# QUARTERLY REPORT

# KENYA MICROFINANCE CAPACITY BUILDING PROGRAM

CONTRACT: GEG-I-00-02-00011-00, TASK ORDER: 804

OCTOBER – DECEMBER 2004



VERSION: FINAL

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# I. INTRODUCTION

During the quarter, KEMCAP (referred to hereafter as the "Program") began to implement many new activities, cementing its role as an important force in shaping and moving forward the micro, small and medium financial services sector. It is not without note, however, that the Program has encountered certain difficulties working with its primary partner, the Association of Microfinance Institutions (AMFI). These issues have complicated KEMCAP's implementation, slowing down particular activities since its capacity-building component is reliant on AMFI's active and timely participation. This reporting period has brought many issues to light and KEMCAP has begun discussing problems encountered with USAID. USAID and KEMCAP are working to develop a strategy, with the involvement of AMFI's board, to overcome these obstacles.

In other important areas, KEMCAP has actively begun working with the Development Credit Authority, a US government guarantee mechanism, expanding the range of financial service opportunities available to ordinary Kenyans. In addition, The Program has initiated discussions with microfinance institutions (MFIs) considering transformation to commercial bank status under the pending microfinance bill. The Program has begun to provide capacity building to the Coastal Development Authority on a suitable lending approach to individuals in resource-poor Muslim areas as it struggles to structure and deploy a $500,000 USAID-funded activity.

Further, KEMCAP will broker a high-quality workshop on HIV/AIDs in the Workplace into the country and at no cost to USAID Kenya. The Program is establishing a presence in the financial services marketplace by developing linkages and partnerships with the Central Bank of Kenya, private-sector enterprises, apex institutions, banks and non-banks alike. A solid foundation is being put into place that will create the necessary architecture for KEMCAP to produce desired outputs and results.

# II. IMPLEMENTATION ACCOMPLISHMENTS

## A. Technical

### 1. Progress Against Performance Indicators

KEMCAP submitted draft performance indicators to USAID for review and comment during the reporting period. USAID recommended that the Program follow AMFI's performance indicators after it receives new funding sometime during the first quarter of the New Year, assuming AMFI resolves negative audit findings and compliance issues. The Program will advise AMFI on the preparation of its proposal, helping to integrate AMFI and KEMCAP deliverables and outputs around objectives central to both activities. Afterward, a joint PMP will be prepared.

### 2. Performance Trends and Customer Feedback

*The AMFI no-cost extension and small grant proposal:*

USAID, AMFI and KEMCAP held a series of meetings regarding AMFI's attempts to secure funding to finance ongoing operations and a facility to underpin innovation. USAID indicated to AMFI that it should re-submit a request for phase-two funding rather than another no-cost request, while concurrently working to resolve audit-related issues. Previously, AMFI's funding requests were denied resulting from a negative external audit report, prepared in mid 2003 that detailed gaps in business systems and non-compliance with USAID contractual obligations, namely cost-share contribution, documentation and reporting.

Throughout the reporting period, KEMCAP provided technical guidance to AMFI's executive director, accountant and other personnel on cost-share documentation and reporting, encouraging her active, hands-on involvement. The Program participated in meetings with USAID contract's office as part of the process to ready AMFI for a close out review. The pace of AMFI's preparation has been slow, and quality not in keeping with USAID expectations. As previously recommended, the executive director must take a more proactive, hands-on approach to ensure that the work is carried out as requested by USAID and supported by ongoing advice from the Program.

The Program prepared a draft funding proposal on AMFI's behalf and submitted it to the executive director for review. This proposal will be eventually submitted to USAID. The Program recommended to the executive director that the proposal should be approved by AMFI's board prior to submission and that USAID's contact point person should be the chairman, not the executive director. This recommendation is based on findings outlined in a diagnostic of AMFI that the Program prepared. USAID can use its new funding agreement with AMFI to strengthen governance, increase transparency and build management accountability.

*Integration under AMFI phase two funding:*

USAID recommended that the current KEMCAP workplan and performance monitoring plan be incorporated into AMFI's new project design under its phase-two funding request. The new workplan and PMP for both AMFI and KEMCAP will be on centered on deliverables, results, and objectives central to the successful evolution of the Kenyan microfinance industry, individual institutions, and AMFI itself. Both USAID-funded activities will be tightly integrated along prioritized activities, work sharing, joint responsibility of outcomes, and transparency to AMFI's board and combined accountability to USAID. Integration, however, does not require a physical integration of AMFI and KEMCAP personnel, such as joint management of personnel or other resources. Both are separately funded USAID activities. The purpose of KEMCAP is to work through AMFI to achieve contractually-mandated results and other outcomes in developing the financial sector, while strengthening the association so it can eventually standalone managerially, technically and financially.

*AMFI audit compliance effects and funding delays:*

Following the disclosure of the negative audit report in mid-2003, AMFI devoted little-to-no resources addressing the findings and solving identified problems. Subsequently, AMFI's proposal requests were denied approximately twelve months after the release of the negative audit report. Only after the rejection of its proposals did AMFI begin to tackle the issues outlined in the audit report with significant pressure exerted by USAID and the Program. AMFI's failure to comply with contractual stipulations outlined in its USAID funding agreement significantly threatened its ability to sustain ongoing operations in a productive, businesslike manner since AMFI is ninety-five percent reliant on USAID.

Further, AMFI's inability to manage its stated obligations with one donor has serious implications for securing resources from other funding agencies. Beyond USAID grant income, AMFI has no hope of sustaining operations in a meaningful way. Compounding this dilemma, AMFI has a concept proposal outstanding to another donor, predicated on USAID funding and the Program's involvement in providing technical oversight of a grant facility for which AMFI has no prior experience managing. Without USAID backing, AMFI will experience problems in gaining access to these funds and others.

It also appears that the executive director withheld the significance and impact of the audit while misleading the board about its effect on the relationship with USAID as evidenced through discussions with two high-ranking board members.

Addressing these issues, delayed the timely and effective implementation of KEMCAP since the Program was forced to redeploy valuable time and resources, helping AMFI personnel to act upon the audit findings and prepare additional documentation, including proposals. Given the status of AMFI's funding was undecided, the Program delayed hiring until AMFI's financial condition was resolved. The prospect of modifying KEMCAP was discussed as a means to cover a bare minimum of essential ongoing AMFI operational costs, should AMFI's USAID funding have been discontinued.

*Additional compliance issues:*

In a letter dated April 2002 from USAID to AMFI, the hiring of AMFI's current executive director was made conditional upon the board entering into a performance-based contract with management that outlined annual objectives, accompanied by a review mechanism. This stipulation was never completed and forwarded to USAID. Moreover, the executive director's employment contract was not provided to the mission, even though a request was made for the document.

The USAID-approved AMFI budget requires the association to cover a portion of the executive director's salary on a declining scale—one hundred percent in the first year covered by USAID, fifty percent covered by USAID in the second year, and twenty-five percent covered by USAID in the third year. This important detail is clearly specified in the agreement budget. AMFI has failed to abide by its obligation and no attempt was ever made to notify USAID of additional spending outside the bounds of the contract. (Personnel indicated the executive director ordered the agreement to be disregarded and the salary fully expensed.) No action was taken to modify the cooperative agreement by AMFI, which could have easily resolved this problem.

As part of the process to help AMFI begin complying with external audit recommendations and the USAID cost share arrangement, the Program discovered that the executive director entered into a consulting agreement on behalf of AMFI with the UNDP in May 2003. The contract was prepared in the executive director's name and the proceeds from the assignment were never received by AMFI. The payment was supposedly received by the executive director, according to the association's accountant. During the period UNDP contract work was performed, the executive fully billed the USG for her salary.

The Program made these findings working with AMFI to prepare for its USAID close-out review as part of the process to resolve outstanding external 2003 audit issues. KEMCAP has not done a detailed forensic audit; all findings evolved through and cursory inspections and observations.

*KEMCAP funding and hiring plan:*

KEMCAP delayed the hiring of two staff positions due to stoppages in and uncertainty around the AMFI no-cost extension. Had the AMFI funding not been approved, the possibility of modifying the KEMCAP contract was discussed as a means to support AMFI ongoing operations. Since it now appears the AMFI audit and compliance issues are being positively resolved, KEMCAP will hire additional personnel as described in its budget. The Program advertised for a technical position. It is anticipated that both positions will be filled during the first quarter of the new calendar year. The pace of activities has increased and the new personnel are needed to facilitate Program growth and impact.

At USAID's request, KEMCAP prepared an estimate on how long its current $800,000 obligation will run, if no short-term technical assistance is utilized. Given the mission's funding shortfall, it informally indicated the probable need to suspend STTA for as long as possible. The Program should be able to run through the first quarter of fiscal 2006, activities and spending held constant. KEMCAP will strive to accomplish as much as it can (i.e. contract deliverables) using resources available inside Kenya. At some point, however, discussions must be held regarding the likelihood achieving contractual requirements while the project is slowed and/or other possibilities or scenarios are explored.

*Strategic, operational and marketing plans:*

In October, the Program prepared a "draft" strategic plan for AMFI—its first ever. The plan was modified slightly and endorsed by AMFI's executive director. The plan was sent to the board for review and comment. The board recommended various changes that were incorporated by the Program. Afterwards, the plan was vetted by AMFI's membership, which, in turn, recommended minor changes. Those changes were incorporated by the Program and the plan was forwarded to the CEO for finalization. The plan has not yet been completed.

The strategic plan was scheduled for completion in December so that a calendar year 2005 operational plan could be prepared, guiding AMFI's implementation and serving as a basis to hold management accountable for milestones and reporting performance to the board. Since the strategic plan was not finalized, work on the operational plan did not begin. Likewise, following the strategic plan, a marketing plan was scheduled for production.

From the onset of KEMCAP, the Program has maintained that AMFI must develop a written strategy so its structure, systems and skills can be properly aligned. This approach is well documented and tested; it has been long employed by private-sector consulting firms and businesses alike.

Failure to act on finalizing its first-ever business plan will cause further delays, resulting in a continuation of poor business practices, sub par performance, and ad hoc planning. It also further accentuates an environment of opaque transparency and almost-no accountability to the board and donors.

*AMFI diagnostic:*

The Program completed a draft institutional diagnostic of AMFI. The diagnostic identifies institutional strengths and weaknesses, including specific area findings and recommendations. The report cites key management failures that contribute to low-levels of organizational performance, ultimately leading to AMFI's negative external audit report and forcing USAID's denial of its no-cost extension request.

AMFI's board is strong and comprised of high-level banking, business and microfinance professionals. These executives are extremely time-constrained, running their respective financial institutions. Board governance and management oversight requires strengthening. The diagnostic contains specific recommendations to enhance governance mechanisms and improve management accountability and performance. After the diagnostic is finalized, the Program intends to create a capacity-building plan linked to quarterly institutional report cards, used to track progress toward milestones and benchmarks.

*The Development Credit Authority:*

The Program coordinated an exposure visit to Uganda for Cooperative Bank of Kenya, USAID Kenya, and the Kenya Maize Development Program (KMDP). The Program synchronized trip details with USAID Uganda and the SPEED project based in Kampala. The purpose of the trip was to build capacity inside the bank so that it could better utilize the Development Credit Authority (DCA), a USG loan guarantee facility. The team also reviewed DCAs currently in place at a variety of participating banks. The lessons learned from the visit are intended to facilitate an increased utilization rate at Cooperative Bank.

After returning from Uganda, the Program began a series of extensive meetings with the bank, KMDP, Pipal (a private-sector partner active in the agriculture sector) and USAID, in order to structure the facility to meet the rapidly approaching maize harvest season.

KEMCAP also participated in a training at the Cooperative Bank College by delivering a lecture on the DCA in particular and SME lending in general.

The Program prepared a solicitation for a new DCA designed to generate competition among interested banks. Using lessons learned from Uganda and elsewhere, USAID and the Program expect to gain a higher level of preparedness and participation from Kenyan banks, in addition to securing access to innovative proposals. Interested banks include K-Rep, Standard Chartered, Commercial Bank of Africa, and Equity Building Society. The facility is expected to close in April 2005.

USAID Kenya approached the Program seeking technical advice for ideas that could be used to support women-owned and/or operated businesses, using funds provided by the US embassy. The Program suggested that funds could be used to underwrite a new DCA specifically for women. The Program is prepared to provide technical assistance and capacity building to the bank, in addition to helping it build a marketing and public relations campaign around the product.

*Transformation planning:*

Part of the Program's mandate under its contract with USAID focuses on preparing a class of MFIs for bank conversion, perhaps three to five institutions, when the MFI bill passes and becomes law. In preparation, the Program has entered into a verbal agreement with one MFI, SMEP, to begin the process of readying it for transformation. The Program has begun preparing a scope-of-work, a consulting agreement (e.g. contract) and a non-disclosure agreement—scheduled for completion during the first quarter of 2005. The partnership will produce a comprehensive plan that includes an institutional diagnostic and a transformation plan (the latter supplemented by a capacity-building and financing plan). The work is slated to begin in February 2005.

Once the SMEP partnership is announced, the Program anticipates additional MFIs will seek similar arrangements with the Program. Next quarter, KEMCAP will begin marketing this opportunity within the microfinance community.

*Coastal Development Authority:*

At the mission's request, the Program initiated discussions with the Coastal Development Authority (CDA) on the prospect of forming a capacity-building partnership. The CDA is the recipient of a USAID cooperative agreement, a portion of the funding, approximately $500,000 devoted to facilitating the development and expansion of microfinance in resource-poor Muslim areas along the coast. The Program and the CDA participated in on-site planning visits in both Mombassa and Nairobi, exchanging documentation and ideas. KEMCAP will most likely fund a short consultancy to a Kenyan firm or individual for the benefit of the CDA. The Program will be involved throughout the process during all phases of design, delivery, oversight, and monitoring.

The Program has identified three key areas where the CDA requires assistance: (1) the structure of its revolving loan fund, (2) the suitability of various MFIs or the CBOs as delivery channels to the target clientele, and (3) the appropriateness of its lending methodology. Each area requires direct or indirect Program support.

Next quarter, the Program will submit a request to the mission for funding a short-term consultancy, while it provides management oversight and quality control. The Program will also prepare a concept paper defining options under each of the three areas.

*Microfinance and HIV/AIDS:*

The Program continued to prepare for a training scheduled for delivery in January 2005. The course, entitled, “Microfinance and HIV/AIDS: Defining Options for Strategic and Operational Change,” is a workshop for managers of MFIs, focusing on how organizations can address the institutional challenges that arise from working in a medium to high prevalence HIV/AIDS environment. The three-day course takes participants through a series of exercises and training tools that will assist them in thinking about, planning and making institutional changes to respond to the economic impact of HIV/AIDS.

The training was developed under the USAID-funded AMAP Financial Services Knowledge Generation project. The Program brokered the training into Kenya, working together with WAM, Women Advancing Microfinance. All costs of the training will be incurred by the AMAP IQC, not the Program. Delivery dates are set for January 10 through 12, followed by two days of aftercare, helping the prepare HIV/AIDs management plans.

*Industry performance, standards and best practice:*

AMFI convened a performance standards workshop during the period. The workshop was held at the Kenya School of Monetary Studies (KSMS). The purpose of the workshop was to bring together stakeholders in the Kenyan microfinance industry to build consensus on and develop common performance standards/reporting framework for the industry.

The workshop was designed to:

- Identify critical performance indicators for MFIs
- Build consensus on how performance indicators are computed
- Build consensus on common performance standards/reporting framework for the industry
- Develop an implementation plan for establishing a performance reporting framework.

The microfinance industry was well represented. The workshop was comprised of participants from MFIs, MFI support agencies, the Ministry of Finance, the Central Bank of Kenya and the cooperative sector (SACCOs). The workshop was highly participatory, involving group exercises, plenary sessions, and panel discussions. Through the process, participants built consensus on performance standards and a reporting framework for the microfinance industry in Kenya.

The workshop ended with the participants developing an implementation plan for establishing a performance-reporting framework. A number of proposals were made, including:

- Circulate a report incorporating workshop proposals to participants, other MFIs and stakeholders for review and endorsement
- Create a task force comprised of representative MFIs to quicken the implementation process
- Organize a technical committee having accountants and MIS officers, charged with developing a final reporting framework (the process will require a review and probable customization of the Uganda PMT)
- Publish and launch final recommendations by yearend 2004
- Target first reporting by first-quarter end 2005

*Proposed implementation timetable:*

| **Activity** | **Timeline** |
|---|---|
| Circulation of the Workshop Report & Review by Technical Committee | 15 - 30 Nov. 2004 |
| Report by Technical Committee received | 15 Dec. 2004 |
| Publishing and Launch of the Kenya MFI Performance Reporting Framework / Tool | 30 Dec. 2004 |
| First Reporting by MFIs | 31 Mar. 2005 |

The participants recommended that AMFI arrange related events on a more regular basis. Participants asked for a Code of Ethics workshop aimed at creating "harmony" for guiding operations in the industry.

At USAID's request, KEMCAP attended a workshop sponsored by MESPT, the Microenterprise Support Program. Normally, leaders of various apex institutions gather informally to discuss common issues, share information and ideas intended to strengthen the microfinance industry in Kenya. These organizations include Oikocredit, Jitegemee Trust, Stromme Foundation and MESPT. The four apex institutions agreed to expand their circle and include other industry actors. The Program hopes this type of collaboration will evolve into more formal coordination targeted at the industry level.

*Central Bank of Kenya:*

While the CBK still remains hesitant to enter into a capacity-building arrangement, the Program continued to engage it through a series of face-to-face briefings and by providing it with specific information on microfinance theory and practice.

The Program will take a soft approach in working with the CBK until it becomes more receptive.

*DFID Output to Purpose Review:*

KEMCAP sourced an assessment of a bank in Malawi jointly financed by DFID and USAID. The Program will oversee all work, ensuring deliverables are met on time and with within other agreed terms. The proceeds of the assignment will contribute to AMFI's cost-share agreement with USAID Kenya, while strengthening the association's bottom line, approximately $24,000.

*FAO funding proposal:*

At the request of AMFI's executive director, the Program prepared a funding proposal that was submitted to FAO. The proposal informed FAO that AMFI hopes to create a Competitive Small Grant Program with a $500,000 grant from USAID. AMFI requested an additional $1,000,000 from FAO to increase the facility's capital. No decision has been taken, although the FAO proposal indicated that USAID will provide the initial capital and the Program will offer ongoing technical assistance.

The purpose of the grant facility is to overcome industry sluggishness due to marginal or declining profitability and institutionalized conservatism by pooling and spreading risk thereby spurring product development and innovation. Lessons learned will be considered a public good, disseminated and shared throughout the industry using AMFI's website and other media channels.

As noted earlier, AMFI's request to USAID for capitalizing a small grant facility is in jeopardy. Without proper technical guidance and management oversight, the safe and sound use of donor funds will be endangered. Further, should AMFI's USAID request be denied, FAO should be informed since its request was predicated on USAID capitalization and technical assistance.

### 3. Gender Participation and Discussion

USAID Kenya, after conferring with the American embassy, approached the Program for design advice given an expression of interest to support and work with women-owned and/or operated businesses. The Program suggested embassy funding could be used to finance a new DCA for lending to the stated target market through a commercial bank. Technical assistance and business development could be built around the product and offered to the participating bank and its clientele.

The Program coordinated with the group WAM, Women Advancing Microfinance, to bring the workshop, "HIV/AIDs in the Workplace," to Kenya. WAM is a leading microfinance group for women throughout the globe.

### 4. Public Private Sector Leverage

The Program worked closely with Pipal, a private-sector agriculture enterprise, on the design and marketing of a warehouse receipting scheme to Cooperative Bank of Kenya. This relationship will continue into 2005.

### 5. Institutional Strengthening of Grassroots Organizations

As its primary focus, the Program strives to build capacity inside AMFI. The process, however, is more complicated than envisioned, given the pace of and acceptance of change. With CTO concurrence, the Program will begin to work closely with AMFI's board to manage institutional transformation from the top down. In the absence of change, USAID's investment in AMFI is at risk—in terms of implementation results and financial oversight as evidenced by contractual compliance and performance to date. The program, as suggested by USAID, will begin to meticulously document AMFI's issues, problems and change management.

The Program has entered into a partnership with the Coastal Development Authority to build capacity. KEMCAP has also begun working closely with JM Mantle, an indigenous local consultancy. Work with both will continue in 2005.

The Program will soon begin work with SMEP (a microfinance provider intent on transformation to a commercial entity).

### 6. Success in Promoting Agency Objectives and Values

By working through AMFI with various government agencies, the Program supports the USAID objective of private-sector led development. Inside AMFI, the Program has identified the need to increase management accountability and build transparency to the board and donors alike. In turn, working with the board should instill similar practices and approaches, creating reference points for these high-caliber CEOs.

## B. Administrative

No significant administrative actions occurred during the period.

## C. Expenditures to Date

| Category | Budget Amount | Cumulative Amount | Remaining Amount | Percent Expended |
|---|---|---|---|---|
| Workdays Ordered | 1,167,582.00 | 200,998.56 | 966,583.44 | 17.21% |
| Less 5% Withheld | - | (10,049.93) | - | - |
| ODCs | 667,185.00 | 166,780.84 | 500,364.16 | 25.00% |
| G&A @ 8.28% | 55,240.00 | 13,809.45 | 41,430.55 | 25.00% |
| **TOTAL** | **1,889,967.00** | **371,538.92** | **1,518,428.08** | **19.66%** |

USAID requested that KEMCAP curtail its use of short-term technical assistance due to mission funding constraints. The Program has a negative budget variance of 12%, i.e. spending is slightly trailing projections, which is expected since USAID's request has been followed. This action should allow the Program to extend the life of its $800,000 obligation. Of the $800,000 that is funded, the project has expensed 46.44%.

## C. Successes

KEMCAP brokered a HIV/AIDs in the workplace training into the country at no cost to USAID Kenya. The Program also suggested the design of a new financial product to USAID that is in the process of adoption, funding permitted. KEMCAP negotiated the review of a microfinance bank that will add approximately $24,000 to AMFI's cost-share contribution, an important addition since the association's funding dilemma hinges on increasing and documenting its counterpart.