FINANCIAL INCLUSION FOR RURAL MICROENTERPRISES (FIRM)

QUARTERLY REPORT:

APRIL 1 – JUNE 30, 2011

CONTRACT: AID-623-BC-11-00001

June 2011

This publication was produced by Development Alternatives, Inc. for review by the United States Agency for International Development.

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Program Title:	Financial Inclusion for Rural Microenterprises
Sponsoring USAID Office:	USAID Kenya
Contract Number:	SOL-623-KE-10-028
Contractor:	DAI
Date of Publication:	June 2011
Author:	Mark Rostal

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SECTION I

INTRODUCTION

The second quarterly report on USAID Kenya's Financial Inclusion for Rural Microenterprises (FIRM) activity, hereafter referred to as the "Program," summarizes achievements and lessons learned, including specific activities and results. Other topics are covered related to implementation processes and issues affecting performance.

The document is organized into six main sections. The first part provides an overview of the Program, its approach, achievements and lessons; the second part provides a summary of activities and lessons learned; the third part discusses results achievements; the fourth part internal operational issues; the fifth part summarizes miscellaneous topics, including problems encountered and corrective actions; and the sixth part reviews the budget.

BACKGROUND

USAID Kenya has played a major role in the development of the microfinance sector in Kenya by working simultaneously at the micro (client), meso (institution) and macro (policy and supervisory) levels. However, demand for financial services continues to outstrip supply, particularly for specific market niches in agriculture and women/youth in rural areas. Likewise, demand for financial services to support clean and renewable energy and information communications technology has started to occur. The modernization of the financial sector combined with the global economic crisis that occurred from 2008 onwards brought to the surface new areas of concern for regulators and supervisors necessary for continuous growth and innovation, while maintaining prudent standards for a healthy financial system.

Within this context, FIRM, a USAID Kenya-funded activity implemented by DAI, was designed to play an important role as part of USAID Kenya's Strategic Objective 7. Under SO 7, FIRM contributes to following Intermediate Results outlined in its Workplan and Performance Monitoring Plan (PMP).

- IR 1: Increase access to financial services for rural and agriculture enterprises
- IR 2: Expand access to and the use of clean/renewable energy
- IR 3: Incorporate innovative ICT solutions to enhance inclusion
- IR 4: Promote new financial models for youth, women and very poor groups
- IR 5: Maximize the use of DCA loan guarantee facilities
- IR 6: Enhance financial sector reforms

Under this framework FIRM's primary objective called for: "Increasing the productivity and growth of on- and off-farm agriculture value chains by increasing financial services to underserved groups throughout Kenya, particularly in rural areas."

FIRM's five-year workplan and PMP (January 1, 2011 – December 2015) was organized around the primary objective and supported by the six IRs. The primary objective contains five results indicators that are supported and consolidated from the six IRs that have a total of twenty-six results indicators. The results indicators for the primary objective are listed below and have the following numerical targets.

Result Indicator	2011	2012	2013	2014	2015	Total
1. Total number of rural households benefiting from USG interventions	200,000	250,000	400,000	500,000	650,000	2,000,000
2. Total number of microenterprises receiving finance from firms participating in a USG assisted value chain	18,000	48,334	125,000	250,000	441,667	883.001
3. Total value of credit (financing, loans) disbursed to target beneficiaries from USG assistance ($)	17,500,000	42,250,000	130,000,000	260,000,000	474,000,000	923,750,000
4. Total amount of private financing mobilized with a DCA guarantee ($)	12,000,000	31,250,000	75,000,000	150,000,000	250,000,000	518,250,000
5. Total number of product/service innovations created and implemented	12	21	28	33	41	135

The twenty-six results indicators, corresponding to IRs 1 – 6, are not listed in this report. They are detailed in FIRM's Workplan and PMP. Each quarter, FIRM will report on the results indicators outlined above. The Program will track results for the additional twenty-six indicators every quarter and the information will be archived in FIRM's TAMIS (technical and management information system).

CONTEXT

Agriculture is the cornerstone of the Kenyan economy. It accounts for 24% of Kenya's gross domestic product and generates 60% of foreign exchange earnings. Over 75% of the labor force is engaged in agriculture, including four million rural smallholders who rely on farming for their livelihoods. Even so, Kenya faces chronic and growing food insecurity and, coupled with increasing population growth and urban migration, the situation has the potential to deteriorate significantly. An estimated 8% of land in Kenya is arable; most of this valuable resource is used to cultivate export crops. The rest of the agricultural sector remains highly labor-intensive, and half the outputs generated are at subsistence levels. In addition, agriculture production is heavily dependent on rain, leaving it vulnerable to boom and bust cycles. Continued deforestation and climate change contribute to land degradation and weather variability.

The government of Kenya designed a reform agenda focused on market-led agricultural policy and investments, as articulated in the Agriculture Sector Development Strategy and the Comprehensive African Agricultural Development Compact. These plans fit into the country's broader development strategy outlined in Kenya's Vision 2030 – the government's twenty-year economic development blueprint to transform Kenya into a middle-income country by achieving annual economic growth rates of 10%. The first five-year plan calls for investments in tourism, agriculture, manufacturing, trade, information technology, and financial services.

Against this backdrop and in support of Kenya's Vision 2030 agenda and US government priorities, FIRM seeks to help Kenya improve its food security situation – in terms of both the availability of food and consumers' ability to purchase it – by developing financial models that enable smallholders and small and medium-sized enterprises (SMEs) to invest in improved production, processing, and the marketing of staple foods and other important commercial crops. Food yields, market linkages, and producers' incomes naturally increase as investments are made in key value chains including staple crops, horticulture, fish, dairy, and livestock as value-added food moves from production into end markets.

Building on previous USAID-Kenya activities in the financial sector, FIRM continued to implement an opportunistic approach to ensure that appropriate financing was available where possible and that it served as an enabler for improving the availability of productivity-enhancing inputs and services, post-harvest and processing technologies, transport, marketing and trade in for agriculture. However, many if not all of the financial institutions seeking assistance from FIRM to finance the sector were under-prepared to begin immediately. As a result, the Program focused on customizing individualized business strategies, financial models and operational plans. In other areas, such as clean/renewable energy, ICT and gender/youth, FIRM focused on identifying institutional and client needs as a basis to later support strategy development, operational planning and execution since these areas are relatively newer areas where financial services has longer been absent.

FIRM'S APPROACH AND PRINCIPLES

FIRM's guiding approach and operating principles are firmly centered on finding and facilitating opportunities to support the growth and development of the financial services industry through the identification of opportunities, risk sharing and technical assistance. FIRM works to ensure that entrepreneurs, businesses and individuals have access and choices, not only to credit but also to savings, secure transfer services, etc. To this end, the Program is focused on strengthening the overall financial system at multiple levels so that it becomes more inclusive. FIRM's focus is not strictly on credit and the philosophy that it – credit and in particular microfinance – will alone transform entrepreneurs, businesses and individuals. Without a developed financial sector, growth and opportunities are seriously constrained since a financial sector will always undershoot its potential if it is unable to commercially serve a majority of the population. Therefore, as part of FIRM's approach, it works to improve the overall system that facilitates products tailored to the low-income market segment that includes but is not exclusive to women and youth. FIRM's approach and partnership with financial/non-financial institutions and the government of Kenya will help some poor people and not others. FIRM's support will however create choices for everyone and overtime the approach will draw unbanked cash into the financial system where it hopefully be intermediated and bring down borrowing costs across the board.

This approach was successfully implemented under two previous USAID Kenya financial services activities but on a much smaller scale and not as comprehensively as designed for FIRM that now includes additional areas where finance is not widespread. To meet its contractual benchmarks, FIRM will primarily work at the meso (institution) and macro (policy and supervisory) levels. At the meso level, FIRM will work with financial and non-financial institutions, including: commercial banks, deposit-taking microfinance institutions, MFIs, SACCOs and other businesses that offer finance and other services such as Lesiolo Grain Handlers, mKopa, iCow, Earthoil, the Body Shop, Backpack Farm, Unga Millers, etc. At the macro level, FIRM will work with the Central Bank of Kenya, Treasury, the National Economic and Social Council and others.

SECTION II

ACTIVITIES AND LESSONS LEARNED

IR 1: INCREASE ACCESS TO FINANCIAL SERVICES FOR RURAL AND AGRICULTURE ENTERPRISES

Activities

Value Chain Finance Center

The VCFC partnership between FIRM and Financial Services Deepening (FSD) Kenya was further solidified with the approval of its business plan by FSD's program investment committee. FSD has pledged $5 mm for the center's first three years' of operations. FIRM will provide technical assistance to the center, its employees and clients. FIRM and FSD secured and successfully negotiated shared office space on Upper Hill in order to effectively operate the center. In addition, the recruitment process was launched for the center's director and research manager. Qualified Kenyans will be hired in during the upcoming reporting period and the center will be fully operational before yearend after FIRM and FSD locate to their new office premises.

Kenya Commercial Bank

Kenya Commercial Bank (KCB) is the largest bank in Kenya by assets and it has one of the most far reaching branch networks in the country. The bank has two Development Credit Loan Guarantee facilities – one for SME and the other in agriculture and clean energy. The SME facility comes to close this year after five years of successful lending. The agriculture/clean energy guarantee began in September 2010 and KCB has begun booking loans.

KCB serves a broad range of customers including corporate clients, SMEs, microenterprises and retail customers. Its product offering includes: loans and advances, savings and term deposits, transaction accounts, trade facilities, foreign exchange trading, card and custodial services, etc. Within its corporate division, KCB targets a range of clientele active in different economic sectors, including agriculture. Some of Kenya's largest agribusinesses are longstanding customers of the bank. Likewise, the bank markets and underwrites agriculture finance across SME, retail and microfinance. KCB, however, lacks a single unifying strategy for agriculture that it can use to manage and measure the success of the bank's consolidated agriculture loan book

Under USAID's previous program, Kenya Access to Rural Finance (KARF), two products were developed for the dairy sector and the value chain. During the final three months of 2010, the products were piloted in branch locations throughout Eldoret Main, Eldoret West, Kapsebet, Limuru, Githuguri, Ol Kalou, and Nyahururu. The plan and pilot were bolstered by limited on-site technical assistance with the marketing and loan underwriting process driven by KCB. Opportunities for finance were identified and analyzed at each branch, creating actionable and viable loan pipelines. The pilot was a very good start and valuable lessons were learned.

Shortly after FIRM began, the Program and KCB analyzed the successes and failures of the pilot. KCB expressed keen interest in financing additional agriculture value chains. As a result, FIRM recommended that KCB develop a comprehensive agriculture strategy for the bank, given full support and approval by its board, to consolidate all agriculture financial services under a single business unit with assigned resources – loan capital, fully dedicated and trained personnel, transportation, etc. – and the systems and tools to manage and measure success on a fully-costed profit and loss basis.

During the reporting period, FIRM produced the following documentation for KCB, sought and obtained approval for the strategy.

THEMATIC AREA #1

Strategy Design

To realize KCB's aggressive agriculture finance priorities in the absence of a comprehensive board-level approved strategy, FIRM designed a new agriculture strategy for the bank. The strategy called for the creation of a standalone Agribusiness Retail Banking Unit, as a profit and loss center, separating it from corporate banking. The strategy led to the development of an internal bank document termed the "Agriculture Strategy Paper."

Financial Model and Projections

Next, FIRM developed a financial model and projections to track, measure and report progress in conjunction with the implementation plan (below) for the new Agribusiness Retail Banking Unit

Implementation Plan

The strategy must then be incorporated into an implementation plan necessary to operationalize the strategy across prioritized agriculture commodities for KCB, including the dairy pilot currently underway. This activity will produce an internal bank document termed the "Implementation Plan."

THEMATIC AREA #2

Corporate Documentation

The documentation outlined above required packaging the information into standardized KCB templates so that middle management could present and secure approvals for the Strategy Paper, Financial Model and Projections and the Implementation Plan at the executive and board levels. FIRM worked with KCB to prepare: a Board Paper, a Senior Management Presentation, a Terms of Reference and a Memo of Understanding. Production of this documentation required significant interaction with KCB.

THEMATIC AREA #3
Dairy Second Stage Pilot and Rollout Support

FIRM developed a new detailed roll-out implementation plan specific for dairy necessary to maintain momentum of the partnership. The rollout is expected to commence during the upcoming quarter.

As part of the board approved dairy strategy and implementation plan, FIRM designed and delivered a four-day training on asset finance and herd improvement for approximately sixty KCB personnel – business bankers and branch managers. The training sought to operationalize two previously developed dairy product manuals and underpin a pilot launch in thirty branch locations clustered in Githunguri (Central), Nakuru (Rift Valley) and Eldoret (Rift Valley and Western) In addition, vendors of dairy equipment, an insurance company and a veterinarian delivered presentations to the bankers and visits were made to nearby model Brookside dairy farms.

While the work described above was undertaken, KCB embarked on a reorganization strategy carried out by McKinsey & Company. The consultancy led to a new organizational structure and a hiring freeze. With the hiring freeze in place, FIRM and KCB entered into discussions on how to overcome planned hiring of dedicated agriculture specialist to support the dairy rollout and entry into additional value chains. FIRM and KCB expect to overcome this short-term obstacle during the coming quarter.

Technoserve

TechnoServe Kenya is an international NGO with over fifteen years of experience working with rural-based enterprises in Kenya's dairy sector. Today, TechnoServe is a consortium member of the East African Dairy Development (EADD) program, a replication of TechnoServe's dairy hub model, and in this activity, it has helped create over seventeen new farmer-owned dairy enterprises. The program aims to improve the lives of nearly 180,000 families, approximately one million people, and double household dairy income by 2018 through integrated interventions in dairy production, market access and knowledge generation.

Based upon the findings of a comprehensive dairy industry strategic plan (ISP), conducted by TechnoServe Kenya in 2005, significant potential exists for smallholder famers to improve productivity and increase incomes through sustainable and commercial access to credit services, appropriate on-farm technology and a strong end-market for dairy products. The availability of affordable credit is necessary to increase smallholder producers' purchase and use of farm inputs to advantage existing market opportunities.

However, in most rural environments, smallholder dairy farmers are locked out of growth markets due to limited financial resources with the following detrimental consequences:

- Inability to purchase veterinary drugs and other services when needed.
- Poor access to information and technologies available through private extension service providers.
- Limited access to artificial insemination services necessary for improved breeding necessary to enhance milk production.
- Difficulty in purchasing and keeping stocks of feed required to ensure stable milk production, especially during dry seasons.
- Limited access to farm inputs such as seeds and fertilizer necessary for on-farm income supplementation from other crops.
- Limited resources to improve housing and sanitation facilities in homesteads due to the high cost of construction materials and equipment such as water tanks, iron sheets and so on that are often available for sale in most rural hardware stores.

FIRM and TechnoServe continued to hold meetings to further define areas of support and partnership in the dairy sector. The meetings informed FIRM on the nature of services offered by TechnoServe to Financial Services Associations (FSAs), dairy SMEs and smallholder farmers through self-help groups (SHFs). From these discussions, FIRM identified the need for TechnoServe to adopt a strategic approach with respect to FSAs as the primary provider of financial services and the main constraint to growth in the sector. This recognition led to agreement on key areas for partnership that was summarized into a series of prioritized SOWs. Under the first SOW, FIRM will conduct a needs assessment centered on the FSAs. The FSAs provide limited financial services throughout the dairy value chain and are customized around and located in close proximity to milk collection centers and chilling hubs, SHGs and their clientele. The FSAs are clustered around the following locations: Nandi North, West Pokot, Nandi South, South Rift Valley, Kesses and Keiyo South District. FIRM expects to begin this work during the next quarter. The findings will animate other areas of engagement.

Faulu Kenya

Faulu Kenya is a Deposit-Taking Microfinance (DTM) company, the first such institution licensed by the Central Bank of Kenya. Founded by the Food for the Hungry International (FHI) circa 1992 in the Mathare slums, Faulu has grown to become a top-tier and leading DTM offering both savings and credit services to ordinary Kenyans, underserved by the formal financial sector.

Faulu Kenya received valuable support in its formative years from USAID, DFID and the European Union. Faulu Kenya is profitable and it has over ninety distribution channels throughout Kenya – these outlets currently service over 350,000 clients.

Faulu Kenya's clientele operate diverse businesses, including agriculture, which the institution has yet to finance. Faulu Kenya recognizes the potential opportunity financing agriculture presents, given its importance to the lives of rural Kenyans and the economy as a whole. To advantage opportunities and overcome risks, Faulu Kenya seeks partnership with USAID's FIRM program.

During the quarter, additional discussions were held with Faulu to focus on specific areas of partnership. Faulu seeks to systemically finance the growing agribusiness sector but, as deliberations continued, it became apparent that they lacked a comprehensive strategy on agriculture finance. FIRM and Faulu therefore agreed to first focus on an approach similar to the one put into place with KCB. Furthermore, Faulu expressed interest in the development of a SME strategy. FIRM began drafting detailed SOWs for both activities and it is anticipated that work will begin during the upcoming quarter.

The Women Enterprise Fund

The Women Enterprise Fund (WEF) is a semi- autonomous, government of Kenya, agency housed under the Ministry of Gender, Children and Social Development. WEF was established to provide alternative financial services to women excluded from the formal and informal financial sectors. It offers accessible and affordable finance for women to start and/or expand businesses in every constituency through Kenya. WEF is a flagship program under the social pillar in Vision 2030 and it is also a demonstration of the government's commitment to the Millennium Development Goal (MDG) on gender equality and women empowerment.

WEF's objective calls for the social and economic empowerment of women entrepreneurs. Its related mandates include:

- Providing government-subsidized loan capital for women enterprise development.
- Building the capacity of women credit beneficiaries.
- Supporting local and international marketing of goods and services produced by women entrepreneurs.
- Facilitating the development of infrastructure beneficial to women entrepreneurs, e.g. markets.
- Creating linkages between women-owned enterprises and corporate entities.

WEF has two main financial products that it distributes through two channels: the Tuinuke and Jiimarishe loans.

- *The Tuinuke loan* is disbursed by WEF at the constituency level to groups registered through the Ministry of Gender, Children and Social Development.
- *The Jiimarishe Loan* is on-lent by private financial institutions. Through this channel, WEF has seventy-four partners.

In an effort to improve accessibility, enhance service delivery, enrich disbursement and repayment schemes, WEF sought partnership with FIRM to formulate an ICT strategy that will assist the fund to enhance institutional efficiency and service delivery to its clientele through an improved mobile money/repayment scheme in Northeastern Kenya. In addition, since WEF's women clientele play a critical role in agriculture – undertaking a wide range of activities that throughout every stage of value addition (production, processing, distribution and marketing) – WEF also requested assistance to develop a comprehensive strategy and plan to make agriculture finance a core product offering of the fund. FIRM will first focus on the ICT SOW and then the program will craft another for agriculture. WEF plans to pilot its agriculture strategy is Nyanza province. Both areas of work are planned to commence during the upcoming quarter.

Juhudi Kilimo

Juhudi Kilimo is a for-profit social enterprise that provides asset financing and technical assistance to smallholder farmers and small-to-medium agro-businesses mainly in Western and Nyanza provinces. Juhudi Kilimo began in 2004 as an initiative within K-Rep Development Agency, an NGO that performs research and product development for the microfinance sector, and became an independent for-profit company in April 2009.

Juhudi Kilimo finances specific agricultural assets that offer immediate and sustainable income for farmers. Assets vary from high-yield dairy cows and other livestock to agricultural equipment and greenhouses. The assets act as an alternative form of collateral. Prior to each loan, officers visit the client's farm to perform a business assessment and advise on improvements. Juhudi Kilimo clients support each other within farming groups, and co-guarantee their loans through a sub-section of five members of the group, called the Watano.

Juhudi Kilimo has over 7,000 members in seven field offices across the Central, Western, and Rift Valley provinces of Kenya. As of April 2011, Juhudi had 3,609 active borrowers, 48% of whom are women. The average disbursed loan size is approximately $608, with an average outstanding loan balance of $428. The most recent repayment rate was 97%.

FIRM and Juhudi Kilimo built upon meetings held during the previous quarter and narrowed the partnership request to three key areas of potential support and assistance: ICT and mobile money, marketing and capacity building. It was also agreed that Juhudi restructure their proposal so that each potential area of partnership indicate the nature of technical assistance required and the expected results from each area of support. The reconfigured proposal was submitted; FIRM and Juhudi will begin with the marketing strategy, followed by capacity building and documentation, and then the ICT project. FIRM reworked the marketing strategy into a SOW and expects to begin implementation next quarter.

Through its partnership with FIRM, the three-year marketing strategy will help Juhudi Kilimo understand the needs of their clientele and subsequently adapt operations in order to meet those needs and achieve greater sustainability. The strategy will address issues of new product development, pricing, distribution channels and the promotion of the institution and its products. By the third year of the implementation, Juhudi plans achieve the following benchmarks: increase clientele by 500%; grow the number of active borrowers by 480%; increase profitability by 20%; develop three new financial products and expand its geographical coverage to Nakuru and Kericho areas.

CNFA

FIRM and CNFA (implementers of USAID's Kenya Dryland's Livestock Development Program) held a series of meetings on how the FIRM might support CNFA efforts in Northeastern Kenya. CNFA was in the process of conducting a financial services needs assessment. FIRM helped CNFA source and hire local and experienced financial services consultants to carry out the assessment. CNFA completed the assessment at the end of June, titled: "Development of a Community Owned Finance Institution (COFI) for Pastoralists in Northeastern Kenya – Feasibility Study and Project Design." The assessment calls for the creation of new financial institution. FIRM will review CNFA's report and provide feedback during the upcoming quarter.

Milango Financial Services

Milango Financial Services (MFS) is a microfinance institution operating in Kenya since 2009. It is headquartered in Mombasa and currently serves four counties in the Coast province. Milango has approximately 9,600 clients, growing from a base of 1,000 in just two years. Its rapid growth and expansion was supported by a US government Development Credit Authority guarantee that has helped leverage additional external finance. To date, it has disbursed over Ksh 400 M (approximately $4.5 M) and has fifty-three employees.

MFS seeks to strengthen and improve its presence in Kenyan through an aggressive expansion into new geographical regions and by increasing its product offering. MFS plans to grow from 9,600 to 45,000 clients within the next four years and increase its average monthly loan disbursements to $3.0 M. MFS requires external assistance to develop a five-year business strategy that will guide its growth in profitability and sustainability as it incrementally professionalizes operations. In this regard, MFS proposes to partner with FIRM.

In the first quarter of 2011, USAID FIRM held discussions with Milango with a view of understanding Milango operations and future growth plans for its agricultural portfolio. Milango is interested in expanding its agricultural portfolio by developing market – led products with a bias to passion, mangoes, sweet potatoes and dairy in the Coast, Eastern and Central Provinces. The USAID FIRM in collaboration with Milango have prioritized the key areas for support – which after implementation will spur the MFI's growth and improve livelihoods of rural households, in particular the women and youth, who make about 52% of Milango's membership. The areas identified for partnership include: review and update the current business strategy to include new growth fronts i.e. agriculture, review and refine financial products, build capacity of staff, support credit risk, equity and IT management.

By the end of the second quarter of 2011, FIRM and Milango consolidated the key partnership themes into terms of reference. During the same time, FIRM developed a draft Memo of Understanding that stipulates the rights and responsibilities of the two institutions. FIRM also is has drawn a request for proposal to review and update Milango's current strategic business plan – which will provide a road map to implementation of the other activities.

Earthoil/The Body Shop/Backpack Farm

Earthoil is a unique organization within the organic industry. It supplies organically-certified essential oils and other natural extracts to buyers throughout the world. Earthoil is one of the few organizations having expertise throughout the entire supply chain – growing and processing, freight and distribution, oil analysis and market knowledge. Around Mt. Kenya, Earthoil oversees approximately five hundred small-scale farmers who produce organically-certified tea tree oil for sale on a forward contract to the Body Shop. Earthoil provides field officers and agronomists to support farmers growing Tea Trees. Many of these producers, subsistence farmers growing food crops such as maize, have openly welcomed the partnership with Earthoil as a means to provide a valuable and much needed second income for their families.

At the request of USAID Kenya, FIRM entered into discussions with Earthoil to help it link smallholder farmers with finance to purchase tea tree seedlings. After understanding Earthoil's requirements and the needs of its farmers, FIRM began the process of identifying potential financial institutions that might offer financing customized for both parties. In May, FIRM selected Milango Financial Services – a smaller MFI with a greater risk appetite and more willing and able to move quickly since it has less bureaucracy than larger institutions. Multiple meetings ensued between FIRM, Earthoil, its farmers and Milango. FIRM designed a structured loan product that allows farmers to finance the purchase of seedlings with a thirty-six month repayment period at market-based interest rates.

At the writing of this report, additional requirements were identified, such as irrigation (drip kits and storage tanks). FIRM has begun remodeling the loan product after identifying a suitable and reputable supplier of water supplies. It is expected that lending will commence in October 2011 after the seedlings are ready for shipment to farmers.

Imperial Bank

Founded in 1993 as a finance and securities company, Imperial Bank converted into a commercial bank in January 1996. Since then, the bank has demonstrated strong financial performance and it has successfully grown throughout Kenya. Currently, it has twelve branches in major cities and towns. Since 2002, Imperial was recognized with five FiRe awards (Excellence in Finance Reporting) – an award that identifies excellence in financial reporting, sound corporate governance, corporate social responsibility and environmental reporting. In 2008, the bank was also distinguished in the Best Bank category and, in 2009, Imperial won the Best SME Bank award.

Since the beginning of the calendar year, FIRM met on multiple occasions with Imperial to discuss opportunities and potential areas for partnership. Imperial expressed interest to pursue agribusiness finance in the dairy sector around Thika and Eldoret where the bank has branch offices. The bank also cited interest in financing fruit exports through its Diani, Kilifi, Mombasa and Watamu branches with particular attention to mango processing for the export of fruit concentrate.

Given the distinct opportunities Imperial would like to pursue, FIRM and the bank agreed to first develop an agribusiness strategy and followed by an overarching operational plan (similar to the approach used for Kenya Commercial Bank). It is expected that this work will begin during the upcoming quarter.

Equity Bank/Equity Foundation

Several meetings were held over the course of the reporting period to discuss potential areas of partnership including agriculture, renewable energy and micro insurance. Thus far, nothing was agreed upon with the bank or the foundation.

iCow

In 2010, the US Department of State sponsored Apps 4 Africa, an East African regional competition designed to highlight the talent of local developers and to leverage the power of mobile technology to help solve some of Africa's most challenging problems. Several hundred applications were received. The State Department made an award to iCow – a mobile-based technology designed for dairy farmers. iCow is a SMS (text message) and voice-based mobile phone application for small-scale dairy farmers in Kenya. It functions as a virtual veterinary midwife, helping farmers track a cow's oestrus stage, while also providing readily available, up to date and important information on breeding, animal nutrition, milk production efficiency and gestation. Farmers register their animal and enter a birth date. Farmers are prompted at various stages of the animal's life, and when they chose to receive information, the text message costs five Kenyan shillings and is deducted from their M-Pesa account.

The application prompts farmers on an animal's gestation period; it helps farmers find the nearest vet and artificial insemination (AI) providers; it also collects and stores milk yield, feed consumption and breeding records, in addition to other best dairy practices. Text messages and voice prompts are sent to customers within the 365-day cow cycle and the application is designed to run on both low-end and high-end mobile phones. Ultimately, iCow aims to reduce animal mortality rates, produce healthier and more robust calves and provide improved financial returns for dairy farmers.

In January 2011, FIRM began preliminary discussions with the entrepreneur behind iCow who is also the owner of Green Tech Ltd. Those discussions continued throughout the following months leading up to the official launch of iCow that FIRM supported. Since the launch, iCow registered farmers across twenty-seven counties throughout Kenya and four new modules were added based on farmer demand. The new additions to the platform include:

- *iCow Soko* enables farmers to purchase and sell livestock across Kenya with other registered users and with farmers connected to markets in their geographies. This success led Soko to expand and create a virtual marketplace that includes nurseries selling animal fodder, fruit and timber trees. Others can register with Soko and sell non-farm commodities; Soko has therefore morphed into a self-populating module for buyers and sellers of almost anything.
- *Find Agri Service Provider AGSP* allows farmers to locate agricultural specialists and input providers. In addition to veterinarians and AI providers, farmers can source extension officers, organic advisors, biogas manufacturers and agro dealers.
- *Agri Info Search* is a work in progress and yet to be launched. It will function as a virtual agriculture library, allowing farmers to find information as per keyed in searches. This feature also gives links to web based and radio agricultural information.
- *Agri Weekly Prompts* was originally designed around a three- prompt a week model. Now, iCow weekly prompts allow farmers to receive prompts either once, twice or three times a week, creating improved flexibility and choice.

Within this backdrop, FIRM offered to assist iCow across a range of business needs, including strategic planning, operations, financial modeling and forecasting, capital formation – as is necessary given iCow's recent surge in business growth and future expansion plans. As with many entrepreneurs, iCow and its owner require sustained consultancy, expert advice and mentoring. FIRM is in the process of structuring this assistance.

Kenya Women's Finance Trust

KWFT is the premier deposit-taking microfinance institution in Kenya and focused on providing financial services to women. KWFT is regulated by the Central Bank of Kenya and it is fully compliant with associated guidelines and regulations.

Since its inception thirty years ago, KWFT has grown to become the largest and most successful DTM/MFI in Kenya. It has the widest distribution network throughout the country. KWFT has ten deposit-taking branches, over two-hundred offices and more than 1,800 personnel.

KWFT has far reaching national coverage; its financial services network is strategically dispersed throughout urban centers and into underserved rural areas. As of June 2011, KWFT had 450,000 clients. These clients are all women and KWFT has a proven record through its provision of financial services to help its women clientele create wealth and build assets. With the increasing wealth and assets of its clientele, demands placed on KWFT have significantly grown.

As a result, KWFT seeks to partner with USAID Kenya's Financial Inclusion for Rural Microenterprises (FIRM) program. FIRM is designed to facilitate the expansion and innovation of financial services in five areas key to the development of Kenya's economic growth and prosperity: agriculture, renewable/clean energy, information and communication technology, gender/youth, and policy reform. Moreover, FIRM capitalizes on opportunities that can potentially advance the frontier of financial services into, for example, water, health, and education, in order to benefit marginalized and excluded populations across Kenyan society. To achieve these objectives, FIRM works in partnership with and supports a wide variety of commercial actors in the financial services industry, government of Kenya agencies and stakeholders, associations, donors, business service providers and consultants.

KWFT requires to expand its product offering and at this time requests to explore opportunities in agriculture and clean/renewable energy. Leveraging resources from FIRM, KWFT proposes to carry out a comprehensive opportunity assessment to better understand the needs of their clientele in these sectors; subsequently, KWFT seeks to develop appropriate and profitable products to meet those opportunities. The assessment will identify opportunities and obstacles that will animate its decision making processes and the development of action plans.

KWFT has aggressive growth plans and it seeks to dramatically increase loan and savings balances across its current portfolio of clientele, while moving into new sectors and customer niches. KWFT plans to increase profitability twofold and add multiple products – within a three year timeframe.

FIRM and KWFT held initial discussions during the second quarter of 2011 to define areas that the two institutions can work together to improve the livelihoods of rural women and youth enterprises. From the discussions, agriculture and renewable/clean energy sectors were noted to be key areas that required support as most of KWFT membership, who are women/young women, were involved in agricultural farming yet lacked appropriate agricultural products and services to improve their production and incomes. Additionally, most of them live in the rural areas that are not connected to the national power grid.

A consensus was drawn from the discussions that there was need to develop market-led products in agricultural and renewable. In order to be sure and definite on the kind of assistance the target clientele, FIRM and KWFT agreed on a set of activities, which were documented into a terms of reference, to be implemented systematically to increase financial access to women/young women in the agriculture sectors. The first activity, which is expected to be carried out in the next quarter and will involve preparing and sending out the request for proposals for needs assessment for both sectors, followed by selecting the consultant and carrying out the needs assessment that will bring out financing gaps for the target clientele.. The assignment will be carried out in Rift Valley, Central, Nyanza, Western, and Eastern provinces

Lessons Learned

In agriculture, many financial institutions seek entry points to finance multiple value chains. Engaging these institutions, FIRM has learned that each partner or potential partner lacks a vision, strategy and plan, within the context of their current business model, to profitability finance the sector and/or various agriculture commodities. Rather than engaging institutions on a commodity-by-commodity basis without a board approved strategy and plan in place, FIRM has successfully marketed the idea of providing the institutions with the necessary strategic and operational planning (e.g. consulting assistance) before they enter a given commodity or sector, ensuring that adequate funding levels are in place and that the proper approvals have been secured with buy-in at the highest levels. While doing so requires more time to launch activities, it will allow the institution to make better decisions that guide successful entry into agriculture finance and implementation. Further, plans will allow the financial institutions to match available resources to finance and expansion with benchmarks that can be tracked and monitored.

IR 2: EXPAND ACCESS TO AND THE USE OF CLEAN/RENEWABLE ENERGY

Activities

FIRM has pursued a strategy similar to agriculture insofar as the Program is working with partners, and in most cases, to develop appropriates strategies and plans to finance the sector or niche markets. Partnerships have generally evolved by working with institutions in agriculture. Currently, FIRM is assisting with KWFT, Milango and KCB. FIRM has partnerships with each institution in agriculture and the Program is building on those relationships and their expressed demand to custom strategies and create entry points in clean and renewable energy. FIRM expects to expand into partnerships other institutions

With Kopa Solar, FIRM is working with the Office of Development Credit to design a Loan Guarantee that will underpin Kopa's expansion into financing solar lamp in rural areas. Kopa Solar is a private clean energy company in Kenya that seeks to help low-income consumers purchase solar power systems via a leasing system with pay-per-use payments made by mobile phone. After a successful pilot conducted in July 2010 through a partnership between Mobile Ventures Kenya, a leading mobile payments firm, and D.light, a solar product design company, Kopa-Solar seeks to roll out its product to 15,000 consumers in rural areas across Kenya. Consumers benefit from reduced spending on kerosene and a reliable source of energy. Kopa Solar has strong existing relationships with local Kenyan banks, particularly Commercial Bank of Africa, and is in conversations regarding an eighteen month, $1 mm loan to be taken in October or November 2011. With a USAID guarantee, Kopa-Solar is more likely to get a loan on good terms and prove the commercial viability of its model. This in turn will lead to its ability to secure future larger debt investments from local Kenyan commercial financial institutions without a guarantee.

Lessons Learned

Clean and renewable energy is similar to agriculture. Institutions, with the exception of Kopa Solar that is a blended ICT, clean/renewable energy and MFI, lack clear strategies and plans. FIRM is working with these institutions to develop strategies and to put them into practice. Additional partners will be added as the Program progresses.

IR 3: INCORPORATE INNOVATIVE ICT SOLUTIONS TO ENHANCE INCLUSION

Activities

ICT is again similar to agriculture and clean/renewable energy. FIRM is building upon relationships with institutions in those two areas to create opportunities for financial services in ICT. To this end, FIRM is working with Juhudi Kilimo, the Women's Enterprise Fund and KCB, Technoserve, iCow and Kopa Solar. Excluding Kopa Solar, activities with these partners are still under discussion and will not be launched until the upcoming quarter.

Lessons Learned

Agriculture is the nexus where other opportunities converge, particularly clean/renewable energy and ICT. Financial and non-financial partners seek support in these areas as it primarily supports their entry or ongoing expansion into agriculture. There are notable exceptions, however, such as Kopa Solar which does not have an agriculture linkage. Kopa is focused exclusively (for now) on rural areas which directly benefits farming households. FIRM will continue to search out opportunities in ICT and other possibilities for partnership that are related to agriculture.

IR 4: PROMOTE NEW FINANCIAL MODELS FOR YOUTH, WOMEN AND VERY POOR GROUPS

Activities

FIRM has two important partnerships with organizations exclusively focused on women – Kenya Women's Finance Trust and the Women Enterprise Fund. With both institutions, FIRM will actively design and customize products and services that cut across agriculture, clean/renewable energy and ICT. With other partners, FIRM will support product development that is gender neutral and the Program will disaggregate the uptake. FIRM will apply the same principle to youth.

Lessons Learned

Customizing specific financial products and/or services for women, thus far, is less difficult than for youth. The microfinance movement was built upon the thesis that financing women was less risky that doing so for men. Later, when this was proven, microfinance was opened to men.

Financing youth is problematic, especially if working through and in partnership with for-profit commercial institutions. In Kenya, youth is defined as sixteen to thirty five. The USAID definition is eighteen to twenty four. Financial services are provided to individuals in both those brackets and across genders. FIRM will closely aggregate data provided by financial partners to use for the development of customized products and services in the areas of gender, youth and very poor groups where appropriate.

IR 5: MAXIMIZE THE USE OF DCA LOAN GUARANTEE FACILITIES

Activities

FIRM inherited eight USAID DCA loan guarantees from the Kenya Access to Finance Program (KARF), totaling $42,930,000. Those facilities cover a range of financial products including SME, community water, post- election violence liquidity, micro-health insurance and agriculture (summary table below). The majority of the facilities were Loan Portfolio Guarantees (LPGs) – credit enhancements directly supporting lending by a financial institution to a specific sector where the institution was adequately capitalized to on-lend its own resources. The guarantees to Faulu and Lesiolo are Portfolio Guarantees – institutional guarantees allowing each to source commercial finance from a bank to support their lending into an intended sector since they required an injection of capital to support operations.

DCA Summary Table (June 2011)

Partner Financial Institution	DCA Support For	Guarantee Value
1. K-Rep Bank	Community water	$5,000,000
2. Fina Bank	SME	$5,000,000
3. Kenya Commercial Bank	SME	$7,900,000
4. Equity Bank	Post-election violence liquidity	$5,000,000
5. Oiko Credit	Post-election violence liquidity	$5,000,000
6. Faulu	Micro-health insurance	$5,000,000
7. Kenya Commercial Bank	Agriculture, general	$5,750,000
8. Lesiolo Grain Handlers	Agriculture, grain warehousing	$4,280,000
	Total:	**$42,930,000**

Since the beginning of the calendar year, FIRM worked with the Office of Development Credit to structure and close two new facilities – one with Fina Bank in agriculture and another with Kopa Solar to finance its business in solar lighting. Fina is expected to close before the end of USAID's fiscal year in September 2011 and Kopa will be finalized before the start of the New Year (2012). The facility with Fina will be in the $4 – 5 mm range and Kopa will be approximately $1 mm.

Lessons Learned

DCA is an important tool that – when structured, used and monitored correctly – can significantly lower a FI's threshold for risk and reduce entry barriers in new product areas or other customer segments. In the past, USAID has been opportunistic, generally responding to requests from FIs. USAID has moved to structure targeted facilities, aligning transactions with its overarching objectives such as Feed the Future (KCB agriculture in 2010, Lesiolo Grain Handlers in 2010, Fina agriculture in 2011 and Kopa Solar clean/renewable energy in 2011).

Collecting, analyzing and reporting information to USAID is often problematic, particularly with bigger institutions and/or complicated facilities. FIRM is devoting significant resources to collect information and data from partner institutions in order to present an accurate picture of USAID's return on its investments.

IR 6: ENHANCE FINANCIAL SECTOR REFORMS

Activities

Central Bank of Kenya

FIRM met with CBK during the first quarter of the calendar year to discuss potential areas of collaboration, building on previous support provided by USAID. The CBK agreed to draft a proposal outlining potential areas where support is required and to send it before the government of Kenya's fiscal year ends (June 2011). With intensive planning underway, the CBK missed its submission deadline to FIRM; however, the CBK communicated the following key areas and agreed to send the proposal in July 2011. The areas discussed include: deposit-taking microfinance regulatory framework review and prudential and risk management guidelines; anti-money laundering and know your customer prudential guidelines and risk management review; crisis management – early warning systems and a crisis management plan; agency banking/agent register; training and capacity building in deposit-taking microfinance; and, consumer protection and information sharing.

Kenyan Treasury (Ministry of Finance)

FIRM held meetings with three officials from Treasury – one from the Microfinance Unit and two others from the Economics Affairs Department (EAD). The Microfinance is tasked with overseeing a long term activity called, "Program for Rural Outreach of Financial Innovations and Technologies" (PROFIT). PROFIT is funded by jointly by IFAD and the government of Kenya. PROFIT is designed to reduce poverty in rural Kenya by targeting smallholder farmers, small pastoralists, artisanal fishermen, women, youth and landless laborers through the provision of sustainable access to a broad range of financial services and capacity building. PROFIT was launched by the government of Kenya in June 2011which FIRM supported and participated in.

Afterwards, Treasury expressed interest in potential partnership through the Value Chain Finance Center and in other activities that FIRM has undertaken and planned.

EAD asked FIRM to complete a review and draft legislation for Consumer Protection. Discussions regarding this potential work will continue in the upcoming quarter. In addition, Treasury expressed interest in additional areas of collaboration. A meeting was scheduled for July 2011 to discuss these areas after Treasury prepared a draft proposal.

Kenya Banker's Association

FIRM continued to hold meetings with the Kenya Credit Information Sharing Initiative (KCISI) and its project director to familiarize him with the Program and potential areas of collaboration. FIRM and KCISI acknowledged the need to evaluate the usage and usefulness of credit reports in Kenya to ascertain how the documentation is currently used in credit appraisals and for purposes of risk mitigation in the banking sector. Actionable and practical recommendations will be developed as part of the review to improve, better inform and increase the uptake of lending. A Scope-of-Work was drafted in partnership with KCISI for the assignment. FIRM is in the process of procuring a suitable consultant to conduct this assignment during the upcoming quarter.

In addition, FIRM will work with KCISIS to organize a regional conference on credit information sharing (through formalized credit reference bureaus) during the upcoming quarter that will involve other East African countries. FIRM will co-sponsor and facilitate the conference; the Program will prepare the final conference report that will be disseminated to stakeholders in the financial sector in Kenya and throughout the region.

KCISI is schedule for review in July 2011. If the donor currently funding it decides to continue into a second phase, FIRM will support the project in key areas central to financial inclusion and deepening.

Retirement Benefits Authority, Pension Funds and Private Equity

Following the pension fund and private equity conference held in March earlier this year, USAID Washington began work on sourcing qualified fund of fund managers with African experience and potential investors. USAID and FIRM started work on a training program for Kenyan pension fund trustee and managers on the fundamentals of private equity. This work is expected to continue throughout the upcoming quarter.

Lessons Learned

The financial services industry in Kenya is dynamic and rapidly changing. Of the Central Bank of Kenya's three core pillars – stability, efficiency and inclusion – the focus has historically centered on stability but recent trends, both national and global, have shifted the focus toward inclusion. All three areas, however, are interdependent and linked to the ultimate success of the financial sector's development and its important relationship to economic growth.

USAID Kenya has long supported the development of the financial sector through policy reform. Typically, USAID's engagement with the CBK has involved microfinance but, as demonstrated through the KARF program, the regulator has sought to expand its relationship with USAID and channel support to other crucial areas required to maintain the safe and sound expansion of finance services into underserved segments of Kenyan society.

USAID has traditionally followed the lead of the CBK since the government of Kenya drives the reform agenda which is typically aligned to USG objectives. The rate of change and adoption of reforms moves according to their priorities, absorption capacity and other internal and external constraints. For USAID, this reality requires patience and persistence but within accepted cultural and business boundaries and practices. For this reason, FIRM is structured future to work at the micro, meso and macro levels simultaneously, ensuring that when policy reform slows for whatever reason, FIRM has other activities ongoing at the other levels.

The successful relationship that USAID has maintained with the CBK over the years has created the conditions for other government entities to call for partnership. These government agencies include Kenyan Treasury, the Retirement Benefits Authority, the SACCO Society Regulatory Authority (SASRA) and others. Working with multiple partners will help to improve the ongoing development of the financial sector at the macro level that will ultimately benefit the economy and consumers of financial services at the grassroots.

SECTION III

RESULTS ACHIEVEMENT

Results Indicator	2nd Quarter 2011 Target	2nd Quarter 2011 Actual	Variance
1. Total number of rural households benefiting from USG interventions	25,000	21,578	(3,422)
2. Total number of microenterprises receiving finance from firms participating in a USG assisted value chain	1,300	2,635	1,335
3. Total value of credit (financing, loans) disbursed to target beneficiaries from USG assistance ($)	1,700,000	42,652,389	40,952,389
4. Total amount of private financing mobilized with a DCA guarantee ($)	1,200,000	38,663,231	37,463,231
5. Total number of product/service innovations created and implemented	0	6	6

Note: FIRM has collected financial service data from its partners. The figures provided are unaudited. FIRM will complete an audit of the data for the complete fiscal year during the final quarter of the calendar year. In addition, some of the information provided by partners is not complete. Therefore the results provided above are under reported.

1. Total number of rural households benefiting from USG interventions

At the conclusion of the reporting period, the number of rural households benefiting from assistance provided by FIRM through its financial partners totaled 21,578. The program's goal was 25,000. The deficit was attributable to the larger volume of SME loans disbursed by banks. Those disbursements have much higher loan values spread across a smaller group of entrepreneurs, businesses and households. In the coming reporting periods and fiscal years, USAID expects that FIRM will accelerate its provision of services to rural households given the number of strategies, plans and partnerships developed throughout 2011. SME lending will become a smaller part of FIRM's overall portfolio with more lending taking place at the production level of value chains (the grassroots). Loan sizes will decrease across an increasing population of microentrepreneurs and households. In 2012 and 2013, targets are 250,000 and 400,000. USAID will not alter benchmarks as it expects FIRM to meet those targets given the work that was accomplished in 2011.

2. Total number of microenterprises receiving finance from firms participating in a USG assisted value chain

Through FIRM's assistance, 2,635 microenterprises received finance in a USG assisted value chains, exceeding the target of 1,300 - a 103% increase over the baseline. These microenterprises are predominantly based in rural areas and engaged in agricultural activities to support their livelihoods. Results were driven by MFIs, such as Juhudi Kilimo in dairy, Milango Financial Services in general agriculture and Oiko Credit through its wholesale lending to rural-based financial institutions (MFIs and credit unions).

USAID expects these numbers to increase as FIRM deepens and grows its partnership network with financial institutions that will, in turn, lead to further development and implementation of products and services customized for agriculture, clean/renewable energy and marginalized groups. New products and services will be offered through specialized providers of financial services. Financial access and inclusion will dramatically increase in rural areas and throughout populations lacking access to finance. For example, FIRM is working on strategies with three of the largest deposit-taking MFIs licensed by the Central Bank of Kenya. These large MFIs intermediate deposits into loans and they include: Kenya Women's Finance Trust, Faulu Kenya and SMEP. FIRM also provides support to a wide range of other institutions that have far reaching networks and distribution channels in rural areas. These USAID partners include: Technoserve, the Women's Enterprise Fund, Molin, FEWA, and many others. In addition to these specialized providers, FIRM is preparing commercial banks for entry into these underserved markets. This list is long and expanding and includes Barclay's Bank, Family Bank, Cooperative Bank of Kenya, Commercial Bank of Africa, Imperial Bank, etc.

3. Total value of credit (financing, loans) disbursed to target beneficiaries from USG assistance

FIRM's second quarter value of credit disbursed was pegged at $1,700,000 million and the Program helped financial sector partners facilitate approximately $42,652,383 million in new lending, exceeding goal by 2,409%. Two USAID Development Credit Authority (DCA) loan guarantees primarily contributed to FIRM surpassing its projections. These facilities were placed to help the banks - Fina Bank and Commercial Bank of Kenya (KCB) - catalyze small and medium enterprise (SME) loan products in 2006. At the time, both banks were *not* lending to SMEs. The guarantees provided the impetus for both banks to launch new product offerings for small and medium sized businesses. Today, SME loan products represent core product offerings that both banks provide throughout the country. USAID's assistance created the incentives necessary for the banks to enter this important lending space where they, beforehand, were entirely absent.

The remainder of lending facilitated through USAID partners resulted from other DCA loan guarantee facilities and via partnerships in agriculture product development with financial institutions. During the first year of FIRM's operations, considerable time was devoted to developing relationships with banks and MFIs in order to prepare the sector to develop new financial products and services in agriculture, ICT, clean and renewable energy and gender/youth. Approximately, forty partnerships were developed. The vast majority of financial institutions were unprepared for entry into new areas of business lending and FIRM worked with each partner to identify and prioritize opportunities and prepare strategies with accompanying plans for eventual product launch in 2012. Kenya Commercial Bank and Juhudi Kilimo launched new products designed for the dairy sector.

4. Total amount of private financing mobilized with a DCA guarantee

FIRM manages one of USAID's largest DCA portfolios by number of transactions: eight facilities that support a wide range of financing across SME, agriculture, wholesale lending to MFIs and credit unions, community water projects and micro-health insurance. The guarantees are placed with a diverse group of partners, including: Fina Bank, Kenya Commercial Bank, K-Rep Bank, Oiko Credit, Faulu Kenya and Lesiolo Grain Handlers. At the end of the reporting period, USAID guarantees mobilized $38,663,231million in private sector financing through its partners, and increase over the target of $1,200,000 of 3,122%. Current USAID guarantees will continue to leverage increasing amounts of private capital for entrepreneurs and households; thus, creating the conditions for business growth and expansion.

In previous years, USAID has focused on incentivizing banks to enter the underserved SME lending sector through its guarantees. Support will continue to support SME finance but primarily through non-guarantee assistance such as credit scoring and by developing linkages to the newly implemented credit reference bureau. Aligning to Feed the Future, USAID has shifted credit guarantees in favor of agriculture and currently FIRM manages three agriculture facilities. Two were closed at the end of fiscal 2010: a general agriculture guarantee with Kenya Commercial Bank and a guarantee with Lesiolo Grain Handlers, a privately owned and operated grain storage facility. At the end of 2011, a third agriculture facility was placed with a Fina Bank. In 2012 and 2013, USAID plans to develop partnerships and place guarantees in agriculture with other financial and non-financial institutions. Discussions are currently underway with potential candidates and demand is very high.

USAID also plans to expand its loan guarantee program to include other sectors important to Kenya's sustainable economic growth such as clean/renewable energy and water. Early in 2012, USAID plans to guarantee a solar lighting company that is built around a microfinance leasing model and a mobile payment system designed to reach businesses and households in rural areas. In addition, based on the success of K-Rep Bank's community water guarantee, USAID plans to expand the program to further penetrate rural areas and other municipalities throughout Kenya. Discussions are underway with donors to support the expansion.

5. Total number of product/service innovations created and implemented

Two of FIRM's partners, launched six financial products as a result of the assistance received by the Program. As part of KCB's phase II partnership with FIRM, two existing products were retooled for dairy finance – herd improvement and asset finance – and an agriculture savings product was added. Juhudi Kilimo launched three distinct products: (1) herd improvement, (2) chaff cutters and (3) cow/milk shed loans.

CONCLUSIONS

DCA loan guarantees have proven overtime to produce significant results for USAID Kenya at a low-cost/high-benefit ratio if actively managed and supported with targeted technical assistance and training. The guarantees are multi-year and therefore necessitate ongoing USAID support, without gaps between funded programs, to generate results through documented reporting. In addition, relationships established with financial institutions, built on long-term partnerships and trust, yield on-going requests to support new innovations that underpin continuous investments in production, driving economic growth and development.

Equally important are USAID's investments in agriculture finance – requiring a multi-year and a long-term perspective. Developing customized products for value chains requires time and a consistent approach but FIRM has demonstrated that financial institutions are willing partners when provided with high-quality consulting services. These partners are also prepared to commit significant levels of private capital to finance investments when products are contextualized to the operational environment throughout a specific value chain and at each transaction point, especially when data is quantified and linked to the financial profitability of not only value chain actors but the financial institutions.

Financial sector policy reform has created the conditions for ongoing innovation, especially in mobile money transactions, branchless banking, credit bureaus and microfinance – together all areas continue to improve efficiency and expand the frontier of access for people and businesses in need of financial services. Equally important, however, is the stability of the financial sector. One exogenous event or an internal crisis has the potential to destabilize and negatively affect the ongoing safe and sound evolution of financial sector development and economic growth.

Policy reform requires the multi-year involvement of USAID and a long-term vision. USAID Kenya has strong relationships with the Central Bank of Kenya and the Ministry of Finance based on the success of working together on a common platform over many years. Supporting crucial reforms with these two key partners are critical to the success of USAID's other financial sector activities and the economic prosperity of the country.

Women are increasingly becoming higher priority targets of banks and other financial service providers for their products. Institutions are also customized products for "women-only" based on their specific needs. FIRM has reported new "women-only" products developed by two partners and lending has increased to women-owned businesses and to women as household heads for utilities (water) and health insurance. It is anticipated agriculture products will be developed specifically for women since they are involved throughout all levels of value addition. These are positive signals and USAID Kenya will continue to support ongoing innovation in this gender segment.

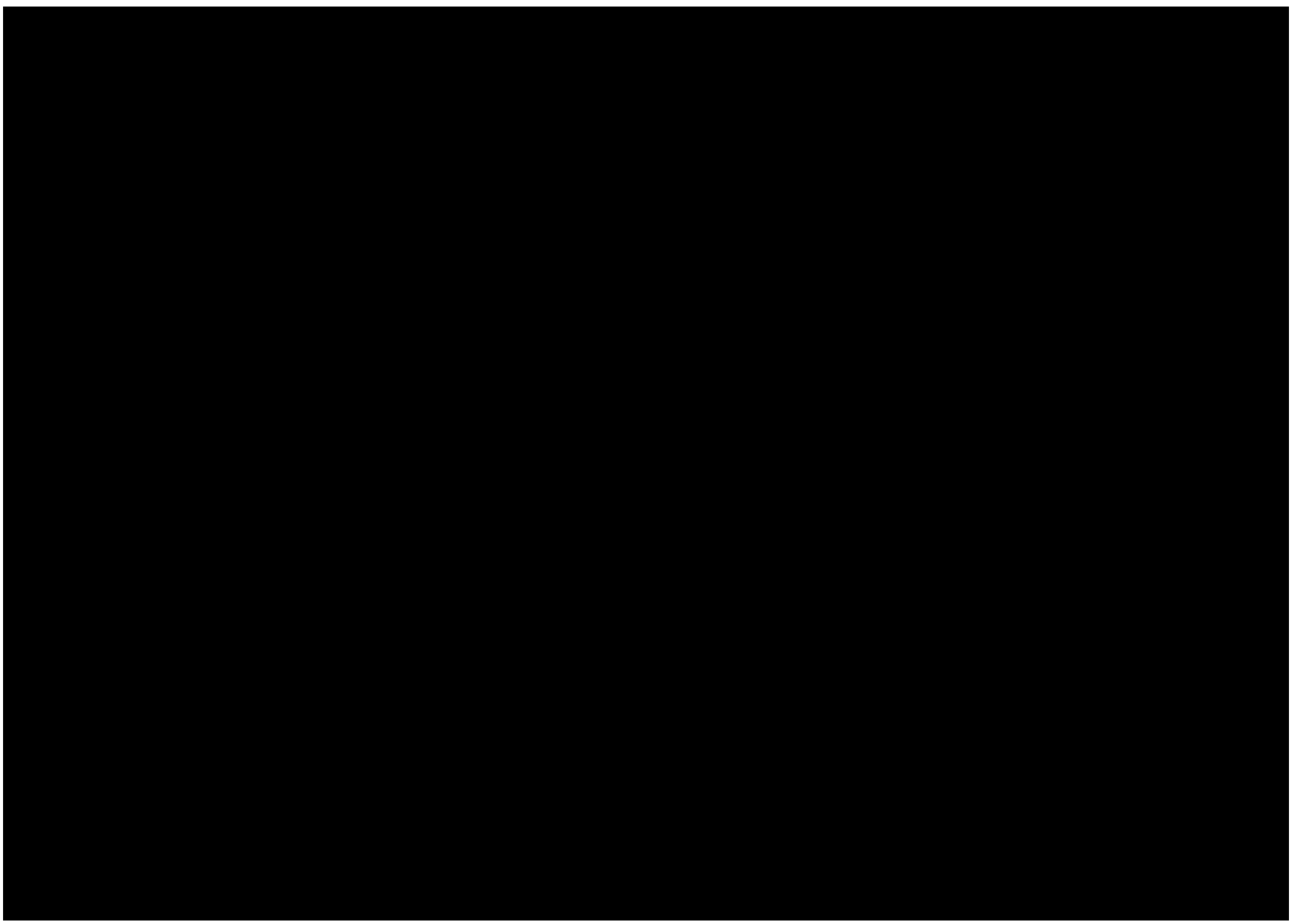
Credit in various forms is the unifying embedded structure in the global economy. Credit underpins the monetary system, investment financing, government deficit financing, trade, letters of credit, bond markets, business and personal debt, etc. Credit and the promise of future economic growth supports stock markets, production, employment, wealth creation, national budgets, individual livelihoods and much else. It is the primary infrastructure of all economies. The recent global economic crisis attests to this important fact. USAID's involvement in the financial sector is critically important to the economic growth of Kenya and the prosperity of its people.

USAID has long supported the development of the financial sector in Kenya. The array of investments deployed to institutions and people have far outstripped initial costs, yielding success upon success which has, in turn, created the conditions for further involvement of the United States government to advance the sector's growth for the benefit of Kenyans excluded from the financial system. Measured in terms of cost/benefit, USAID Kenya's modest program investments supporting innovation in the financial sector have produced many multiples of leverage to US government monetary outlays. Viewed through this lens, targeted investments in capacity building and technical assistance have generated millions of dollars in additional private sector capital leveraged and intermediated into the Kenyan economy by locally-owned, private-sector, commercial, financial institutions.

Very recently, USAID Kenya has begun supporting agriculture value chain finance – agriculture, a cornerstone of the economy upon which most Kenyans depend and a crucial sector to economic growth that has long been neglected by financial institutions. The methodology deployed by USAID Kenya is pioneering and new to the Kenyan marketplace. It is data driven and based on statistical analysis and quantitative research which informs product development, leading to market-led and demand-driven partnership with financial institutions. The methodology is rigorous and widely accepted by Kenyan private-sector partners as best practice.

USAID Kenya has developed multiple MOUs with financial institutions to pilot new products across wide geographies and in marginalized populations. Engagement in this far-too-long neglected area is expected to produce significant numerical results by improving the functionality and profitability of value chains throughout multiple agricultural commodities, making finance a reality for farmers and small businesses upstream in the chain through the end market. Based on USAID Kenya's previous experience in supporting the growth and development of the financial sector, it is anticipated that success will beget success, further driving demonstration in agriculture finance and greatly expanding access and the availability of credit to grow small businesses that will unlock the entrepreneurial aspirations for millions upon millions of Kenyans.

USAID Kenya's long-term relationship with and assistance to the financial sector has produced quantifiable results and leveraged local private sector capital, providing clear evidence that further engagement will yield similar outcomes and is therefore warranted. Moreover, USAID's involvement overtime has not been static; it has evolved with the ongoing needs of the sector, allowing financial and technical support to advance institutions, products and policy reforms opportunistically moving from one level of assistance to the next. Under USAID Kenya's Financial Inclusion for Rural Microenterprises (FIRM), the US government builds upon its long-track record of success by entering new areas considered important to the sustainable evolution of the financial sector in agriculture, clean energy, information communications technology, gender, youth and policy reform. The opportunity for continued innovation in the financial sector offers exciting prospects for the US government to maintain and expand its support.



[redacted]

SYSTEMS AND TRAINING

In April, DAI's Business Manager from the Bethesda headquarter's office provided on-site technical assistance to the Chief of Party and Kenyan new hires in operations. The following tasks were completed.

- Customized and delivered a series of trainings on USAID compliant systems and project management.
- Established and fully documented procurement procedures for goods, services and labor.
- Introduced an inventory and asset management system
- Set-up office management policies and procedures.
- Integrated established financial and internal control guidelines across all program operations.
- Instituted record management procedures in compliance with DAI record management policies.
- Assisted with the Expression-of-Interest prescreening for vendor prequalification (technical and nontechnical).
- Finalized and issued long term-employment LCN contracts.

In May, a DAI staff member supported FIRM to develop a PMP manual covering monitor and evaluation policies/procedures, data quality management, analysis and reporting. He also assisted the Program with refining existing operational manuals, including procurement, finance/accounting and personnel.

FIRM's Monitoring and Evaluation Manager began attending the KODE Monitoring Evaluation course (www.kodeonline.com) and SPSS Statistics software application training. Additional skills development was considered necessary given the increased role and importance monitoring, evaluation and reporting has taken under FIRM. The KODE Monitoring and Evaluation training will further equip her with skills needed to apply best practice to FIRM's Monitoring & Evaluation processes and therefore ensure successful implementation, reporting and management of FIRM's activities. The Program will eventually incur cost savings by building internal capacities and not out-sourcing. Once the training is successfully completed, Ms. Kagota will transfer learning to her three team members.

SECTION V

UPCOMING QUARTERLY PLAN AND PROPOSED DEVIATIONS

FIRM will continue working with partners and others under development to undertake the activities described in this report. It is expected that a majority of the activities will begin in each IR. Monitoring, data collection and reporting plans will be put in place for each activity and partner. There are no proposed deviations to the workplan or PMP.

GENDER ISSUES AND OTHER DYNAMICS

FIRM works to ensure that entrepreneurs, businesses and individuals have access and choices, not only to credit but also to savings, secure transfer services, etc. To this end, the Program is focused on strengthening the overall financial system at multiple levels so that it becomes more inclusive. FIRM's focus is not strictly on credit and that it alone will transform entrepreneurs, businesses and individuals. For without a developed financial sector, growth and opportunities are seriously constrained since a financial sector will always undershoot its potential if it is unable to commercially serve a majority of the population. Therefore, as part of FIRM's approach, it works to improve the overall system that facilitates products tailored to the low income market segment that includes, but is not exclusive to, women and the youth. FIRM's approach and partnership with financial/non-financial institutions and the government of Kenya helps some poor people and not others but it offers choices for everyone. Overtime, it will draw unbanked cash into the financial where it hopefully be intermediated and bring down borrowing costs across the board.

ENVIRONMENTAL ISSUES AND ACTIONS

No environmental issues were encountered during the reporting period and therefore no corrective or other actions were taken. FIRM continued working on its Environmental Monitoring and Mitigation Plan (EMMP) that was drafted during in March/April 2011. The Program will incorporate the policies and procedures outlined in the EMMP in all activities, where applicable.

PROBLEMS ENCOUNTERED AND CORRECTIVE ACTIONS

No technical problems were encountered during the reporting period. Preparing financial institutions for partnership has taken slightly longer than anticipated but activities will be launched throughout the upcoming quarter. FIRM is on track to achieve the results outlined in its Workplan and PMP.

EVALUATIONS AND ASSESSMENTS

During the second quarter of the Program, FIRM completed an assessment of the small scale clean energy sector. The Program will review the findings and work to implement the recommendations. Also, FIRM completed its Environmental Mitigation & Monitoring Plan (EMMP). FIRM's Monitoring and Evaluation team will put the plans' recommendations into practice during the upcoming quarter.

FIRM also completed a series of documents for Kenya Commercial Bank (KCB) detailed in Section II and the Annex.

[redacted]

Annex: Report Index

Documentation Produced by FIRM (Cumulative)

USAID Contractual

- FIRM Year One and Life of Project Workplan
- FIRM Year One and Life of Project PMP
- Quarterly Report, January 1 – March 31, 2011
- Quarterly Report, April 1 – June 30, 2011

Agriculture

- Value Chain Finance Center Business Plan
- KCB: Agriculture Strategy Paper
- KCB: Agriculture Strategy – Financial Model & Projections
- KCB: Agriculture Strategy – Implementation Plan
- KCB: Corporate Documentation: Board Paper
- KCB: Corporate Documentation: Executive Committee Presentation
- KCB: Terms of Reference Pilot and Memo of Understanding with FIRM
- KCB: Detailed Dairy Rollout and Implementation Plan
- KCB: Dairy Loan Product Training Manual and Presentation

Clean and Renewable Energy

- USAID FIRM Clean Energy Assessment and Recommendations

Miscellaneous

- Environmental Mitigation & Monitoring Plan (EMMP)