we need to re-examine how we reform groups and that we will need to have sessions targeted at building group solidarity".

- 10. Transport:** Transport appears to be a major issue, with some transport routes closing, and costs of transport increasing in troubled areas. MFI response to this crisis has been mixed, some MFIs appear to have pulled workers out of the affected areas, one or two have established temporary offices, operating closer to clients. Institutions responses to operating difficulties need to be established, so that successful responses can be replicated and can be used to minimise impact. "In Rift Valley there is a lack

of transport in rural areas as Matatus no longer ply those routes, so we have had no choice but to establish some short term offices”

- 11. Risk Management Mechanisms:** As the situation stabilises MFIs must quickly adopt risk management mechanisms. Some of the mechanisms quoted were – contact clients, establish short term offices near clients and encourage displaced clients to join an office of their MFI operating near to them. Institutions that have stated risk management mechanisms appear, at first glance, to be less badly affected. This suggests that business continuity planning could significantly improve response and decrease risks in the event of future disasters.

Jamii Bora was particularly affected

Jamii Bora works with street children, beggars and youth and provides much smaller loans than those under other microfinance programmes. Much of Jamii Bora’s programme operates in the slums of Nairobi particularly those of Kibera and Mathare. Approximately half of the members have been affected by the current unrest, many are still missing. There has also been an impact through an influx of displaced people into established areas.

Jamii Bora has been providing support to members through being food distribution agents for the Red Cross and WFP. In addition it has tried to play a role in bringing the communities together through speaking with village elders and holding peace marches. However, following the resurgence of violence in the slums there is a need to rethink this strategy. The situation has been especially difficult in Mathare as the slum is divided into Luo and Kikuyu communities. Five people have died in Mathare.

However, while Jamii Bora clients have frequently lost their business, they have not lost everything as they now have knowledge of their business which can be restored through additional capital. Experience from earlier disturbances in Kenya suggests that people that have performed the best after disturbances are those that have established themselves elsewhere after being displaced.

- 12. “Normalisation” is likely to happen in different places at different times:** CGAPs guidelines on microfinance in post disaster situations stresses the need for stability before microfinance can operate and the requirement for a relief phase to give way to a development phase, which is where microfinance can operate. The importance of local knowledge was stressed as it not all group activity has stopped, and there are safer areas in which to work. It may be that gatherings of local MFI leaders can exchange strategic information on where it is safe to work.

- 13. The need for the industry to work collaboratively:** Several commentators made the point that the industry needed to work together. In the words of one MFI leader:-

“Competition within the microfinance industry and competitive attitudes may not help during difficult times. We act like blind competitors, we look at one another like we are

grabbing from each other. So it remains to be seen how much we can cooperate, particularly at the national level. Current the need is big, and any intervention we make is so small, however, our enemy is not each other as institutions at the moment, so how can we cooperate. One thing is that we all have officers on the ground and we can share information at a local level. Offices on the ground talk and share information, but the people who are not comfortable operate at the Board level. One thing we can do is consider partnering with smaller institutions that got badly hit, are these institutions going to need a big brother or big sister.”

AMFI as the industry body can coordinate activities across the industry, however, like most network organisations AMFI has limited staff capacity and in many cases it will need to work with and through its industry members. It has made great strides in hosting feedback meetings with the industry, in beginning to draw up common agendas and in initiating conversations with interested donors.

14. Impact on transformation of microfinance institutions: In 2007 the Kenyan microfinance sector was moving forward rapidly towards transformation, particularly the “blue chip” institutions Faulu Kenya and KWFT, but others too. Commercialisation in other forms was moving ahead rapidly with delivery channel development, computerisation, product development and other innovations. The crisis and its impact have put many of these developments on hold. The impact on transformation is multi dimensional; funding constraints have put expansion plans on hold; human resource constraints as management staff focus on response to the crisis are delaying implementation of transformation oriented technical assistance; institutional focus is clearly divided. The impact on commercialisation is likely to be more subtle and careful strategic planning will necessary to balance new priorities against reduced resources and continued ambitions.

15. Literature review provides important lessons from international experience: These lessons are summarised in section 4: The literature review points have been further expanded and information on post conflict – disaster microfinance is available on the *microsave* website on www.microsave.org/kenya. The lessons have been grouped around the following issues:

- i. Stability is required for the operation of microfinance
- ii. Get back to business using best practice
- iii. Adapt products and services to the new reality
- iv. Expect higher operating costs
- v. Consider using grants in the most affected areas:
- vi. Maintain a solid repayment culture
- vii. Coordinate with stakeholders on a wide range of issues
- viii. Protect records: One or two MFI offices have been burned or looted.

16. Medium Term Economic Impact: Although the need for immediate support for the industry is increasingly clear, several respondents talked about likely medium term economic impacts. In particular the lack of tourists was likely to affect clients supplying the tourist industry. Short term wider impacts

are likely as purchasing power has been destroyed in many communities. Also, many businesses have been closed for their own protection.

A common item of discussion was that many displaced people would not want to return to the communities from which they had been expelled. There is also evidence that within Kibera that new business managers have moved into “vacated” premises, creating additional uncertainty over who microfinance programmes should lend to.

Section 2 – Funding Aspects

17. Investment funds await further information: Several international investments funds have been directly contacted; these include Africap, Triodos and Triple Jump, three of approximately twenty investment funds that are active in the Kenyan market. Aside from rapid action by UNITAS which is corresponding with Jami Bora most investment funds are just attempting to evaluate the current situation rather than at this time providing immediate additional support or rescheduling.

Sources of potential funding have been identified: These include:

- i. OPIC: OPIC is a US based foundation with a development objective. It has invested more than US\$ 500 million in microfinance worldwide. It is able to offer loanable funds either through US corporations such as Citibank, or through US owned institutions. If investing through Citibank, OPIC would be able to offer local funds with a 75% guarantee. However, early indications are that Citibank considers the current situation in Kenya too risky for such an investment.

The second option is for OPIC to invest directly through the US based parents of Kenyan microfinance programmes. This could benefit Faulu Kenya which is 70% owned by FHI; Wedco which is owned by Opportunity USA; and KADET owned collectively by World Vision International.

- j. MicroCredit Summit: The micro-credit summit is seeking information to launch a US based publicity campaign to recapitalise the microfinance industry in Kenya. This initiative is being coordinated by AMFI
- k. Gates Foundation: This initiative is being coordinated by AMFI.

18. MFIs already have means of support: existing funding mechanisms²: Many microfinance programmes at the AMFI network meeting indicated that they had not begun extensive discussions with their international partners, and funds, other than requesting a delay in loan repayments. In part this is

² Not the source of this information is from earlier confidential work and is therefore kept in general terms, due to conditions of confidentiality in *MicroSave's* contractual conditions. It is unclear whether the information provided at this level is in fact a breach of those contractual conditions and clearance is, therefore, being sought.

because a clear picture of impact is only now beginning to evolve. However, there are no fewer than 20 international and local funds which currently invest in Kenya's major microfinance institutions. These include the Government of Kenya, Jitigeme, MESPT, Deutsche Bank, Global microfinance consortium, Standard Chartered Dubai, Dexia, PTA Bank, Blue Orchard, Oiko Credit, Triodos, Cordaid, Hivos, Novib, Planet Finance, Unitus, and Stromme Foundation.

Prior to the elections most programmes were anticipating taking additional funding to cope with anticipated expansion and in the transforming programmes the additional costs and opportunities created by transformation.

Most loans are in local currency, and some loans, particularly those from international development partners are subsidised. However, given economic uncertainty whether future loans would be in local currency is yet to be determined.

Two or three MFIs have international associations or affiliations that they can use to obtain additional funds. These include WEDCO (which has an affiliation with Opportunity International) and KADET which has an affiliation with World Vision International.

Local donors: AMFI is keen to involve local donor institutions in stakeholder discussions on the future of the industry, and is not averse to grants.

Attitudes towards grants vary with grants appearing to be most sought in institutions with a NGO culture and background.

19. Constraints to rapid funding: There are many operational constraints to the creation of mechanisms that can rapidly respond to the crisis.

- i. Loan appraisal: Oiko Credit, MESPT, JTL have the capacity to appraise and assess the loan portfolio of institutions, but may find it difficult to rapidly assess impact of the current situation on a large number of institutions in a short timescale, given the extent of current impact and that portfolio quality will have significantly diminished. The recommendation, therefore, is for additional support to be available to assist funding institutions to process loan applications more quickly. It is likely that this can be provided through a range of different institutions should this be required including, BankConsult, Microfinanza, Planet Rating (Kampala), and *MicroSave*.
- ii. Procedures: Every funding institution has its loan approval procedures. As far as practical, these procedures should be streamlined. One area which could make a significant difference would be increasing the regularity of loan approval committee meetings to specifically deal with the current situation.
- iii. Funding: Clearly funds need to be available to on-lend. While donor funds may be available they also take time to agree, and to disburse and to determine any on-lending conditions. This

implies that a range of funds may need to be made available. If these funds are available on local terms then interest rate risk should be carefully considered (see below).

- iv. Guarantee mechanism: This is discussed further below, the key point to note here is that a well designed mechanism takes two to three months to establish and needs to be ready prior to the need for funds surfaces.

International Experience from Hurricane Mitch

Following Hurricane Mitch, we found the microfinance institutions were challenged by a lack of liquidity that was caused by three concurrent events related to their operations:

- An increased magnitude of defaults
- Requests from existing clients for additional (new) loans to rebuild homes and businesses, and
- A significant withdrawal of savings because they were needed to rebuild those homes and businesses.

We estimated approximately 20,000 MFI clients and approximately US\$2.8 million in loans outstanding were at risk due to the flooding and impact of the hurricane on economic activity. The commercial banks were not willing (or able) to supply the loan capital needed to help the affected MFI's restructure their loan portfolios, and many MFI clients were in need of fresh financing to restart or expand their businesses.

We ended up providing a \$3.0 million grant to microfinance wholesale lending (the Covelo Foundation) with the condition that the proceeds be used to provide recapitalization assistance to selected MFI's. Those MFI's had to have maintained sound operations before the hurricane hit to be eligible for the recapitalization assistance. There were some subsidies in the rates of interest charged to MFI's and to clients, but overall, we tried to maintain a relatively commercial approach.

In Kenya, I suspect you'll face some hurdles in trying to address the liquidity demands. First, how many microfinance institutions were in good shape prior to the unrest, and how many actually have problems that are a direct result of that same unrest? In Honduras, everyone had their hand out, but we had good statistics on the MFI operations (in other words, we knew a lot about the industry), so it was relatively easy to sift among the applicants. Also, the "good" microfinance organizations were not interested in subsidies because they knew they would affect their relationships with the clients, so we did not have to argue about the application or provision of "recovery loans" as opposed to outright grants. Finally, we had a relatively strong apex institution that possessed experience as a wholesale lender. I don't believe you have one of those in Kenya?

Barry Lenon: formerly USAID in an email to the author

20. The case for donor grants: Clearly donor grants to fund loan portfolio's can be a retrogressive step when the industry had largely been weaned from donor contributions (at least for loan portfolio), and the general lessons from international experience (see also box above on Hurricane Mitch) are to get back to commercial operations as quickly as possible. However, again from international experience there is a far clearer case for donor support for programmes which have been fundamentally undermined by a disaster. This support requires case by case analysis of each institution. A mix of grant and loan would be the best approach.

21. A local investment fund: International experience suggests wholesale funds may need to be available (see box on Hurricane Mitch). Several points stand out. Firstly, lend to institutions which are fundamentally sound, and try to maintain a commercial approach.

Loan design: It is likely that wholesale loans to microfinance programmes will require, or significantly benefit from, a grace period in order for them to on-lend funds and to begin receiving cash flow.

Size of fund: The total size of any fund created would need to cover the total exposure, as even if as expected the actual impact is lower over time, the immediate cash flow requirement could be significantly greater. Potentially this could be through credit lines on a draw down basis to ensure that funds were efficiently utilised.

Guarantee: Loans from the investment fund are likely to have a higher level of inherent risk than loans given under normal conditions for several reasons:

- i. The current decapitalisation of microfinance institutions.
- ii. Many Kenyan MFIs had geared up throughout 2007 to fund expansion prior to conversion to deposit taking status. Meaning that existing funders already have obtained security against customer deposits and the loan portfolio. These existing securities may rank higher than newer loans from the investment fund.
- iii. Higher costs associated with operating in a post conflict environment and loss of income will erode capitalisation through retained earnings.

It is therefore likely that a risk guarantee will be required for the investment fund. The fund will need to consider a number of aspects including:

Foreign currency risk: In the current uncertainty the dollar has depreciated by approximately 15% during the last one month, falling from Ksh61: US\$1 to \$71: US\$1 at the time of writing. Exchange rate volatility may make internationally denominated funds unattractive. There is also the suggestion that foreign currency risk is low because with stability exchange rates are likely to decrease from current levels, rather than increase further.

Interest rate risk: According to one informed observer, interest rates in Kenya are likely to rise due to significantly increased borrowing on the local market as a result of decreased government revenues, and increased government spending. This suggests that microfinance programmes borrowing on the local market should borrow quickly and at fixed rather than floating rates.

Moral hazard: At the moment it is difficult to reconcile the extent of financial impact claimed by different institutions (see Table 1). Several methods can be used to screen for impact. This includes to establish relatively precise areas which are commonly regarded as severely affected and use this as a guide to indicate exposure. Programmes reporting significantly greater exposure than the norm in a particular area would need to be more closely inspected.

Local funding: Funding is likely to be available from Equity Bank and potentially other local commercial banks. Though there are some indications that there is distrust of Equity Bank and some institutions would not want to receive funding from Equity even if were offered.

Institutional Risk: There is a risk, though this appears to be moderating at the time of concluding this report that institutions will have been decapitalised to the extent that a guarantee fund will still not be sufficient to encourage financial institutions to lend to more severely affected microfinance fund.

Section 3: Financial Exposure by Institution

22. Overall Impact: It is difficult, and potentially misleading to assess overall impact on the basis of current information, already some of the articles reported in the press early in the crisis look misinformed. In January total impact looked as if it could run into several billions shillings. However, the total financial impact is being revised downwards as improved information comes in. Nevertheless, the financial impact remains considerable. Reported impact is particularly reducing within those institutions that used their total portfolio in the affected regions to estimate maximum impact in January 2008. Table 1 details the information as reported to AMFI.

Table 1: Extent of Impact on Kenya's Microfinance Sector in January 2008 Based on Self Reported Data

Some indicative assessments in February for Self Declared Exposure have been received and have been included in the column self declared exposure.

	Total Portfolio	Number of Offices	Number of Offices Affected	Staff Rel.	Self Declared Exposure	Basis of Assessment	Clients Killed	Clients Displaced	Businesses Destroyed	Cash flow as % of expected	Notes
KWFT	Ksh.3,600m	o/s	o/s	o/s	Ksh.2,000m see footnote ³	Total portfolio in affected region	o/s	o/s	o/s	o/s	Further details mid February
KADET	Ksh.475	9 branches 50	22-6 four branches badly affected Eldoret Kapsabet Kisumu Narok	36	Ksh.350m (Jan) But cash collateral against this will reduce loss (Feb)	Total portfolio in affected branches	5	o/s	o/s	50% January 55% February	Likely to require liquidity funds, no substantial commitment to date from WVI. Data on client impact still being collected.
SMEP	Ksh.650	17 branches	Kisumu Mombasa Kakamega Bungoma Eldoret Nairobi 2 Nakuru 2	4	Ksh.200m Ksh.30.8m affected and Ksh.200m at risk (Feb)	Total portfolio of 7 affected branches excluding newly affected Nakuru	4	450	540	33% and gradually increasing	Already in discussion with local and international funders.

³ Informal discussions with KWFT have indicated that this figure is a worst case scenario and the likely impact is likely to be considerably less. However with monthly collections compared to an industry norm of weekly collections information on portfolio quality for KWFT comes in more slowly.

	Total Portfolio	Number of Offices	Number of Offices Affected	Staff Rel.	Self Declared Exposure	Basis of Assessment	Clients Killed	Clients Displaced	Businesses Destroyed	Cash flow as % of expected	Notes
Faulu Kenya	Ksh.1,900	70 outlets of which there are 25 branches	Kisumu Eldoret Bungoma Mumias Molo Naviasha Nakuru	o/s	Ksh.87m (best case) 301m after LIF (worst case) deductions	Office by office assessment based on groups	2	328	186	75% higher cash flow attributed by Faulu to portfolio distribution	Situation improving slightly in Bugoma and now Eldoret branch reopened. Molo
SISDO	Ksh.250m	14	Nakuru Eldoret Adams (NBI) Jogo Road (NBI)	2	Ksh.25m (Jan) Ksh.24m at risk Ksh.2.4m lost. (Feb)	Back office system detailed analysis... based	0	532	494	Portfolio Audit currently being carried out	Situation worsening in Nakuru Only 14 clients not tracked. Extensive use made of mobile phones.
KDA	Ksh.154m	16	Nairobi Mombasa Kakamega Busia Kitale	8	PAR 26% Ksh.26m (Feb)	Looted or burned or displaced, partial payments	3	460	1,216	50% January 60% February	890 unaccounted for. Kakamega closed 28.1.08
Jamii Bora	Ksh.382	o/s	Kisumu Kibera Nakuru	5	Ksh.200	Subjective judgment based on percentage of members affected.	5+	c. 50%	o/s	o/s	Increased impact is likely due to unrest in Nakuru. Many people cannot be traced so more clients could have been killed.
K-ECLOF	Ksh.345m	12	Bungoma Eldoret Kericho Kitale Nakuru Kisumu		Ksh.80m	Ability to contact groups	0	485	251	Jan 37.5% Feb 50-60%	Concern is disintegration of groups which is affecting the methodology

	Total Portfolio	Number of Offices	Number of Offices Affected	Staff Rel.	Self Declared Exposure	Basis of Assessment	Clients Killed	Clients Displaced	Businesses Destroyed	Cash flow as % of expected	Notes
			E.Nairobi								
MicroAfrica	115m	5	Nakuru Molo Naivasha Gilgil	0	Ksh.25	Based on outstanding portfolio in affected areas	3	113	o/s	40% disbursement target	
Sunlink	Ksh.130m	5	Nasiko, Jogo Rd, Githurai	0	Ksh 20m PAR 17% Jan PAR 14% Feb	Based on no shows at group level	0	o/s	o/s	60%	Information not collected as it is not safe to visit Nairobi slums and most officers are women
WEDCO	114m	15	14	10	Ksh.28.5m Jan Ksh.23m Feb PAR30-60% by office	Subjective based on displaced clients	o/s	800	o/s	Less than 40%	Not yet calm enough to get exact data or information
Microfinance Oriented Banks											
K-REP Bank	Ksh.6,000	30	Kibera Kisumu Eldoret		Ksh.500m – Ksh.1,000m						
Equity Bank	c. Ksh.11 bn	72			Ksh.30m written off	Actual write offs	o/s	o/s	o/s	o/s	Further assessments after next repayment period. Impact will increase.

Section 4: Peace Building

MFI's, especially those operating group based microfinance, have a vested interest in building peace between different communities, though they are not of themselves recognised vehicles for resolving intra-communal tensions. A meeting of AMFI members recommended a number of actions which could be taken by AMFI these include:

- A) Building alliances with other institutions which specialise in peace building
- B) Adding peace building to the curriculum of group training
- C) Local networking to assess the local security situation on an ongoing basis
- D) Encourage group members to offer refuge to other group members in times of crisis
- E) AMFI to design a curriculum for group based training.
- F) Establishing a steering committee from member MFIs

Peace building will not be easy, and will require careful preparation of staff in the words of one MFI leader: "Locally there has been a very interesting impact. It has been difficult for local officers to hide their feelings or affiliations. We are finding at the moment that it is really important to reiterate corporate values to and through all our staff. We need to live and breathe our values. Staff are also being called upon to counsel each other and to counsel clients, yet this is not something that our staff have training on. There is also a danger of staff "burn out" if the situation remains unstable".

Section 5: Literature Review of Post Disaster Microfinance and Implications for Recovery in Kenya

The bullet points in this literature review have been extracted and adapted from CGAP's own literature review following the Asian Tsunami and other disasters and conflicts. The interpretations relate to the current environment in Kenya.

Stability is Required: There are minimum conditions for microfinance to move forward. In many areas of Kenya these conditions are not yet realised:

- Minimum political stability. Microfinance is not a conflict resolution tool. Program areas must offer a reasonable degree of security and safety for clients and microfinance institutions (MFIs) to carry out their activities.
- Stable population. Maintaining timely loan recovery is difficult with mobile populations. Most programs focus on residents, internally displaced people, and returnees, rather than refugees— unless refugee communities are de facto semi-permanent.
- Sufficient economic activity and a cash economy. Microfinance allows clients to take advantage of economic opportunities— it does not create them. People need access to productive resources, be able to trade, and carry and use money for microfinance to work.
- Patient, long-term perspective. Donors may expect institutions to take longer to become sustainable relative to lower-cost, non-conflict settings. They should commit to three years or more. Donors constrained by short funding cycles should coordinate with others to ensure long-term access to funding.
- Flexible, longer-term funding mechanisms. Whereas relief operations require large amounts of funding disbursed quickly, microfinance requires smaller amounts disbursed over time at higher administrative cost. Donors should offer grant funding without restrictive or rapid disbursement conditions—even in the face of political pressure.

Get back to business using best practice: It is a little dramatic to compare the current situation in Kenya with a long term post conflict situation, however, the experiences drawn together below in the bullet points can help direct our thinking through constructive reflection. The message in these three bullet points is to get back to business as soon as there is stability and to continue to use microfinance best practices including maintaining rigorous loan screening and collection.

- Microfinance works in post conflict environments. Micro-credit is likely to reach the poor and un-banked in a sustainable and efficient way if, as in non-conflict environments, a demand-driven approach is followed.
- Few environmental conditions are required for initiating microfinance in post-conflict settings. An early start is crucial to quickly transition from relief to development.
- Microfinance best practices can and should be adopted from the start of a given intervention to ensure sustainable outreach to the targeted clientele. This particularly applies to market pricing of financial services, rigorous and transparent credit appraisal, and strict loan collection efforts.

Adapt products and services to the new reality: The message in the next three bullet points is that adapting products and services may be necessary and that some individual loans may be necessary. It is likely that market research training and product refinement will be required. Given time lines I would concentrate on product refinement first.

- Standardized products used in normal conditions need to be adapted to suit the post-conflict situation. This requires a clear understanding of the capabilities of microfinance and the realities of the post-conflict environment, such as damaged physical infrastructure, broken social ties and trust, and populations accustomed to quick relief, short-term gains and grants.
- There are no shortcuts in designing appropriate products for conflict areas. Insightful market research is more crucial in conflict settings relative to normal situations.
- Group loans are effective, but individual loans also work in post-conflict settings. Individual loans, however, involve higher risks and costs, and re-quire close follow-up, guarantees, support of community leaders and the incentive of future loans to encourage repayment.

We clearly need to watch out for impacts on staff. Many groups are not being supervised simply because staff members are not able to visit groups. This is likely to decrease internal controls, and create circumstances where fraud and error can increase.

- Security of staff and funds matter. Damage to a society's structure and decreased rule of law can affect the physical safety of MFI staff and cash on hand. Thus, adequate physical security must be in place to safeguard staff and cash. Internal control, good management and transparency in operation are also essential for assuring the safety of capital.
- Qualified staff is crucial for success. Personnel, management and field staff with experience in microfinance should be hired from the start whenever possible. If experienced candidates are not available, training is required to help develop skills in designing and delivering micro-finance products and in effectively managing and monitoring operations. Incentive may be required to motivate staff to re-main focused on the target clientele and to ensure a high port-folio quality.

Expect higher operating costs: We should clearly come to an understanding over time of how much operating costs have changed, what additional costs are being incurred by microfinance programmes as they follow up delinquent borrowers, and how much income has decreased. Trend analysis for assessing impact at an institutional level is likely to be very important.

- Initial start-up and operating costs are high in conflict environments. The costs are especially high due to salary and security expenses. Relative to normal areas, loan losses may also be high in situations immediately following conflicts, at least in the short-run.

Consider using grants in the most affected areas: There may be some situations, for example internally displaced people where grants are more appropriate. It may be that the microfinance programmes can develop strategic relationships with other partners who provide other non financial inputs. Careful research is likely to be required.

- Microfinance is only one of the development tools for rebuilding a war torn society and should be used with care. To facilitate the development of a post-conflict society, non-financial services may be required to precede and/or support financial services provided through innovative and competent institutions. In-deed, there are situations in which it may be more appropriate to use grants rather than microfinance.

Maintain a solid repayment culture: It is important to reiterate the point below through all channels. There are government funds being made available. It is not yet clear what terms and conditions these government funds have attached to them.

- Say “No” to subsidized financial services and a loose repayment culture. Governments and donors should avoid pushing MFIs to directly subsidize the clients through cheap financial services. This can potentially undermine the microfinance sector for a long period of time. Also, MFIs must be strict on loan collections from the beginning and must clearly educate their clients on the differences between grants and loans.
- Sustainable operations are possible. It is not uncommon, however, for MFIs initiated in early post-conflict settings to require a little more time to attain financial sustainability compared to similar MFIs in non-conflict situations or post-conflict areas in their late stages.

Clearly mechanisms to ensure portfolio quality are difficult at the best of times, but are especially difficult in institutions that operate a remote banking policy where clients make repayments through partner banks. This mechanism delays the creation of a realistic picture.

- Maintain portfolio quality: This requires a strong information system that provides timely and accurate information and enables the staff to monitor payments on a daily basis.

Coordinate with stakeholders on a wide range of issues: Clearly in the current context attempting to maintain

- Share, cooperate and collaborate with stakeholders: Sharing information with other practitioners, as well as donors and local leaders, on issues like security, product terms and conditions is mutually beneficial in an unstable environment.

Protect Records: There has already been a suggestion that one MFI office was ransacked by clients who were attempting to destroy records of loans. Clearly this is a very worrying development and MFIs should be reminded to ensure the safety and security of their records in the hot spots.

- Ensure access to staff and systems: MFIs should safeguard their records and make them available from remote locations. Management must develop a communications strategy in emergencies.

PART II: Conclusions and A Way Forward

Conclusions

The financial and psychological impact on the post electoral crisis in Kenya has been considerable. Though the financial impact is moderating as better information becomes known, nevertheless, the impact remains considerable and therefore requires an institutional response from AMFI, FSD Kenya and other stakeholders.

Considering appropriate an appropriate way forward is difficult for a number of reasons, firstly the NGO heritage of the Kenyan microfinance industry predisposes many microfinance institutions to anticipate direct donor funding to manage the impact of the crisis. Given the impact on the sector and in particular institutions a case for donor support can be made.

However, not only does the size of the impact potentially running into billions of shillings make a grant based approach challenging, but the donor industry has evolved from providing grants to individual institutions to facilitating markets and providing enabling conditions making an adjustment to providing grants appear to be a retrogressive step, even if *arguably* in some cases a necessary one; a veritable clash of cultures.

To make matters more challenging none of the industry structures whether AMFI the industry association, MESPT, Jitigemee Trust or Oiko Credit the institutional investors, nor the support industry such as *MicroSave* were established with sufficient capacity to manage a widespread response to crisis.

So creating an industry response is a question of balance between different perspectives, of sourcing better information on which to make decisions, of consulting stakeholders widely, and seeing how others can be of assistance. Pragmatic responses are required that take cognisance of time taken for different mechanisms to be established. This is happening though no doubt more can be done. As of the end of February, for example, USAID have come forward and have sponsored a mission to review the potential for the creation of a guarantee mechanism. Microfinance ratings previously arranged by AMFI and supported by FSD-Kenya are being adapted to assess institutions in crisis.

The need for pragmatism, speed and information is defining the evolution of a strategy for supporting the Kenyan microfinance industry. The outline given below is in no way exclusive of any other efforts that may be taken to support the Kenyan microfinance industry or individual institutions within the industry. Nor is the response based on perfect information. It is likely that additional responses will be required as better information becomes known.

An Outline of A Way Forward

A way forward has to balance need for funds, with the need for improved information, with the requirement for institutional technical support. Different elements are presented below, which can be flexed to some extent for different institutions.

Coordination of Activities: Coordination of different initiatives including those outside the response outlined below is important. So those either considering how they can be of assistance, or actually providing assistance, or requiring an update on current developments are invited to get in touch with AMFI the Kenyan Association of Microfinance Institutions. This can be done through info@amfikenya.com

Direct Funding: Direct relationships between local banks and MFIs can continue on commercial but competitive terms. Direct relationships usually allow the fastest response; however, banks are likely to provide funds to financial institutions that are the stronger, less risky, and often larger institutions.

Indirect Funding: More affected or weaker institutions may require greater support than the strongest institutions, but will carry higher levels of inherent risk. Higher levels risks may make it more difficult to attract local commercial funds. Therefore the involvement of a Guarantee Facility and a Technical Facility is being considered which will complement local or international funds. (see Figure 1)

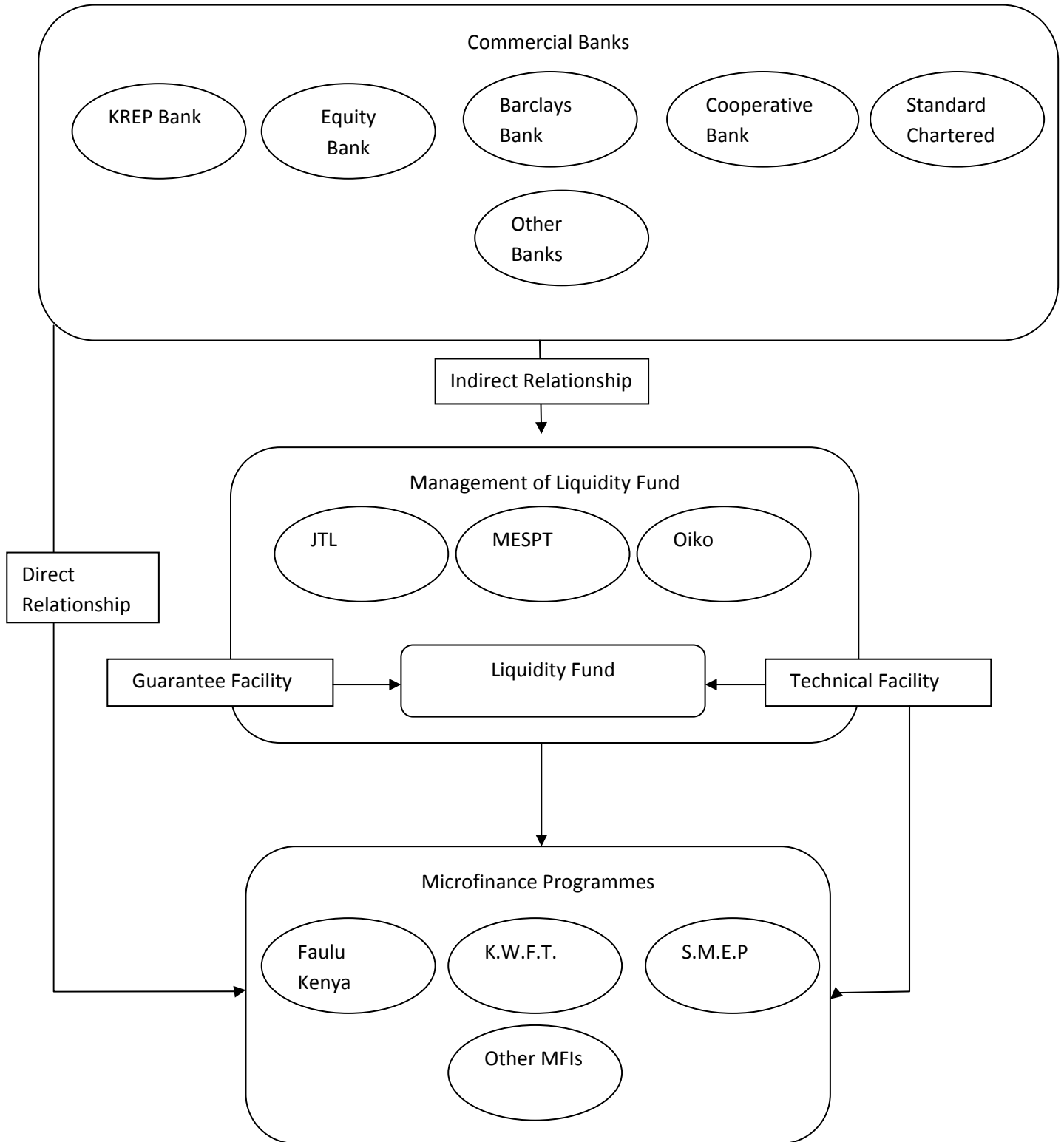
In many ways the technical facility would support the guarantee facility in that it supports activities that help to reduce and manage lending risk, like portfolio reviews, product refinement and business planning. It is envisaged that the technical facility will support the work of some of the local investment funds to help the lending process move as quickly as practical in these difficult circumstances.

Fees: The local investment funds will manage the guarantee facility for the benefit of the participating microfinance institutions and lenders alike. For this they are likely to charge a small fee, though it is expected that many aspects of the technical facility will attract an external subsidy especially at this time. More details on potential fees can only be given after careful work has taken place on the design of the guarantee facility.

Institutional Review: i) To provide a clear and concise review of the institution, its governance and management and the impact upon operations of the crisis; ii) to establish the level of portfolio risk within an institution desiring funds through the Liquidity Fund, especially those institutions requiring access to the credit guarantee facility; iii) to establish any covenants required on the institution by the guarantee facility; iv) to facilitate strengthening of credit management within the institution; v) to facilitate faster access to funds than would otherwise be available through existing funding mechanisms through outsourcing the portfolio appraisal.

Process: The institutional review would be undertaken by an expert from an approved list of suppliers, these would include credit specialists, microfinance rating companies and respected consulting companies.

An Overview of the Proposed Facility



Strategic Business Planning: To assist institutions to plan strategies to manage out of the crisis. This specifically acknowledges that institutions that may have had challenging issues before the crisis, now face very significant challenges that require a careful action plan. It is anticipated this would enable some institutions to access support through their existing channels, in a clearly targeted and prioritised fashion.

Process: Several processes could be used including facilitating board level retreats which could take two or three days, or longer facilitated business planning sessions with senior management teams collecting considering the critical issues within the institution.

Support for the creation of a Guarantee Facility: To assist the formation of a guarantee fund that is realistic given the current situation, international experts in the formulation of guarantees are already providing assistance.

Support to MESPT, Oiko and JTL: The requirement to support an industry level response may require additional support to be provided to JTL, Oiko and MESPT. This could take different forms which could include the use of the technical facility to carry out institutional assessments.

AMFI Product Refinement Industry workshop: i) To assist affected clients in the most appropriate way through products and services that are tailored to their new reality, but which manage risks for the institution and its funders; ii) To use collective field experience from different institutions to suggest preliminary product refinements; iii) To benefit from experience from disasters and post conflict situations worldwide; iv) To consider the role and extent of field research to validate and modify ideas from the workshop; v) To introduce a structured product development process and consider how these different aspects apply within the recovery and post recovery phases.

Process: AMFI coordinates a venue and the invitations for a workshop with maximum 30 participants.

AMFI Counselling Support: Training to assist MFIs to provide on counselling to their staff and to their clients.

Recapitalisation Facility: A recapitalisation facility for those institutions more severely affected may be designed, that could have different terms and conditions than the liquidity fund envisaged above. However, access to this facility would have to carefully consider the impact on the institution, its managerial abilities and the potential for moral hazard.