EQUITY BANK AND THE HUNGER SAFETY NET PROGRAMME (HSNP) IN KENYA

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FSD Kenya
Financial Sector Deepening

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FSD Kenya
Financial Sector Deepening

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

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Table of Contents

Tables and Figures

TABLES

FIGURES

Chapter 1

INTRODUCTION

In November 2010, Equity Bank, headquartered in Nairobi, Kenya, had done what everyone thought impossible. They had established a network of agents in villages throughout the four deserted northern provinces of Kenya who were capable of distributing KSh2150 every two months to 48,000 impoverished beneficiaries of the Hunger Safety Net Programme (HSNP).

Paul Waihumbu, Equity's manager for the project, allowed himself a smile. Everyone agreed that Equity's achievement had been remarkable. What had been a source of tense uncertainty only 18 months before was now a source of considerable satisfaction.

But Waihumbu knew that this was merely the beginning. Not only were there an additional 12,000 targeted beneficiaries to be served, but Equity's intention was for this pilot project to become a foundation for participation in other social transfer programmes. More importantly, they intended it to become the leading edge of a major expansion of their longstanding provision of financial services to the unbanked people of Kenya. Furthermore, the credibility of Equity's expansion into other east African countries was at stake. Their ability to manage the challenges of rural northern Kenya would be indicative of their creativity and tenacity in the difficult environments of Somalia, Ethiopia, and Uganda.

Waihumbu knew that the HSN programme operations were, so far, financially dependent on the subsidies provided by the programme donors. Equity had invested heavily in establishing four new branches in the four remote districts, and they had also subsidized the provision of the equipment which made the wireless financial transactions and beneficiary authentication possible. The company's investment was not merely a public service which Equity had undertaken as corporate social responsibility but a core element in their strategy of customer expansion, a strategy that was central to Equity's projected revenue and profit growth. Waihumbu's boss, Allan Waititu, who was Equity Bank's Director of Projects, was a keen advocate of the HSN project. But he was paying close attention to how the expansion of the project would fulfill Equity's expectations that scale would yield profitability.

1.1 EQUITY BANK'S HISTORY

Equity Bank was founded in 1984 as the Equity Building Society to provide financial services for Kenyans with low income. While its sense of purpose was strong, its operations management was not. The result was that, by 1993, 54% of its loans were non-performing, and it had accumulated losses of KSh 33million. Equity was declared insolvent by the Central Bank of Kenya (CBK) providing a one-year window to turn the company around.

In 1994, Equity Building Society began a renewal. This renewal was led by James Mwangi who reaffirmed the company's basic mission to the poorer people in Kenya, but brought creative, disciplined management alongside his inspirational leadership. As one of the founding investors, Mwangi left a secure and lucrative position as Group Financial Controller of Trade Bank to become Chief Financial Officer of Equity¸a position he held until becoming CEO in 2004. Having been raised in a poor family, he identified with the poor people of Kenya and found that Equity's "cause", which had led to his initial investment, appealed to his "heart and soul".

Perceiving the needs of unbanked Kenyans more clearly than other banks, Equity developed savings products which were easily accessible and attractive to people with little income and few assets. On the strength of those savings deposits, they built their loan portfolio. To manage the large volume of small deposit and credit accounts, Equity developed administrative efficiencies through the extensive use of information technology. The combination of innovative products and administrative efficiency directed at the large, neglected market of unbanked people catapulted Equity into the top ranks of Kenyan banks.

In December 2004, Equity Building Society was legally transformed into a commercial bank with the new name, Equity Bank Limited. In August 2006, the bank became listed on the Nairobi Stock Exchange with an initial valuation of KSh 6.3billion. Table 3 shows the financial highlights from the company's 2009 annual report. Table 4 shows Equity's place in 2007 among Kenya's top 15 commercial banks. By any measure, Equity's growth was phenomenal. At the end of 2009, Equity's Kenyan operations had more than 4 million bank accounts. That translated into more than 50% of all bank accounts in the country. Equity had also received various awards, both locally and internationally, for their superior performance.

1.2 FUTURE GROWTH AND DEVELOPMENT

Equity's growth strategy included expansion into other countries in the East African region, most notably through the acquisition of Uganda Microfinance Limited in 2008. But they also saw opportunity within Kenya as only 5 million of the estimated 15 million Kenyans living on less than $2/day had access to banking services.

The bank remained clearly focused on this poorer segment of the retail banking market. According to the 2009 annual report, the bank had the following purpose: *"We exist to transform the lives and livelihoods of our people socially and economically by availing them modern, inclusive financial services that maximize their opportunities."*

To accomplish its objectives for growth in this market, the bank was developing an "agency model". This was a strategy in which wireless communications technology was used to provide "branchless banking" through a network of merchants (agents) who already existed in towns and villages. The GSM communication network which enabled mobile phone service was employed to accomplish financial transactions through the use of "point-of-sale" (POS) devices and/or mobile phones. The bank would hire and train local merchants to expand their current sales by conducting money transfers of funds between individuals, or from individuals to companies or agencies. It would allow people to receive and send funds at their convenience. For this service, the merchant and the bank would each receive a fee. Such branchless banking allowed the bank to provide its services at a much lower cost than through a conventional branch, a mobile bank van, or even an ATM. Figure 1 compares the capital and operating costs of various financial service outlets.

In Equity's view, agents were the future for retail banking in Kenya. That's because the principal value of the model was its use of technology to bring affordable financial services to new customers who were in remote geographical areas. Opportunities to do that matched Equity's growth strategy.

Chapter 2

THE HUNGER SAFETY NET PROGRAMME (HSNP)

In December 2007, Financial Sector Deepening – Kenya (FSD Kenya) issued a Terms of Reference (TOR) requesting expressions of interest (EOI) for a pilot project to distribute cash payments to 60,000 beneficiaries in the most remote parts of northern Kenya. FSD Kenya was a specialist development programme originally established by the UK government's Department for International Development (DFID) to provide a continuing mechanism through which donor agencies in Kenya could pool their efforts to support the development of inclusive financial markets. In addition to DFID it was funded by the Swedish International Development Agency (SIDA), World Bank, Agence Francaise de Developpement (AFD) and the Gates Foundation. Because of its local expertise and experience in financial service development, FSD Kenya was asked by DFID to take responsibility for developing a solution to the payments element of HSNP. FSD undertook a long process of market preparation before issuing an open call for tenders to provide payments services.

The continuing objective of the HSNP was to deliver long-term guaranteed cash transfers to chronically food-insecure households. The pilot programme was aimed at 60,000 households in the four northern districts of Turkana, Marsabit, Mandera, and Wajir. These districts were known as the arid and semi-arid regions of Kenya with often more than 50 kilometers of dusty dirt roads and cross-country driving between villages. Foliage of any sort was rare making it hard to imagine how the small herds of goats, donkeys, and camels, and their nomadic owners, survived. Rugged four-wheel drive vehicles often broke enroute to some villages in these "pastoral" areas. It was an environment that tested the resolve of anyone who sought to serve these people. Figure 2 provides some photographs of the region.

The pilot project was designed to distribute KSh.2,150 every two months to each of the 60,000 households that were targeted in 200 of the 434 sub-locations throughout the four districts. The pilot phase was being used to build evidence of the impact of the cash transfers, and that evidence would inform the second phase. If the three year pilot phase was successful, the government of Kenya would consider joining DFID to expand to a national social protection system addressing the needs of 2 million Kenyans living in extreme poverty.

The TOR specified clearly the criteria for the contract. Table 5 summarizes those criteria and their relative importance. FSD Kenya determined that the chosen service provider would distribute the payments through a "store-of-value"[1] (versus mere cash payment) and that there be the potential for further financial services beyond the store-of-value account. The purpose was to provide beneficiaries with the opportunity to manage their benefit more carefully and begin to engage financial institutions which could help them build the human and financial assets necessary to overcome their chronic food insecurity.

In February 2008, FSD convened an assessment panel of experts to evaluate the 12 responses to the TOR and short-listed eight of them. Those eight organizations or consortia were invited to submit full, formal proposals. Four of the eight did so. One of those proposals was from Equity. Equity had a very strong track-record of extending financial services to poorer people in Kenya, was obviously well-positioned to offer other financial services beyond the HSNP payment, and offered to establish substantially more points of payment than competing bidders. However, they did not have direct experience with social transfers. Despite that fact and the daunting challenge of accessing the beneficiaries, Equity bid very aggressively on price and showed a convincing commitment to accomplishing the program. In April 2008, they were selected by the bid panel to provide the payments.

2.1 EQUITY'S DECISION PROCESS

Equity had a carefully developed strategy of corporate social responsibility (CSR). Among other initiatives, this included scholarships for academically gifted orphans and vulnerable children, innovative financing for farmers throughout the full value chain of agricultural production, and creative use of technology to expand access to financial services. But the bank's intention, as stated in the 2009 annual report, was to "embed corporate responsibility into its core business." The decision to bid for the HSNP contract was driven by this marriage of social responsibility and business opportunity.

The bank's executive committee, relying on the technology committee, examined the risks of offering the first smart card, wireless, solar-powered, biometric point-of-sale infrastructure for social transfer payments in the region. There was a high potential for failure on the part of the technology as well as the operational disciplines necessary to instill in the agents chosen to employ it. Alternative projects for bank investment had looked attractive; but in the end, the executive committee reaffirmed the bank's foundational strategy to advance into the unbanked retail market using technology and operational discipline.

2.2 PROGRAMME IMPLEMENTATION

Having won the bid, Equity then joined a team of six agencies designing and managing the HSNP. This team had two particular challenges: to administer successfully a programme that almost no one believed was possible because of the array of technical and environmental difficulties inherent in it; and to manage that difficult programme by committee. Table 1 outlines the agencies involved and their respective roles in the programme.

Each agency was represented by a strong-minded, experienced individual who had clear opinions about the character and impact of the programme. Collaboration among the team members was to be coordinated by the HSNP Secretariat which had the power to convene the team but was not given a strong mandate to resolve the disagreements which often arose. The team's work was complicated by individual agency assignments that would, at points,

[1] A "store-of-value" is an account which may or may not be a bank account, into which and from which funds can be (electronically) transferred and which can hold financial value.

duplicate the responsibility of another agency; and by the discovery, at other points, that essential elements in the programme had not been assigned to anybody. The glue that ultimately kept the team together was each member's stubborn resistance to failure and their sense of participation in something really special, a pioneering effort of unprecedented value. By the end of the first year of operation in January 2010, most team members were amazed and deeply pleased with how far they had come. Without exception, they credited much of this early success to the skill and tenacity of Equity Bank in its roll-out of the agent network payment scheme.

Table 1: HSNP component organisation

Component agency	Function
Department for International Development (DFID)	Funding agency w/intention of scale
Financial Sector Deepening – Kenya (FSD Kenya)	Manage payments component
Oxfam International	Programme admin, esp. beneficiary targeting
Help Age International	Beneficiary rights
Equity Bank	Payment service provider
Oxford Policy Management	Programme monitoring and evaluation
HSNP Secretariat	Coordination of component agencies

2.2.1 Technical means of implementation

Equity's chosen method for making the payments combined a "smart card" with a wireless point-of-sale (POS) device. These were both technologies with which Equity was familiar in their normal bank operations. The smart card was a plastic ATM-type card with an embedded computer chip which contained identification information about the beneficiary/card-holder and current information about the benefit to which the beneficiary was entitled. The POS device, while familiar, included an additional feature: a biometric fingerprint reader which would be used to identify the beneficiary. Because of this feature, the POS could be used in locations where there was no wireless (GSM) signal. This was important as the places without wireless signal coverage tended to be the most remote areas where many of the HSNP beneficiaries lived. In such cases, the POS was taken to a place where there was a wireless signal and loaded with beneficiary and payment information. Back at the agent's shop, the payments would be recorded on the POS for subsequent downloading to the central HSNP database.

The process of payment began with an insertion of the smart card into the POS device and an initial fingerprint reading to verify that the person was the entitled beneficiary. Once established, the appropriate benefit of KSh.2150 was recorded on the card's computer chip as a data file. The POS then printed a receipt showing that the legitimate beneficiary had been given the value to withdraw. The next step was a second fingerprint reading to authenticate, again, the beneficiary who was then eligible to receive as much of the recorded benefit funds as he/she wanted. Funds could be left on the card as a kind of "stored value" for future payment, or the entire amount could be withdrawn. The agent would type the amount of the payment into the POS, another receipt would be printed showing the amount of the withdrawal, and the beneficiary would be paid that amount in cash.

2.3 GOVERNMENT REGULATION

According to the regulations established by the Central Bank of Kenya (CBK), using agents for payments like HSNP was permissible. And CBK had no quarrel with the accumulation of funds on the stored-value "accounts" of the beneficiaries. However, CBK had not granted permission for bank agents to receive funds from the beneficiaries. In other words, deposits into any kind of savings or transaction account could not be taken by an agent. Of course, beneficiaries were free to open accounts at an Equity Bank branch, but that was obviously impractical for all but a few HSNP beneficiaries.

In April 2010, CBK was due to publish new regulations which would permit deposit-taking by bank agents. This would facilitate Equity's fulfillment of not only its own growth strategy but also the intention it stated in the HSNP proposal to extend other financial services to the HSNP beneficiaries. The only cloud on that horizon was the intention of the CBK to charge a licensing fee of KSh.5000 per year for each agent.

2.4 AGENT EXPERIENCE

On the rugged, barren road between Lokichoggio and Lodwar in northern Turkana district (see map in Figure 3) lies the town of Kalobeyei. One of the first agents commissioned by Equity was a man named John Moite whose shop had grown as a direct result of the HSNP. He was a native Turkanan, had lived all his life in Kalobeyei, and had some standing in the community before the programme. He worked in the shop with his wife, and they collaborated on the HSNP payments. He began the service because of the community value which the programme had, but he would not have done so without the commission which he earned on each payment. Since beginning the payments, spending at his store had multiplied, and he was currently willing to make the payments without the commission. There were ~500 recipients who each received Ksh.2150 every two months. That translated to a total of over Ksh.1MM in potential new spending. He had expanded his shop dramatically with increased inventories, had added phone recharge to his business because of the solar generator supplied with the programme, and had added a maize mill which he purchased out of cash flow (versus debt) as a new business. He intended to build himself a more permanent home in the near future. Not surprisingly, he was very satisfied with the programme, and his stature in the community had risen considerably as a result of the perception that he was not only doing well financially but also helping people.

The primary wrinkle in his experience was liquidity: he had to travel to Lodwar (2.5 hours drive) every two weeks (four times for each two month payment cycle) to get funds from his account at the Equity branch in order to service the recipients. His business, despite having grown, did not generate sufficient cash to make all the payments. He had access to a car with which to make the trip; but he remained fearful of robbery, often using a ruse like taking a holiday when he went to the bank. He transported cash in bags normally used for carrying charcoal instead of the more customary valises. He also experienced what appeared to be a common problem: the failure of a recipient's fingerprint to authenticate the person. While not a frequent problem, it almost always proved time-consuming to resolve. Otherwise, the smart card and point-of-sale device system had functioned well.

South of Kalobeyei on the road to Lodwar was the town of Kakuna. Because of its size, Kakuna had two HSNP agents, one of whom was a very prosperous Somali Kenyan. Throughout Kenya, Somalis were known as shrewd traders, and this man had built a good wholesale business alongside his retail store. He began the HSN payment programme because of the commission, but had also been able to reduce the frequency of trips to the bank in Lodwar and the associated risks of robbery. Unlike many agents who needed supplementary cash, this man had cash in excess of what was consumed by the programme payments. Other than a few technical problems with fingerprint authentication, his primary concern was to serve a larger number of recipients to further reduce his abundant cash. Though he recognized the community value which the programme had, participation was, for him, a simple business proposition.

Unlike Kalobeyei and Kakuna which had the advantage of its "highway" location, the settlement of Turkwell was 40 kilometers east of Lodwar with no sign of life in between. You have to know the way as dirt roads blend into stretches of thick sand and dry river beds. Mama Cash, whose given name was Dorcas, managed a small shop with her husband out of which she paid approximately 250 HSNP recipients. Her new identity, proudly displayed on her store, had been given in recognition of her HSNP role. Her mobile phone was permanently perched on a shelf in the store, evidence of the only location in which she could receive the wireless phone signal.

In contrast to the disciplined, orderly payment process that John Moite had been trained to implement, Mama Cash's beneficiaries completely ignored the schedule for payment, and she had accommodated them, in part, by going to Lodwar once each payment cycle to withdraw more cash from the Equity Bank branch. Her beneficiary load was due to double in the coming months as the programme expanded, even with the addition of two new agents. She was confident she could handle the volume, though it was not clear how she would do that. Unlike Moite, Mama Cash's store business had not expanded substantially, though some beneficiaries did buy some goods from her store, spending as much as KSh.150, usually on sugar. A few recipients purchased some staples for resale in their own villages.

A retired government officer served as the second agent in Turkwell. He was involved with HSNP because he did not want to be bored in his retirement. He too served about 250 beneficiaries, most of whom also seemed to ignore their scheduled payment day. He successfully avoided boredom by making 2-3 trips to Lodwar each cycle to get cash. T he frequency of these trips reflected his fear of carrying cash because of a frightening near robbery when he first began making payments. The cost of each trip was either Ksh.300 by "public" van or Ksh.2000 by private motorbike which was much more secure. These costs were not fully compensated by the commissions he received. As a result, he wanted Equity to loan him funds for a motor bike.

According to Boniface Ichwaa, one of Waihumbu's field managers, agents throughout the four districts reported that the POS devices and the wireless network functioned well. While all agents reported incidents of unreadable fingerprints, it was a very small percentage of the total and loomed large only because of the time required to solve the problem of a frustrated beneficiary. Paying a beneficiary who had missed the previous payment was even more time-consuming. To accomplish this additional payment, Equity was required to replace the unused value on the card, an awkward and unanticipated exception to the standard process. Ichwaa also noted that many agents required supplementary cash from the local branch of Equity to meet the liquidity needs of the programme.

During the first year, Ichwaa and Waihumbu had discovered some of the challenges in establishing agents in small villages. As people who lived on the margins of existence, shop merchants, like the people they served, were skilled in doing whatever was necessary to survive. This entrepreneurial drive showed the skill and determination Ichwaa knew was necessary to administer the HSNP payments, but it coincidentally meant that these merchants were not inclined to conform to a system that required disciplined, repetitive transaction and reporting procedures. This was multiplied in the case of some agents whose business savvy made them prone to creative exploitation of the system. One example of that had been the discovery of an agent who had intentionally provided partial payments so as to multiply the number of transactions and thus his commissions.

Lawlessness in these districts was also rampant. The fear of robbery in transit to and from an Equity branch was justified. The growing influx of Somali combatants/immigrants into Manjera and Wazir magnified that issue in those districts as crime had created a growing insecurity among both residents and business people.

Of the 83 active agents, 10 had been prior bank customers, though most of them had been dormant prior to HSNP. Since becoming part of HSNP, a majority of the 83 had begun saving at the bank and had accessed other bank products like loans and checking accounts. Deposits and transaction volume had increased 45% with most agents using their account on a daily basis. They repaid loans on-time, had regular contact with bank staff to learn of new products, and had introduced new customers, including HSNP recipients, to the bank.

2.5 BENEFICIARY EXPERIENCE

Three elderly male recipients in Kalobeyei indicated that they were very satisfied with the system and grateful for the income. However, none of the three used much of the KSh.2150 payment for food because they were benefiting from a separate supplemental food grant. Instead, they used it for education, healthcare, and clothing, primarily for family. This was typical of beneficiaries in other locations. At least two of the three felt that, where they had previously been ignored by their community, they had become recognized people since beginning to receive the benefit. One, pointing to his proper clothes, said: *"I have become a man."*

According to Moite, the HSNP payments had relieved recipients of the necessity of selling livestock to buy food or pay for schooling or healthcare; and one recipient said he had used HSNP funds to obtain veterinary care for livestock, thus protecting assets necessary for survival.

In measuring the value of the payment system for beneficiaries, Waihumbu used several criteria which indicated the system was effective. Table 2 shows those criteria and the results.

Most beneficiaries withdrew the full KSh.2150 benefit, and almost none of the beneficiaries had opened bank accounts. Three women who were receiving the payment for a disabled relative said they received the full payment to avoid being accused of taking any of the money for their own benefit. Most recipients reported using the money for education, healthcare, asset acquisition, asset protection, potential consumption (livestock), and income generation. Other than the residual card balance, any savings took the form of an asset purchase.

2.6 EQUITY'S EXPERIENCE

Waititu, Waihumbu, and Ichwaa all noted that Equity had from its inception sought to serve people at or toward the bottom of the economic pyramid. They had intentionally focused on unbanked people. The HSNP programme was a natural extension of that business strategy. Furthermore, they had become convinced of the need to develop a full-blown agent banking strategy for business expansion even before HSNP, so the programme gave them a valuable opportunity to learn lessons about the promise and pitfalls, and to do so at a subsidized cost. The HSNP also provided an opportunity to address the undesirable regions of the north. They welcomed the challenge to expand further into the unbanked population of Kenya and provide credibility for their extension of services into Somalia, Ethiopia and Uganda.

Equity had chosen to open five new branches in the four HSNP districts, a decision that was motivated as much by their strategy to expand into more remote areas as it was to service the HSNP. Legitimate returns to the investment in these branches would necessarily require business beyond the service payments from HSNP. According to Waihumbu, that business had materialized such that the branches had passed break even and were making significant contributions to bank income.

The strategy to expand their business via agents who could also take deposits was to be rolled out in a very measured fashion. The bank needed to find agents capable of handling the responsibility of deposits. They hoped HSNP agents would prove capable of assuming that role, but they already knew that some, perhaps many, were not ready to handle the responsibility of more cash. Others might not want the additional cash brought by deposits because of security concerns. Equity also knew that community members would need to develop trust in giving their money to an agent rather than to a "real" bank branch.

One key to the success of that rollout was the underlying MIS system which would need to work flawlessly. That had been a historic strength of Equity's

Table 2: Beneficiary experience criteria and results

Payment criterion	Result(s)
Accessibility: Proximity & availability.	All agents/shopkeepers within 20 km radius.
Timing	95% of payments within the 2 month programme window.
Suitable means (given 80% illiteracy).	98.5% successful/1.5% unsuccessful payments.
Security	Biometric authentication has guaranteed correct household receives payment – has produced beneficiary confidence.
Savings	20% of beneficiaries leave average 30% of payment on card per cycle. Saved balance usually withdrawn after second savings cycle.
Financial services	Beneficiaries are able to make at least four withdrawals and balance checks per payment cycle. Livestock insurance offered in one district.

business model, but this expansion required an entirely new level of control procedures.

The strategy of using deposit-taking agents for growth was essential because of Equity's historic dependence on inexpensive funds from savings deposits (at a cost of ~1%) which could then be available for loans (at a rate of ~15%). This was the heart of their revenue and profit model, and Equity's management expected the model would continue as beneficiaries became full bank customers. They knew, however, that the costs of managing an extensive, disbursed, independent agent network were still unknown and could prove expensive, especially compared to more typical agent partnerships with large retail chains.

As of December 2009, the funds Equity had received for administering the payment service, including contributions to the capital expenses of start-up, had exceeded their expenses by 22% of those costs. That positive cash-flow did not, however, account for direct staff costs and allocated overhead expenses. Those staff and overhead expenses for both branch and headquarters operations, as calculated for the 12 months through November 2010, were considerably more than that initial cash-flow surplus. As a continuing cost, they amounted to $1.20 (KSh96) per beneficiary payment[2] which was 20% higher than the cost per payment Equity quoted in their bid. However, Equity management expressed their willingness to accept such losses in anticipation of their ability to cross-subsidize the losses with other bank products and services.

In order to build on its investment and experience in HSNP, Equity was bidding on other social protection programmes being introduced by the government and private donors. Kenya was preparing to expand an existing programme for orphans and vulnerable children, and the World Food Programme was planning a pilot programme to explore the replacement of food aid with cash in emergencies. In addition, DFID was planning a hunger safety net programme for Uganda. As with HSNP, Equity believed that the beneficiaries of these G2P programmes would, in the long-run, become customers.

2.7 HSNP TEAM MEMBERS' OBJECTIVES

While Equity had to stay clearly focused on the evolution of the HSNP programme into the larger, financial self-sustaining agent strategy for business expansion, it also needed to account for the purposes of the other component members of the HSNP team. To a person, the leaders of the individual team components were amazed at how well the first year of operations had gone and were exceedingly complimentary of Equity's achievement in establishing the agents in the various towns and villages. They had a deep appreciation of the hurdles presented by the forbidding environment of the arid districts.

Yet, Waihumbu knew that DFID had a strong conviction that the HSNP programme should be merely the prelude to a much larger effort to reach 2 million people in 10 years. There would be pressure for rapid programme expansion. The team members from Help Age International who were charged with assuring the rights of the beneficiaries were at least as formidable a force. Operating with the conviction that the HSNP payments were a human right, not merely a benefit, they held uncompromising standards for timely and accurate delivery. Their simple standard was 100%; and they held Equity Bank accountable for assuring payment despite the inevitable problems like missed payments to wandering nomadic herders.

Wiahumbu understood the social value of assuring that beneficiaries didn't have to absorb the losses that came with the flaws which any system has. He knew the rights people respected Equity's accomplishment so far and understood the effectiveness of a for-profit service provider in the scheme. But he was not sure that they understood how, in order to fulfill the rights' objectives, Equity would also have to fulfill their own profit objectives. He was not sure they understood that, unless those two objectives accommodated each other, neither would be served. In other words, what was appropriate for Help Age to expect from a company with limited resources, especially knowing the risk that beneficiaries would receive poor service from a provider that lacked the motivation of efficiency inherent in a for-profit company?

2.8 EVALUATION

Waihumbu knew the bank needed to execute well the business opportunity with unbanked poor people. And he believed that successful operations would fulfill the social objective of transforming people's lives. He was not unaware of the potential for tension inherent in attempting to achieve both profitability and social good. But he echoed the belief of everyone at Equity that the two could coincide: "The unbanked? That's what we do!"

The HSNP experience so far had lent credence to that confidence. The payment system had proven effective and efficient. While not fully profitable, the model was self-sustaining and Waihumbu believed that scale would accelerate the arrival at breakeven. The adoption of HSNP by the new bank branches caused a focus on cost reduction that had prepared the branches for a full scale programme without the need for any supplementary programme staff. The payment system had proven transparent and easily audited. The two factor beneficiary authentication had achieved effective payment integrity. And Equity could capitalize its investment by selling its distribution network to other service providers.

However, as Paul Waititu noted, if Equity ultimately failed to develop a profitable business and had to withdraw after the HSNP initiative, they would undermine the fundamental image and reputation of service to the under-served which had been the foundation of the bank's success.

[2] Source: Equity Bank data for 12 months through October 2010. Assumption of 60,000 beneficiaries being paid.

Building that profitable business was complicated because the lives of the HSNP beneficiaries, and Equity's future customers, were so difficult. The mobility of beneficiaries in their quest for survival complicated the provision of services. Ethnic differences among the people meant that some agents were not trusted by all the local people. Long distances between villages made marginal groups more difficult to serve. And the issue of safety loomed not only over the agent merchants as they transported cash, but over the people as well. Agents mirrored their communities in their efforts to survive, showing a self-interest in their commercial behavior that complicated Equity's judgment about when to trust and when to control them. Was it possible that Equity had already chosen the best agents in each town or settlement? Would expansion depend on even tighter agent management?

Waihumbu also knew Equity had to interact closely with their customers to build the trust essential to drawing in unbanked people, a trust that was at the heart of their reputation. This was a task that was more difficult to do through agents than through branches staffed by employees. They also needed to offer other attractive products; and while they had already extended credit to traders among their existing customers, those products would need to be tailored to nomadic farmers.

Nevertheless, Waititu was optimistic: *"Though it is still early to have real lessons, we are ready to scale up because we know the economies of scale."* Waihumbu was also optimistic because he knew Equity had the right technology, that the services were good for the consumer, that they had the right training materials for the agents (despite illiteracy), and that they were one of the most efficient banks in the country.

Their experience told them that as these marginal, unbanked people grew in economic capability, Equity would grow with them. But was a new dose of technology, in concert with their established skill and undaunted courage, sufficient for success?

ANNEX

Table 3: Equity Bank financial highlights – 2009 annual report

KSh, millions	2007	2008	2009
Total Assets	53,076	78,879	100,812
Profit Before Tax	2,378	5,022	5,278
Customer Deposits	31,536	50,334	69,843
Customer Numbers (000's)	1,840	3,296	4,371
Gross Loan Portfolio	22,228	45,195	65,732
Borrower Numbers (000's)	370	619	776

Table 4: Summary statistics of banks in Kenya (2008)

	Total Assets (KSh, millions)	Return on Average Assets (%) (2007)	Profit Before Taxes (KSh, millions)	Core Capital (KSh, millions)
Kenya Commercial Bank	191,212	3.97	6,013	16,187
Barclays Bank Kenya	168,510	5.14	8,016	19,980
Standard Charter Bank	99,020	5.70	4,720	9,332
CFC Stanbic Bank	83,166	3.97	N/A	5,952
Equity Bank	78,837	6.39	4,988	14,272
Diamond Trust	56,146	3.73	1,604	4,457
Citibank	47,535	4.19	3,353	8,898

Source: The Banking Survey, 2008 and 2009; Think Business Publications

Table 5: HSNP service provider proposal criteria

Objective	Description of criteria	Weight (%)
1. Price	Cost effective: defined by the bid matrix provided.	30%
2. Value to recipients/ beneficiaries	(a) Accessibility to recipients: Proximity; availability; speed; suitability; security; (b) Additional financial services available to recipients.	30%
3. Ability to deliver payments to recipients	(a) Demonstrated track record. (b) Credible detailed plan.	30%
4. Improve financial access to the general population of non recipients	(a) Additional financial services available to non recipients.	10%

Note: These evaluation criteria were applied to bidders who had fulfilled mandatory eligibility requirements.

Figure 1: Capital and operating expenses: Financial distribution points

Source: BFA (2006) using norms prevalent in developing countries. Note: log scale compresses cost differential

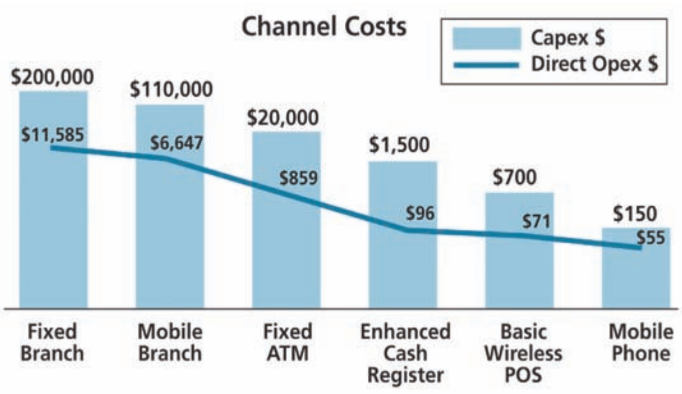

Figure 2: The landscape of Turkana region

Figure 3: Map of Kenya

NOTES

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