



LOUVAIN
School of Management

UNIVERSITE CATHOLIQUE DE LOUVAIN
LOUVAIN SCHOOL OF MANAGEMENT

DISRUPTIVE INNOVATION IN MICROFINANCE – THE CASE OF KENYA

Supervisor:
Prof. Frank Janssen

Research Master Thesis submitted by
Marius Declerck

With a view of getting the degree
Master in Management

ACADEMIC YEAR 2015-2016

This master's thesis was written during the academic year 2015/2016, in view of completing the master's degree in Management, and under the guidance and supervision of Prof. Frank Janssen, Louvain School of Management, Université Catholique de Louvain.

Several individuals merit special and explicit thanks for their invaluable contribution to this work:

First, I would like to thank my supervisor, Prof. Janssen, for his guidance throughout the development of these analyses, and for his input on constructing and presenting qualitative findings.

I would also like to thank Mrs. Milissen and Dr. Verelst for the countless hours spent on proof-reading and improving this report; Madam Ambassador De Bilderling, Mr. Otieno and Mr. Declerck for allowing me to tap into their network at Kenyan microfinance institutions; and last but not least, I would like to thank all the interview respondents who, despite their busy schedules as microfinance executives, made time to sit and discuss with me the topic of innovation in microfinance.



Marius Declerck
Author

ABSTRACT

Microfinance has made great strides since its popularization by Mohammed Yunus in 1982, but the industry is now coming of age and an important question stands in front of microfinance institutions: do they follow their current customers upmarket, or do they instead maintain their focus on the ‘banking the unbanked’? While the answer to this question is everything but straightforward, and empirical research overall has found mixed results, an important stream of it is criticizing microfinance institutions of abandoning their social mission in favour of higher financial gains – a process known as *mission drift*. This study contributes to the mission drift debate by analysing the case of microfinance in Kenya. Specifically, it does so through the lens of disruptive innovation, a theory which conveniently sorts innovations according to whether they encourage upstream or downstream movements. The findings provide mixed answers to the question of whether mission drift is present in Kenya. Crucially though, they also reveal that a possible reason for which prior research has been inconclusive or has diagnosed mission drift is because of an outdated categorization of microfinance institutions. Furthermore, the innovation scan of the Kenyan market appears to further corroborate this by identifying both sustaining and potentially disruptive innovations, and by suggesting that socially-oriented institutions are more likely to detect disruptive innovations. Implications for microfinance practitioners are discussed, and future research avenues are explored.

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LIST OF ABBREVIATIONS

AMFI-K	Association of Microfinance Institutions, Kenya
EIB	European Investment Bank
KWFT	Kenya Women's Finance Trust
MFB	Microfinance Bank
MFI	Microfinance Institution
MSME	Micro, Small and Medium Enterprise
SACCO	Savings and Credit Co-Operative

1. INTRODUCTION

Since its formalization by Mohamed Yunus in 1982, microfinance has made great strides, both as an industry and as a tool against poverty. Maes and Reed (2012) for example estimate that in 2010 – roughly 30 years after Yunus founded the Grameen Bank in Bangladesh – microfinance worldwide counted 137.5m customers borrowing a total of \$52.6bn. It is certainly with this in mind that researchers at the Wharton School of the University of Pennsylvania named microfinance the seventeenth most influential innovation of the past 30 years (Wharton, 2009). It is also in the light of such inspiring data that Yunus and the Grameen Bank were awarded the Nobel Peace Prize in 2006.

Kenya, the focus of this case study, has been a success story in its own right: according to responsAbility, a global microfinance investment vehicle, the country's microfinance market has experienced recurrent year-on-year growth of over 20%, rising from the 11th biggest worldwide in 2013/2014 to 3rd biggest in 2015/2016 (Hug *et al*, 2016). In the process, financial inclusion of poorer Kenyans has greatly expanded – especially for those in urban and peri-urban areas (Central Bank of Kenya & FSD Kenya, 2013).

The industry is now slowly entering into the next phase of its development, where on the one hand, financial service delivery needs to be formalized as per more rigorous banking standards, and on the other hand, microfinance institutions (MFIs) are being solicited for the financial inclusion of the next tranche of unbanked citizens – a target which is often poorer, more rural, and more geographically dispersed than the previous one. Innovation is playing a key role in unlocking this transformation (Manos *et al*, 2013). Powerful innovative forces abound in microfinance, as noted by a study on expert opinions about transformational trends in the industry (Hug *et al*, 2016).

Thus, it appears a valid question to ask is *which trajectory innovations in microfinance are encouraging*. Do they favour service formalization and a movement of MFIs into richer market segments¹? Do they favour service transformation and/or simplification, thereby facilitating downstream movements by MFIs? Or do they facilitate both simultaneously?

A strong voice in this debate is a strand of microfinance research which argues that MFIs are abandoning their social mission in favour of increased financial gains – a phenomenon known as mission drift. Though valid counterarguments have been made, the prospect of microfinance

¹ This process of moving into richer segments is known as upscaling.

losing touch with its *raison d'être*, which is to help alleviate poverty by including the very poor into formal finance, is certainly frightening enough to merit further attention.

The present research seeks to contribute to the microfinance mission drift debate by studying microfinance developments in Kenya at the hand of disruptive innovation, a theory popularized in 1997 by Harvard professor Clayton Christensen (Yu & Hang, 2010). The disruptive innovation framework is particularly salient and powerful in this context for three reasons. First and foremost, it mirrors the possible trajectories of MFIs by categorizing innovations as either sustaining (which help organisations pursue more profitable clients) or disruptive (which help organisations generate growth and profits in low-end or new segments of the market). In doing so therefore, it provides a way to anticipate potential mission drift by MFIs. Second, the framework urges organisations not to discard low-end innovation, and to instead leverage them to find new growth avenues. Such advocacy is of course welcome in a microfinance context. Third, the framework provides a simple way of evaluating ongoing changes in an industry (Christensen *et al*, 2004), a valuable characteristic given the sheer number and diversity of innovations that abound in microfinance.

The following report is structured into five parts. First, the extant theoretical and empirical streams of literature on microfinance and disruptive innovation are reviewed and leveraged to refine and inform the research questions of this study. Then, the case study research methodology applied in the study is presented. Third, the findings of the study are presented and discussed in the light of previous research. Finally, the report closes an overview of research limitations and potential avenues for future research.

2. LITERATURE REVIEW

The following sections look at the existing body of research, theoretical and empirical in nature, that has been published on disruptive innovation and microfinance. The review begins with microfinance, especially looking at challenges and opportunities that abound in the industry. Then, the literature on disruptive innovation theory is presented, in particular focusing on its exact definition and on ways of measuring it.

MICROFINANCE

The following sections lay out the extant literature on microfinance. First, the concept is precisely defined and the context in which it arose is explained. This builds for theory on microfinance challenges, especially mission drift of MFIs. Lastly, innovations in the industry are presented.

DEFINITION AND CONTEXT

“Microfinance refers to small-scale financial services—primarily credit and savings—provided to people [...] who operate small enterprises or microenterprises [...] and to other individuals and groups at the local levels of developing countries, both rural and urban.” (Robinson, 2001, p.9) Alternatively, microfinance can be seen as “the provision of financial services to clients who have otherwise been neglected by the mainstream banking industry.” (Parikh, 2005)

The underlying thesis to microfinance is that, in contrast to what most formal financial institutions believe, the poor *are* in fact bankable (i.e., profits can be derived from providing financial services to such clients) and that providing them with access to financial capital should result in increased entrepreneurial activity, thereby generating economic growth at a local level and contributing to the alleviation of poverty (Robinson, 2001; Mersland & Strøm, 2010; Manos *et al.*, 2013; Alvarez & Barney, 2013).

Numerous arguments have been brought forward to justify why traditional banks expect the costs of delivering small-scale financial services to be unsustainably high (Robinson, 2001). Chief among them are (i) the lack of collateral required to back loans (Morduch, 2000; Karnani, 2007), (ii) the lack of data needed to certify creditworthiness (Robinson, 2001; Parikh, 2005) and (iii) the lack of education, skills, business expertise and infrastructure needed to exploit opportunities profitably (Buckley, 1997; Alvarez & Barney, 2013), all of which are commonly observed at the bottom of the pyramid (see for example Rangan *et al.*, 2011). Under traditional banking structures and practices, this context may indeed make the delivery of micro-financial services unprofitable.

However, the decision to leave so many unbanked also resulted in a large number of non-consumers which, as predicted by disruptive innovation theory, provided the needed room for the development and growth of innovative microfinance business models (Hart & Christensen, 2002; Christensen *et al*, 2006). While several such models coexist today (Kar, 2011), the most common and classical approach to providing micro-financial services to the poor is the one developed by Yunus². It involves providing loans to small groups of borrowers that secure their loans collectively (Yunus & Jolis, 1999). Manos *et al* (2013, p.3) explicate that “[t]he competitive advantage and the distinctive feature of microfinance relative to conventional lending and saving institutions lie in its core mission of providing access to financial services to those considered unbankable by the formal financial services industry.” Today, microfinance institutions profitably disburse \$52.6bn to 137.5 million borrowers on a yearly basis (2010 figures, reported by Maes and Reed, 2012).

THE DOUBLE BOTTOM LINE

In pursuing their mission of fighting poverty, MFIs have become subject to a dual bottom-line, namely a social one and a financial one. From a social perspective, it is expected of MFIs that they contribute to the alleviation of poverty (Robinson, 2001; Woller, 2002). This is also known as ‘MFI outreach’ which can be assessed along two main dimensions (Hermes & Lensink, 2011):

- i. Breadth of outreach refers to the number of people helped by the MFI, and is most commonly evaluated using the number of active borrowers of a MFI;
- ii. Depth of outreach refers to the level of poverty which a MFI helps to alleviate. The objective ideally should be to reach as deep as possible, so as to support the *poorest of the poor*. A commonly consulted indicator is the average loan size (Bruett *et al*, 2005, p.83).

Simultaneously, MFIs are expected to serve a financial bottom-line, so as to attain financial sustainability. In other words, an MFI’s operations should generate at least enough revenue to cover its costs, thereby ensuring self-sufficiency and independence from subsidies and donations (Armendariz & Morduch, 2005). This is important for example for effective governance, to facilitate growth that is unconstrained by donor budgets (Morduch, 2000) and to ensure that the microfinance business model can continue to achieve its objectives in the long run (Mersland & Strøm, 2012). De Crombrughe, Tenikue and Sureda (2008) note that “such sustainability can be attained basically through ensuring loan repayments on time, earning enough interest revenue and controlling costs to guarantee efficient use of resources” (as cited in Kar, 2011, p.427). Frequently

² Note that the Yunus model was initially introduced in Bangladesh in 1982, and that in 2006, Mohammed Yunus and his microfinance institution, the Grameen Bank, were awarded the Nobel Peace Prize. (See Yunus & Jolis, 1999)

used indicators of operational performance are portfolio-at-risk (PAR), operational self-sufficiency (OSS) and cost per borrower (Armendariz & Morduch, 2005).

CHALLENGES AND FAILURES

Recall that Parikh (2005) defined microfinance as “the provision of financial services to clients who have otherwise been neglected by the mainstream banking industry.” A valid question to ask therefore is: what is mainstream banking? Or, more saliently, at what point does microfinance become mainstream finance? The question is particularly relevant in the face of regulatory changes allowing MFIs to “upscale into profitable commercial banking operations” (Bhatt & Tang, 2001, p.322) and mainstream banks to downscale into microfinance services (Bhatt & Tang, 2001; Parikh, 2005).

Cull, Demirgüç-Kunt and Morduch’s (2009) empirical analysis for example demonstrates that stock-issuing MFIs behave similarly to traditional banks, and that they don’t really intend on serving the abjectly poor. More compellingly, Brière and Szafarz (2015) econometrically highlight that stock-listed MFIs largely converge on the mainstream financial sector, offering minimal diversification potential within the financial sector.

Lastly, Vanroose and D’Espallier’s (2013) work merits particular attention on two points:

- i. Their results indicate that “MFIs reach more clients and are more profitable in countries where access to the traditional financial system is low. This finding is in line with the market-failure hypothesis: MFIs respond to a need that banks do not fulfil and MFIs flourish where the formal financial sector fails.” (p.1965)
- ii. Results also demonstrate that in countries with “well-developed financial systems”, MFIs serve poorer people. This is because in such contexts, MFIs compete more directly with traditional financial institutions, with competition “[pushing] MFIs down the market and makes mission drift by MFIs less likely.” (p.1965)

Another criticism which has elicited much debate in academia is the so-called ‘mission drift’ of several MFIs (Kar, 2011; Manos *et al*, 2013). This occurs when they become overly focused on achieving financial sustainability, for example by extending services to better-off customers, and do so at the expense of the *unbankable* (Mersland & Strøm, 2012; Manos *et al*, 2013). In other words, the mission drift construct lends support to postulation of an inherent trade-off between financial viability and depth of outreach (Hermes *et al*, 2011). Armendariz *et al* (2013) empirically support this by showing that the lack of subsidies worsens social performances, and that strategic

responses differ across regions, with MFIs in Africa and Asia charging higher rates *vis à vis* Eastern European and Central Asian MFIs targeting wealthier clients.

The topic gained particular traction when regulations were introduced that permit NGOs and other non-bank MFIs to “[upscale] into profitable commercial banking operations” (Bhatt & Tang, 2001, p.322)³. These regulations came in response to the non-viability of numerous MFIs, which often had to rely heavily on subsidies to sustain their provision of services to the poor (Armendariz *et al*, 2013). A key concern with mission drift is that it could push MFIs to specialize in the provision of financial services only, as opposed to the wider range of services (e.g., financial and educational) offered by more socially-orientated organisations (Bhatt & Tang, 2001). And as argued by Dichter (1996) and Rangan *et al* (2011), purely financial services do not impact significantly on the economic productivity of micro-entrepreneurs.

Several authors have however shown that there need not be a trade-off between sustainability and outreach so long as MFIs “select a legal form that best facilitates the development of effective financial tools to match the demands and capabilities of MFIs and their clients in terms of affordability, risk and range of services.” (Manos *et al*, 2013, p.6; see also Morduch, 2000; Kar, 2011) Brière and Szafarz’s (2015) finding that “listed microfinance equity still generates significant social performances” lends support to this. Furthermore, Armendariz and Szafarz (2009) emphasize the difficulty in differentiating between mission drift and cross-subsidization (i.e., milking profitably high-end clients to support lower-end operations).

More recently, several authors have issued new mission drift-related critique on the grounds that MFIs, in their pursuit of operational efficiency and financial sustainability, have grown out-of-synch with the market (Woller, 2002; Karnani, 2007; Datar *et al*, 2008; Alvarez & Barney, 2013). As noted by Woller (2002, p.305), “the animating motivation behind the microfinance revolution was ‘poverty alleviation’, and in particular among the ‘poorest of the poor.’” Research has however shown that MFIs have not been successful at producing deep outreach (i.e., “[reaching] very far down the poverty spectrum” (Woller, 2002, p.306)), but instead have developed strong capabilities for helping those around or above the poverty-line (Mosley & Hulme, 1998). In response to this shortcoming, Woller (2002) and Datar *et al* (2008) argue that MFI market-orientation⁴ is the key to achieving deep outreach. Datar *et al* (2008) specifically differentiate between institution-focused

³ In Kenya, such regulation was introduced in 2006, with the first two official microfinance bank, Faulu Kenya and KWFT appearing in 2009 (Central Bank of Kenya).

⁴ Defined as the “organization-wide generation of market intelligence pertaining to current and future customer needs, dissemination of intelligence across departments, and organization-wide responsiveness to it” (Kohli & Jaworski, 1990)

MFIs and client-focused MFIs. Whereas the former believe “building financial institutions for poor clients will eventually help lift these clients out of poverty” (p.40, see also Morduch (2000)), the latter are concerned with actively nurturing both MFI and borrowers’ success. To achieve client-centricity requires extensive investments as it asks of MFIs that they broaden their portfolio to include, say, education and management training, and that they monitor their loans much more closely, for example by tracking what loans are used for. This view is supported by Alvarez and Barney (2013) who theorize that while currently MFIs help finance self-employment opportunities, these do not generate sustainable growth solutions. Instead MFIs should strive to help their clients exploit discovery and creation opportunities because these are more difficult to replicate, especially in a poverty context (Alvarez & Barney, 2013).

Datar *et al* (2008, p.48) eloquently summarize the mission drift conundrum:

“[Economic] pressures and the growing importance of financial sustainability are pushing many MFIs to become even more institution-centred. Yet if the goal of microfinance is to alleviate poverty, MFIs should adjust their theories of change to a more client-centred approach.”

Therefore, in an attempt to contribute to this rich debate, the first research question posed in this study is: *Can mission drift be ascertained in Kenyan MFIs?*

TRENDS AND INNOVATIONS

In their review of challenges and innovations in the global microfinance marketplace, Manos *et al* (2013) identify three core areas in which they expect innovation to thrive: (i) efficiency and effectiveness of delivery methods⁵, (ii) delivery methods themselves and (iii) microfinance policies and regulation. In particular, the authors stress the importance of these two areas in aiding MFIs to “effectively manage the costs relating to the delivery mechanism” so as to “meet the dual mission of extended outreach and improved sustainability”.

Much of the hoped-for improvements in effectiveness and efficiency lie with technological developments. Parikh (2005) writes of “technology-based solutions that [they allow MFIs] to scale more rapidly and reach more clients in a cost-effective manner.” Popular examples of such innovations are mobile banking platforms like the Kenyan M-Pesa (Foster & Heeks, 2013) and crowdfunding platforms like Kiva.org (Marom, 2013).

⁵ The authors use the terms ‘delivery methods’ and ‘business models’ interchangeably.

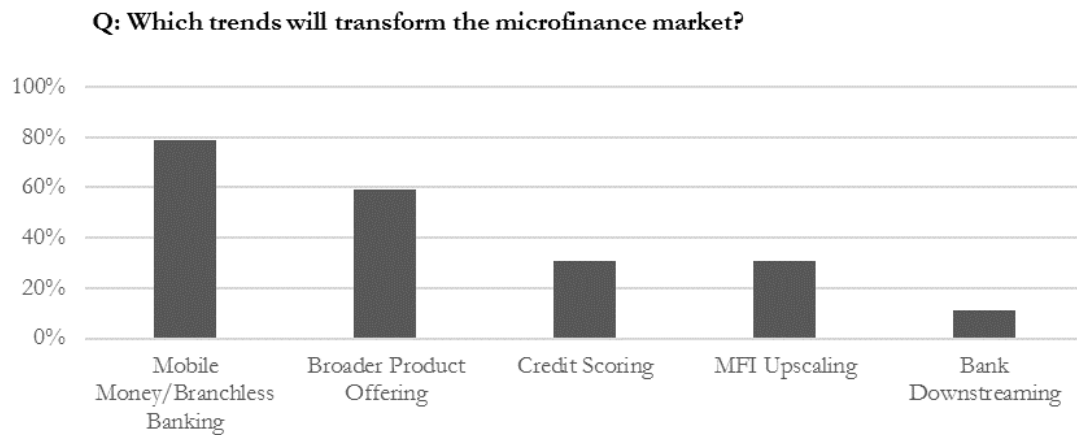
From a delivery model perspective, two noteworthy comments have been made. The first relates to the level of specialisation that is expected of MFIs (Bhatt & Tang, 2001). One school of thought, the “Minimalist Service Delivery Approach”, contends that MFIs should focus on delivering only financial services so as to achieve financial self-sufficiency more rapidly (Otero, 1994; Biggs, Snodgrass & Srivastava, 1991). Opposing this view, are those who argue for an “Integrated Service Delivery Approach”. They maintain that to be effective at alleviating poverty, microfinance programs should go “beyond the sole provision of financial services” (Bhatt & Tang, 2001, p.323). Another consideration related to the delivery model is that of group- versus individual-lending. Whereas group-lending was the mechanism used by early MFIs to combat information asymmetries⁶, with Kar (2011) empirically supporting the model’s ability to help MFIs marry social and financial objectives, Mersland & Strøm (2012, p.878) note that “group loans are retreating, individual loans become more common.”

Researchers and practitioners have also focused on the influence of regulation on financial institutions’ ability and motivation to innovate. One stellar example is that of regulation which facilitates the upscaling of NGOs (i.e., NGOs expanding into commercial banking operations) and/or the downscaling of existing or newly established commercial banks into poorer markets (Bhatt & Tang, 2001; Matthäus-Maier & Von Pischke, 2008; Manos *et al*, 2013).

As if to summarize the extant literature on the topic, Hug, Gonzalez and Mommartz’s (2016) recent survey of industry expert opinions on innovation in microfinance identifies five trends which could potentially transform microfinance. Figure 1 displays their results. It can be noted that technological (i.e., mobile money) and delivery (i.e., branchless banking, broader product offering, credit scoring) developments are expected to be the most transformative for microfinance, followed by up- and downstream movements, which typically result from regulatory changes.

⁶ In the case of microfinance, the information asymmetry relates to the client knowing more about his/her risk profile than the MFI.

Figure 1: Percentage of industry experts who mentioned the trend as potentially transformative for the microfinance industry



Source: Hug, Gonzalez and Mommartz's (2016)

In light of these trends and innovations, one might rightly ask if and how these developments will impact MFIs in their ability to marry social and financial objectives. Therefore, the second research question is: *What is the anticipated impact of upcoming innovations in microfinance on MFI mission drift?*

This study specifically analyses innovations in the Kenyan microfinance industry at the hand of disruptive innovation theory. This theory helps to make sense of ongoing developments in microfinance because it proposes two types of innovations which mirror possible growth paths for MFIs. On one hand, the adoption of sustaining innovations, which enhance a product/service along key performance dimensions and thereby help organisations cater to profitable higher-end clients, would suggest that MFIs are indeed pushing upstream. On the other hand, the presence of disruptive innovations, which emphasize new performance attributes and typically target low-end market segments, would indicate that MFIs are developing new ways of serving the poor. The next section further details this by laying out the extant literature on disruptive innovation theory.

DISRUPTIVE INNOVATION THEORY

In his seminal work on disruptive innovation, Christensen (1997) illustrated how over time, seemingly inferior technologies have the potential to grow and develop into the mass-market norm, thereby disrupting established market linkages and causing industry leaders to fall. His theory gained strong traction over the last decade because it postulates that even well-managed businesses can falter when they fail to identify and respond to low-end innovations in time. Stronger even, Christensen (1997), Markides (1999) and Christensen and Raynor (2003) hold that, due to their extensive focus on profitable up-market growth opportunities, incumbent firms – those with established presence in the marketplace – are less apt than new entrants at bringing to market disruptive innovations. Alarming, Paap and Katz (2004, p.14) report that incumbent firms are often “aware of the new technology that eventually disrupted their business success.” How then does disruptive innovation arise? Can it be predicted, and if so, how? And how should incumbent firms respond to such threats?

The subsequent sections lay out findings from extant literature on these questions. First, the concept of disruptive innovation is defined and described. Second, insights into ongoing debates in academia about limitations of the theory are provided. Finally, the bulk of the literature review on disruptive innovation is dedicated to explicating Christensen, Anthony and Roth’s (2004) framework for predicting industry change.

DEFINITION

It is important to begin by thoroughly defining the concept of disruptive innovation and differentiating it from other forms of innovation, for it is often confused or conflated in research, thus leading to sometimes contradictory findings (Danneels, 2004; Markides, 2006; Schmidt & Druehl, 2008).

Perspectives on Innovation

A new process, technology and/or business model is considered an innovation if it “enlarge[s] the existing economic pie, either by attracting new customers into the market or by encouraging existing customers to consume more.” (Markides, 2006, p.20; see also Ansoff, 1957) Research has consistently shown that economic value can be enlarged by various forms of innovation (Christensen, 1997; Assink, 2006; Markides, 2006). Two recurrent dimensions for categorizing innovations are:

- **Radical vs. Incremental Innovations:** This dimension relates to the *breakthrough-ness* of an innovation, and it is technological in nature. Innovations are considered radical when they improve product or service performance drastically along any given performance dimension. In contrast, incremental innovations provide marginal improvements to product or service performance.
- **Sustaining vs. Disruptive Innovations:** This dimension is market-based and relates to an innovation's ability to alter market linkages. Sustaining innovations are focused on a product or service's current performance dimension, and therefore do not change market dynamics. Disruptive innovations, on the other hand, break market linkages because they emphasize a new performance dimension and thereby alter the 'rules of the game'.

Table 1 provides cases of each type of innovation. Note that while sustaining innovations are largely aimed at the same clientele, disruptive innovations cause market linkages to change because they target new and emergent customer segments that value different product attributes.

Table 1: Illustrative cases of different innovation types

Technological dimension Market dimension	Radical	Incremental
Sustaining	<ul style="list-style-type: none"> ▪ DVD players vs. VHS players ▪ Jet engine vs. Piston engine 	<ul style="list-style-type: none"> ▪ iPhone 6 vs. iPhone 5
Disruptive	<ul style="list-style-type: none"> ▪ Digital cameras vs. Analogue cameras ▪ Cellular phones vs. Wired phones 	<ul style="list-style-type: none"> ▪ Low-cost airlines vs. Traditional airlines ▪ SQL Database Software vs. Oracle

Own construction, based on Govindarajan & Kopalle (2006b); Schmidt & Druehl (2008)

The following section outlines why and how disruptive innovation takes hold of an industry.

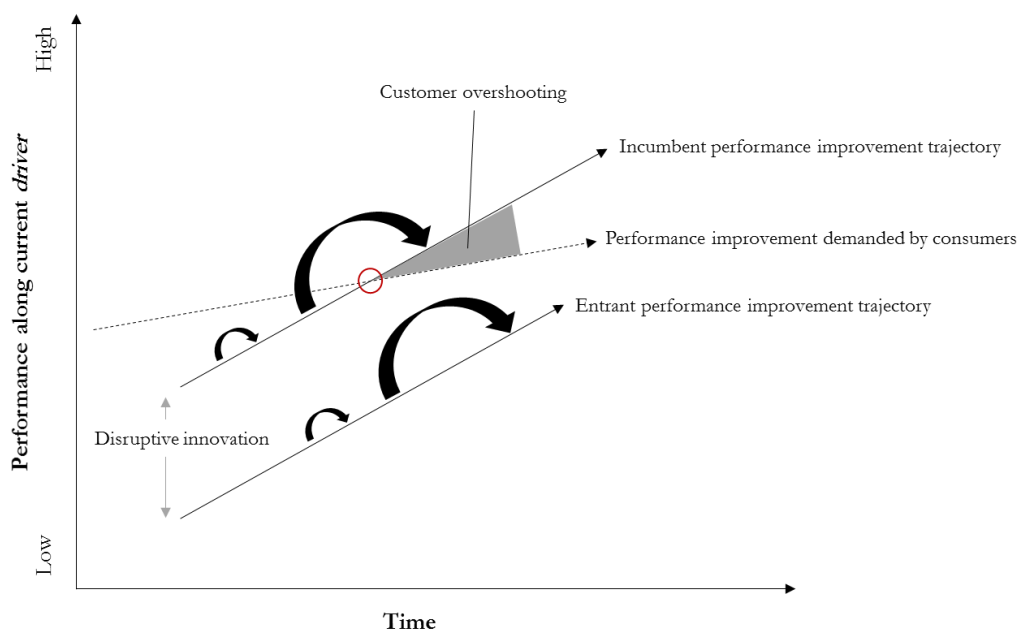
Disruptive Innovation: Why, How, What

Recall that disruptive technologies are initially inferior to mainstream technologies “along the dimensions of performance that are most important to mainstream customers” (Yu & Hang, 2010, p.436) Paap and Katz (2004, p.16) name this the “*driver* [of] a particular segment” and point out that this “represents the major consideration potential customers use when selecting a process, product or service.” In their paper, they theorize that to every process, product or service there is a *leverage limit* which is the point at which the customer “no longer values improvements, and further investments [therefore] provide no return.” (p.16)

Christensen and Raynor (2003) postulate the existence of a similar point, and argue that it is beyond this point that an industry becomes prone to disruptive innovation threats. The leverage limit is shown by the red circle in figure 2, with subsequent performance improvements resulting in customer overshooting.

Disruptive innovation theory begins with the incumbent performance trajectory being below customer expectations. Sustained improvements, whether incremental or radical (illustrated by the small and large arrows respectively) are therefore rewarded monetarily. Beyond the leverage limit however, mainstream customer needs are overshoot and do not attract any returns. At this point in time disruptive innovation may arise.

Figure 2: Disruptive innovations emphasize new performance dimensions to overshoot customers



Sources: Christensen and Raynor (2003); Paap & Katz (2004)

The key tenet to disruptive innovations is that they initially underperform⁷ *vis à vis* the current driver, but perform better than incumbent technology, processes or products along different performance drivers. Low-budget airlines for example perform worse than traditional airlines do on convenience, but outcompete them on price (Christensen *et al*, 2004). Disruptive innovation theory then posits that products and services on the new performance trajectory (usually introduced by new entrants in the industry) will undergo incremental and radical improvements and, in doing so, will eventually attain a level of performance that is high enough to attract the mainstream market and drive incumbent firms out of business.

It should be pointed out that because they initially underperform along the mainstream dimensions, disruptive innovations are always incubated in niche markets (Govindarajan & Kopalle, 2006a). In effect, for disruptive innovations to be a threat to incumbent firms, incentives to pursue healthy business *vis à vis* investing in the disruptive business must be asymmetric in nature (Christensen *et al*, 2004; Paap & Katz, 2004). Put simply, incumbent firms must find it financially more attractive to do business-as-usual than to invest in new business (Christensen, 1997; Christensen & Raynor, 2003; Christensen *et al*, 2004; Yu & Hang, 2010). Charitou and Markides (2003) explain that “the innovations are [usually] small and are not attractive until they start growing.” (p.56) Similarly, Govindarajan and Kopalle (2006b, p.14) recount the failure of AT&T and McKinsey consultants in detecting economic potential in the cell phone market.

Finally, Christensen and Raynor (2003) argue that the niche markets which are capable of harbouring potentially disruptive innovations are twofold; with each niche expected to disrupt markets in a different way:

1. Low-end disruptions ensue from the least-profitable and most over-served customer segments, at the low end of the original value network;
2. New-market disruptions create a new value network, where it is the non-consumption, not the incumbent, which must be overcome.

CRITICISM OF THE THEORY AND ADDITIONAL CONSIDERATIONS

As emphasized by Yu and Hang (2010) in their literature review of the subject, the rather precise and narrow definition of what constitutes a disruptive innovation has led to fierce and extensive debate among academics. Govindarajan and Kopalle (2006a) for example illustrate through the

⁷ Paap and Katz (2004, p.17) however note that there also is a *leverage minimum*, which corresponds to the minimum level of performance needed for consumers to start valuing performance improvements.

case of the cellular phone that high-end disruption also exists⁸. Similarly, Downes and Nunes (2013) provide numerous examples of so-called *Big Bang* disruptors: both low- and high-end disruptions that overhauled an entire industry almost overnight, as opposed to Christensen's lengthy disruption process. Google Maps for example had a *big bang* effect on the market for mobile GPSs. Finally, other researchers warn that while disruptive innovations cause serious and irreversible shocks to established markets, they do not necessarily displace them entirely; nor do they always involve the fall of incumbents (Charitou & Markides, 2003; Schmidt & Druehl, 2008; Markides, 2006).

Looking at disruption from a broader perspective, Utterback and Acee (2005) suggest that Christensen's view of what constitutes disruptive innovation is only one of eight possible technological innovations. In a similar vein, Markides (2006) highlights that researchers frequently err in conflating different types of disruptive innovations. Instead, he maintains that three distinct types exist, namely technological innovations (which pertain to Christensen's theory), business-model innovations, and new-to-the-world (i.e. radical) innovations. "All three types of innovation may follow a similar process to invade existing markets and may have equally disruptive effects on incumbent firms, but at the end of the day they produce different kinds of markets and have different managerial implications." (Markides, 2006, p.24).

PREDICTING DISRUPTIVE INNOVATION

In his review of the literature on disruptive innovation, Danneels (2004) highlighted that a key shortcoming to the theory is the lack of predictive foresight it offers academics and practitioners. In other words, how can the disruptive innovation construct be leveraged to develop methods that enable its proponents to predict disruption and distinguish it from other types of innovation? Meanwhile, several authors have responded to Danneels's call and in doing so, provide the tools, methods and frameworks necessary to pre-empt disruptive change (Christensen *et al*, 2004; Paap & Katz, 2004; Govindarajan & Kopalle, 2006a; Schmidt & Druehl, 2008; Dombrowski & Gholz, 2009).

First, because disruptiveness is a market-based dimension of an innovation⁹ (Govindarajan & Kopalle, 2006b; Govindarajan *et al*, 2011; Reinhardt & Gurtner, 2011), Christensen *et al* (2004, p.3)

⁸ In the same edition, Christensen thanked the authors for their contribution and agreed that in rare cases, high-end disruption is indeed possible.

⁹ Which stands in contrast to an innovation's radicalness which is a technology-based dimension (Gatignon *et al*, 2002; Govindarajan & Kopalle, 2006b; Govindarajan *et al*, 2011) or an innovation's competence-enhancing characteristics (Govindarajan & Kopalle, 2006a).

argue that “understanding when to reasonably expect innovation to lead to [...] industry change [...] involves evaluating three customer groups.”

1. Non-consumers: customers not consuming or only consuming in inconvenient settings;
2. Undershot customers: customers who desire higher performance along the product’s main performance dimension;
3. Overshot customers: customers who are satisfied with the product’s performance along the product’s main performance dimension, and are seeking improved performance along a new dimension.

Much has been written about the relevance of these customer groups (Adner, 2002; Christensen *et al*, 2004; Govindarajan *et al*, 2011). Govindarajan *et al* (2011) for example find that while mainstream-customer orientated companies are well-suited to introduce radical innovations, they are disadvantaged when it comes to disruptive innovations. Conversely, their research indicates that companies which focus on emerging-customer segments¹⁰ are apt at introducing disruptive innovations and not worse off *per se* at introducing radical innovations. Critically, their research also indicates that “[mainstream- and emerging-customer orientation] can coexist and can be pursued simultaneously.” (p.121) Research also warns of the similarities between the uptake of disruptive innovations by emerging customer groups and that of sustaining and radical innovations by lead customers/early: “although disruptive innovations pose a dilemma to the incumbents, [...] early adopters will eventually spread the benefits by word of mouth to the rest of the market.” (Govindarajan & Kopalle, 2006b)

The issue with analysing an industry from the perspective of consumers, as demonstrated by Reinhardt and Gurtner (2011, p.304), is that involves very lengthy and often complex research methods and models. Furthermore, the authors argue that no single customer research method suffices in delivering the insights needed to gauge the disruptive potential of an emerging or latent customer group.

Instead, researchers like Dombrowski and Gholz (2009, p.102) have shown that disruptiveness can more simply be predicted by analysing “whether the innovation improves performance that is measured in traditional ways or in new ways.” Ultimately, an innovation is potentially disruptive only if it at least emphasizes new performance metrics, unlike sustaining innovations which

¹⁰ The authors implicitly define emergent customer segments as non-mainstream. These are primarily non-consumers and overshot customers.

enhance performance along established trajectories (Christensen, 1997; Govindarajan & Kopalle, 2006a; Dombrowski & Gholz, 2009).

This study aims at leveraging the vast body of literature on disruptive innovation to make sense of innovations in Kenyan microfinance. It does so by seeking to answer the two-folded question: *which innovations are Kenya's microfinance market participants wary or cognisant of? And, do these innovations emphasize the same or different performance attributes than those emphasized by mainstream microfinance in Kenya?* In other words: *are the ongoing developments in Kenyan microfinance sustaining or disruptive?*

Furthermore, wishing to provide practical value to microfinance practitioners, the research also sets out to answer the question: *How should Kenyan MFIs respond or embrace the sustaining and/or disruptive innovations.* The following section informs this question by presenting insights from the literature on the topic of optimal incumbent response strategies

INCUMBENT RESPONSE STRATEGIES

Christensen *et al* (2004) posit the existence of two broad types of response strategies. First, incumbents can cede the lower-end of the market (or other relevant niche markets) to new entrants. Signals include announcements that the company will “[refocus] on core customers” or “plans to discontinue low-end products” (Christensen *et al*, 2004, p.48). This is what Charitou and Markides (2003) refer to as ignoring the innovation. Specifically, the authors showcase two types of strategies employed by firms that have decided to ignore disruptive innovations. Firms can decide to focus on and invest in their traditional business, so as to “improve [their] competitive standing relative to the new way of doing business” (p.56). This is for example what Gillette did in response to disposable razors. Firms also tend to ignore potentially disruptive threats – sometimes correctly – because the novelty “might be viewed as a totally different business [...] and diversifying in an unrelated market [...] could lead to disaster.” (p.57) Charitou and Markides (2003) do however underline that ceding/ignoring the disruption is only an appropriate response to disruptive *strategic* innovation (i.e., disruptive business models), because such innovation “usually [grows] quickly to control a certain percentage of the market but fails to overtake the traditional way completely” (p.56). In the case of disruptive *technologies* – the initial focus of Christensen in his seminal 1997 publication – ignoring the disruption is often inappropriate because the new technology eventually renders the past one obsolete.

A second strategy identified by Christensen *et al* (2004, p.48) is co-option which entails “fighting an attack using internal resources”. Specifically, the authors propose two models for co-option:

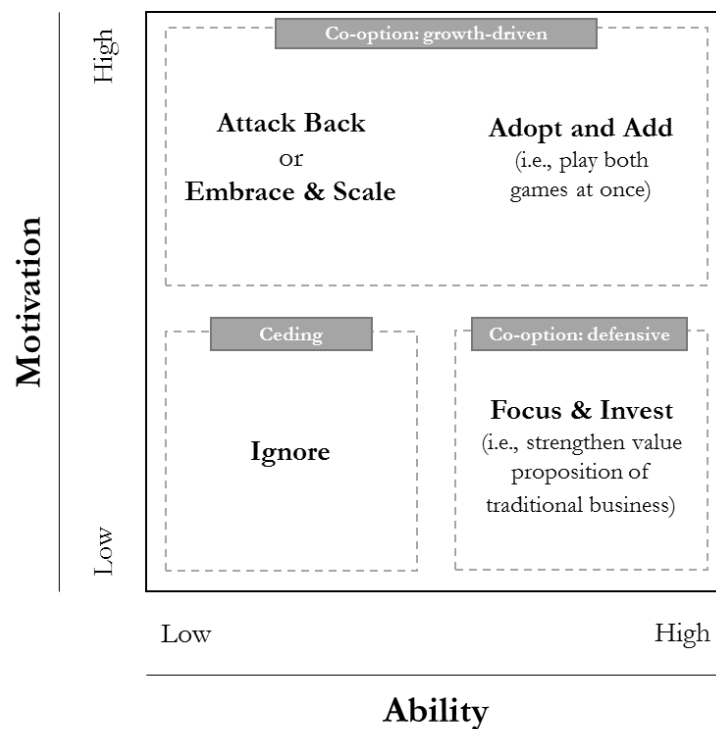
- i. Growth-driven co-option in which the incumbent targets the entrant's customers, for example by introducing a modified version of its core product.
- ii. Defensive co-option wherein the incumbent attempts to build a wall around its existing customers to prevent entrant entry, for example by bringing in a new product to the low end of the existing customer base.

Charitou and Markides (2003) provide slightly different strategies:

- i. Attack back by disrupting the disruptor. The main idea here is that an incumbent can bring-to-market a new product or service that emphasizes yet another performance attribute. A famous example of this is Swatch, which emphasized style over the price and performance attributed of upcoming Japanese quartz watches.
- ii. Adopt the innovation and play both games at once. As demonstrated above, this strategy requires strong ambidextrous capabilities. One common way through which ambidexterity is achieved is by setting up a separate business unit to pursue the new opportunity (Charitou & Markides, 2003; Reeves *et al*, 2015). This point will be developed further in the next section on *Strategic Choices*.
- iii. Embrace the disruption fully and scale it up. This requires of established companies that they “embrace the disruptive strategic innovation wholeheartedly [and] scale it up and grow it into a mass market.” (Charitou & Markides, 2003, p.58) Charles Schwab, a major US online brokerage platform, applied this strategy in 2001 in response to the entry of Net Investor.

Figure 3 below summarizes the aforementioned response strategies available to industry incumbents. Note that the axes used for the matrix correspond to key tenets to innovative capabilities of firms, namely (i) motivation and (ii) ability (Christensen *et al*, 2004).

Figure 3: Industry incumbents should respond to disruptive threats with appropriate strategies



Own construction based on Charitou & Markides (2003) and Christensen, Anthony & Roth (2004)

SUMMARY OF RESEARCH QUESTIONS

Research Question	Expected vs. Alternative Answer
RQ1: Is there mission drift in Kenyan MFIs?	<p>1.1 Expected: Yes, MFIs are abandoning poorer segments and entering into richer ones.</p> <p>1.2 Alternative: No, increasing average loan sizes are due to other factors.</p>
RQ2: Which types of innovations are MFI executives wary of?	<p>2.1 Expected: Executives are mostly wary of sustaining innovations and do not pay attention to disruptive ones.</p> <p>2.2 Alternative: Many executives recognize disruptive innovations too.</p>
RQ3: How should MFI executives respond to disruptive innovative threats?	<p>3.1 Expected: They should be aware of disruptive threats and seek to embrace them as soon as possible.</p> <p>3.2 Alternative: Disruptive threats can be ignored, and focus can remain on embracing sustaining innovations.</p>

3. METHODOLOGY

Given the aim of this study, the methodological approach selected is that of case study research, as proposed by Yin (1984). The methodological design seeks to inform how various innovations can impact the microfinance industry in Kenya and how different industry players are perceiving and responding to these innovations. Case studies, Yin (1984) contends, should focus on research questions related to 'how' and 'why' something happens. Moreover, in comparison to experimental research, case studies do not require control of behaviour events. An important argument for a case study research methodology is a research focus where it is difficult to distinguish between phenomenon and context, and this is certainly the case in this study as the industry context and innovation phenomena are inextricably linked.

Whilst the research questions at hand inspire a primarily qualitative methodology, this study adopts a triangulatory/mixed-method approach. Qualitative analyses were complemented with quantitative data from the Association of Microfinance Institution-Kenya (AMFI-K).

STUDY CONTEXT

The study focuses on the case of contemporary microfinance in Kenya. The geographic scope of the research is country-wide, but specific to the organisations represented by AMFI-K. Temporally, the scope comprises innovations introduced anywhere from 2009 to date.

DATA COLLECTION

The on-site research was conducted over a three-week period, from the 10th of June to the 30th of June 2016. Several key interviews were arranged before arrival on-site, through personal connections and through the Belgian embassy in Kenya. Given the importance of social networking, especially in Africa, on-site representation also helped in securing unplanned interviews with, for example, AMFI and Premier Credit (see table 2 for the list of interviewees). Key informants were selected using information-oriented purposive sampling. 11 key informants representing 9 different institutions were selected in order to construct a comprehensive picture of the innovation landscape in Kenyan microfinance.

Yin (1984) also stresses the importance of pilot testing your data collection strategy before rolling it out. This was done at the hand of an in-person interview with Mr. Obara from Platinum Credit.

Mr. Obara's expertise in the field of microfinance and his interest for IT-led innovation formed an ideal environment in which to test, adapt and perfect the guide for subsequent interviews.

LinkedIn was also used actively to get in touch with key individuals, especially on the innovators side. It is through this channel for example that the initial contact with First Access – a data analytics company investing in algorithmic credit scoring models – was established. C-level managers at other innovative firms were also contacted.

Lastly, to the extent possible interviews were set up with senior personnel. This was important to get a strategic and high end perspective on innovative threats and opportunities whilst drawing from by their vast knowledge of microfinance practice.

DATA SOURCES

Following Yin's (1984) call for implementing data triangulation in case study research, this study relies on a mix of qualitative and quantitative data, drawn from primary sources (i.e., interviews) and secondary sources (i.e., desk research).

A first phase of the analysis comprised desk research and a literature review. In a first instance, a literature review was carried out of key studies, both relevant online and print media. Later on, desk research was again conducted to support, corroborate, and nuance statements made by interviewees.

Central to this study were the interviews that were conducted with key industry stakeholders. Table 2 below lists the interviewees and the organisations they represent.

Table 2: Interview data were collected from 8 interviews with 10 organisational representatives

Organisation	Name	Function	Means of Interview
Platinum Credit (MFI)	OBARA, Ignatius	Director & shareholder	In Person
Jamii Bora (Bank)	KIMANI, Samuel	CEO	In Person
	KAGEMA, Eliud	CFO	
Premier Credit (MFI)	CARSON, Tim	CEO & Shareholder	Phone
First Access	MASUE, Peter	Business Development Associate	Skype

AMFI (Representative body)	KARANJA, Caroline	Programs Manager	In Person
European Investment Bank (External funder)	NZIOKA, Nicholas COLLIN, Catherine	Senior Project Officer Head of Regional Representation	In Person
KWFT (MFI)	KAROKI, Veronica	General manager of R&D	Phone
(Industry Expert)	SATCHU, Aly-Khan	Industry Expert	Phone

Interviews were conducted in a semi-structured manner. This manner of interviewing allowed for the analysis of recurrent themes while maintaining enough flexibility to dig deeper into specific topics during the interview process. The interview guide was developed inspired by the in-depth literature review. Crucially, interviewees were asked to list and describe innovations which they perceived, rather than asking for their thoughts on a given list of innovations. This was intentionally done to generate data that can support or disconfirm the rival hypothesis, namely that social-orientation influences the innovations that stakeholders perceive.

Interviews generally lasted between 30 minutes and one hour. To the extent possible, they were conducted in person, though several had to be done by phone or Skype. Most interviews were recorded and later transcribed. A handful were not recorded, so transcripts reflect the notetaking process undertaken during the interview.

In line with the research methodology applied to this study, the interviewees were carefully selected so as to offer a holistic picture of innovation perceptions in Kenyan microfinance. More precisely, interviewees were selected based on relevance to the study (i.e., SACCO representatives were not interviewed), availability/accessibility, and stakeholder-group representation (i.e., innovators, MFIs, external entities, industry experts, etc.)

Lastly, quantitative data were obtained from the Kenyan Association of Microfinance Institutions (AMFI-K) which publishes an annual microfinance sector report using data reported by its members (i.e., microfinance institutions active in Kenya). AMFI-K is the largest representative body for microfinance institutions in the country and, it appears, the only publisher of microfinance-related data in Kenya.

The AMFI-K data does however suffer from some shortcomings. For example, it does not yet take into account recent developments like M-Shwari (i.e., a partnership between Safaricom and the Commercial Bank of Africa) and KCB-MPesa (i.e., a partnership between Safaricom and

Kenya Commercial Bank) which have enabled new banks to compete in the market for micro-loans and micro-savings. Indeed, the organisation still restricts its sample to the three/four banks that have historically been active in the lower-end of the market. Lastly, AMFI only counts one SACCO member despite the crucial role they play in the delivery of financial services in Kenya.

An alternative dataset was available on the Microfinance Information Exchange (MIX) platform. However, it was rejected for two reasons. First, the data provided by MIX did not coincide with the one reported by AMFI; especially for smaller MFIs. This might be the result of MIX's self-reporting mechanism which smaller organisations find tougher to respect (for example because of more limited monetary and human resources). Secondly, the set of MFIs for each financial year varies considerably, making temporal analyses impossible.

Thus, AMFI data were used. Unfortunately, the data is not available in any editable format. Hence, the data points were transcribed into Excel manually. This refers specifically to data reported in the 2014 sector report (which covers the financial years 2011, 2012 and 2013). To minimize the risk of relying on erroneous information, the data from AMFI were also verified with MFI representatives during the interviews.

DATA ANALYSIS

A thematic analytical approach (Braun and Clarke, 2006) was adopted to identify, analyse, and report patterns and themes within the interview data. All the distinctive steps of thematic analysis were followed (familiarizing; generating initial codes; searching for themes; reviewing themes; defining and naming themes), leading finally to four themes: (i) current characteristics of the Kenyan microfinance industry, (ii) Innovations in microfinance, (iii) Anticipated impact of these innovations, and (iv) MFI characteristics. These themes are presented and discussed in the following sections.

4. FINDINGS

The following four sections describe and present the analyses conducted on the interview data. Because it is often difficult to distinguish between research phenomena and research context in case study research (Yin, 1984), it serves to begin by clearly delineating the research context. This is done at the hand of a brief descriptive narrative of the Kenyan microfinance industry. Building on this narrative, the second section presents the current characteristics of the market, an important category that emerged from the data. The third section then lays out key innovations in microfinance as well as their expected impact. Specifically, three innovations are analysed: (i) mobile banking, (ii) algorithmic credit rating and (iii) microfinance retail innovations. Finally, recall that case study findings cannot be generalized because they occur in a specific context (Yin, 1984). To this end, the findings section closes with an overview of the economic and political context in which Kenyan MFIs, the subjects of this study, operate.

THE KENYAN MICROFINANCE INDUSTRY

Finance for the poor – the *raison d'être* of microfinance – has been around in Kenya since at least 1984, when Equity Bank was founded. The bank, though commercial in nature, specialized in providing financial services to low-income earners.

“In Kenya, in 1984 when the first commercial banks were set up, people could not open an account with less than KES 20,000 (~\$200). This pushed several people to found banks for the unbanked. Equity and KCB grew this way, and are now the biggest commercial banks in the country.” (Obara, Platinum Credit)

Archival data from AMFI-K shows that most microfinance institutions were set up during or after the 1990s. However, it was only as of 2008 that microfinance was institutionalized through the enactment of the Microfinance Act (2006) which “[regulates] the establishment, business and operations of microfinance institutions in Kenya through licensing and supervision” with the expectation that “[...] the microfinance industry will play a pivotal role in deepening financial markets and enhancing access to financial services and products by majority of the Kenyans.” (Central Bank of Kenya)

Since, the industry has grown tremendously in size, with 34 micro-financial service providers reaching over 808,000 borrowers and booking a gross loan portfolio of Ksh 53.8bn (roughly \$538m) in 2013 (see table 3 in appendix). See table 6 and figure 4 in appendix for a more precise picture of the Kenyan microfinance landscape.

Still today, the industry knows yearly growth rates of over 20%, as also depicted by the following quote.

“[...] I expect that Platinum Credit will continue to do well. Over the next years I expect the gross disbursement amounts will increase at ~35% per annum.” (Obara, Platinum Credit)

In line with expectations, microfinance has contributed to deepening and broadening financial inclusion: the share of Kenyans who have access to some form of finance rose from 60.7% in 2006 to 74.6% in 2016 (see table 5 in appendix). Nevertheless, the data also reveals significant poor/rich and rural/urban divides.

Over the coming years, several innovations will come to play an important role in fixing this divide and furthering the progress made thus far with regard to country-wide financial inclusion. Mrs. Karanja of AMFI for example expects that over the next five to ten years the microfinance industry will achieve:

“Broader outreach, with MFIs building a national presence thanks to mobile technologies; Deeper outreach, with MFIs tracking and seeking to improve their social performance; More consolidation at an MFI level, so as to gain critical scale and reduce the cost of borrowing.” (Karanja, AMFI)

CURRENT MARKET CHARACTERISTICS

The first theme addressed in the interviews concerns the prevailing characteristics and dynamics of the market for microfinance. This is salient in the context of disruptive innovation because it sheds light on the key performance drivers for the industry.

One important finding from the research is that MFIs in Kenya differ quite significantly in terms of the importance they attribute to their social impact. For some, social considerations have gradually made way for more financial motivations, as in the case of Jamii Bora:

“The original entity was started [to help] 50 street families and got them to start saving [...] which originally worked only through group lending. Since 2012 however, we have changed our business model, now becoming an enterprise bank.” (Kimani, Jamii Bora)

Others argue that they are maintaining a focus on generating social impact, but are simultaneously branching out into richer markets:

“[...] expanding into the SME markets, and growing our urban footprint [...] enables us to disburse larger loans and increase profitability levels overall. But it does not mean we are losing focus on the rural markets. If you look at our network on-the-ground for example, this is mostly deployed in rural areas.” (Karoki, KWFT)

Finally – and quite surprisingly – some MFIs insist they were never set up with social considerations explicitly in mind. Instead, they argue that through their activities, they help combat poverty. Note that these institutions typically are young in age:

“If your objective is to bring people out of poverty, then microfinance is not the way to go.” (Obara, Platinum Credit)

“[...] we are a commercial institution, and we want to run our institution as a business. That said, we are certain that in doing business the way we do, we help people prosper.” (Carson, Premier Credit)

“Let me be clear: we are here to make money. That said, we believe that by providing small loans to enterprises, we are able to help the owners make a better living for themselves. Socially-oriented MFIs on the other hand keep on giving, but with limited impact.” (Kimani, Jamii Bora)

On a more general level, the data further revealed that MFIs need to be good at various activities:

“I would say there are three central [success] factors. The first is quick disbursement, so as to maximize the amount lent out and maximize returns. The second is efficient collection. Indeed, the scale achieved by quick disbursement only makes sense if collection is efficient and cheap enough to not eat away at your profits. Finally, availability of cash is crucial. These three components can quite easily be achieved with good governance and proactive leadership [...]” (Obara, Platinum Credit)

“We work hard to understand how our clients’ business and cash flows work, and through that, assess their creditworthiness. This is done by our loan officers. The key element they assess is the stability of the client.” (Carson, Premier Credit)

Moreover, the interviews revealed that the importance of price – represented by the cost of borrowing¹¹ – is growing:

“Cost of lending is a challenge to all MFIs, and bringing this down is key to remaining competitive.” (Masue, First Access)

“MFI rates are considerably higher than those of commercial banks. I expect that the pressure and scrutiny under which MFIs fall will increase, and thus lead to a reduction in interest rates.” (Satchu, Rich Management)

One possible explanation for the noted phenomenon is the increased focus that MFIs place on (i) individual lending and (ii) lending to micro, small and medium enterprises (see for example Mersland & Strøm, 2012). The following quotes reflect this:

“Since 2012 [...] we [are] an enterprise bank. That is, a bank for micro, small, and medium enterprises. [...] there has been a shift in the microfinance business, with many MFIs now focusing on businesses as opposed

¹¹ The cost a client incurs when borrowing from a MFI, which mainly comprises the interest rates charged on loans.

to people. This builds on the fact that banks today are more willing to finance microenterprises without collateral.” (Kimani, Jamii Bora)

“[...] we are expanding into the SME markets, and growing our urban footprint. This enables us to disburse larger loans and increase profitability levels overall [...] Individual lending is also there, and it is growing. [...] the average loan size tends to be bigger. Individual loans are mainly disbursed in rural-urban and urban areas.” (Karoki, KWFT)

In pursuing these new market segments, MFIs – and especially microfinance banks (MFBs) – are moving upmarket and experiencing more intense competition from other financial services providers, such as SACCOs and commercial banks, which in turn puts pressure on prices (i.e., interest rates charged). However, on this performance dimension, they still have a disadvantage versus bank, especially in terms of cost of funding:

“KWFT, Faulu and the likes are pushing upscale.” (Carson, Premier Credit)

“Microfinance is still considered as riskier than commercial banking, and this is hurting the MFBs in terms of cost of funding.” (Karanja, AMFI)

As a result, it seems, MFBs are advancing other selling points. A common one, as illustrated by the following quotes, is that of ‘a better understanding of the customer’:

“We believe that we have a better understanding of the micro-enterprise and SME sector, because that is where our roots lie.” (Kimani, Jamii Bora)

“[...] our focus on women has enabled us to truly understand this market, and develop products that cater to client needs. [...] we have a very large product portfolio that is designed to be highly relevant to client needs.” (Karoki, KWFT)

Similarly, credit-only MFIs are advancing their own unique value proposition: flexible and fast disbursements:

“Platinum Credit’s main selling point is its rapid disbursement. By transforming into a bank, we would be subject to various rules and regulations which would make such speeds unsustainable, if not impossible. Furthermore, regulatory supervision would force us to balance our portfolio, so we wouldn’t be allowed to expand as quickly into our market as we have done so far.” (Obara, Platinum Credit)

Taken together, the data suggests that there are two key drivers of performance in microfinance, namely (i) speed of disbursement and (ii) understanding of the customer. Nevertheless, price (i.e., interest rates charged) is an increasingly important factor – especially upmarket – because of growing competition from other financial service providers such as commercial banks.

INNOVATION IN KENYAN MICROFINANCE

In the following sub-sections, three innovations are presented and analysed. The first two, namely (i) mobile banking platforms and (ii) algorithmic credit scoring technology, are technology-led. Then, interviews also emphasized the growing importance of social impact innovations, henceforth referred to as (iii) microfinance retail innovations.

MOBILE BANKING PLATFORMS

Undoubtedly, the most radical innovation to have impacted Kenyan microfinance of late is mobile banking, spearheaded by the now-ubiquitous M-Pesa¹² mobile money platform. The prominence of mobile banking was made evident during the interviews, with every interviewee citing it at least once as a turnkey innovation.

“Mobile platforms have really been a fantastic innovation for us.” (Carson, Premier Credit)

“M-Pesa and subsequent mobile platforms have shaken this market considerably, and I expect them to continue doing so over the years to come.” (Obara, Platinum Credit)

“One innovation is the increased use of mobile phones for banking purposes.” (Karanja, AMFI-K)

“We have seen M-Pesa give rise to numerous financial products such as M-Shwari (mobile loans) and now coming is M-Akibu (government bonds issued for as little as KES 3,000 and available only via phone).” (Kimani, Jamii Bora)

Mobile platforms have altered the Kenyan microfinance landscape in various ways. One such way is by facilitating broader outreach by financial service providers, as illustrated by the following quotes:

“[...] the marginal cost of serving microfinance clients is very low for [banks], especially when they can broaden their reach using mobile [...] technology.” (Satchu, Rich Management)

“[Over the next 5 – 10 years, I expect] broader outreach, with MFIs building a national presence thanks to mobile technologies.” (Karanja, AMFI-K)

More specifically, mobile banking is enabling broader outreach by transforming the delivery model used by financial service providers. The resulting model, which is built on e-float (i.e., digital currency), allows these providers to overcome important barriers to the delivery of their services,

¹² M-Pesa was launched in 2007 by Safaricom, Kenya’s largest telecom provider. As of January 2015, it counted over 15 million users, with “as much as 60% of Kenya’s GDP [passing] through M-Pesa as e-float.” (Eijkman *et al*, 2010)

such as the oft-poor infrastructure that prevails in rural parts of the country. The following quotes underline this:

“[Mobile banking] technologies allow MFIs to bypass infrastructure problems – which used to be a huge challenge – and change the delivery model completely.” (Karanja, AMFI-K)

“[Mobile platforms] help MFIs and banks to significantly increase their efficiency. Take Faulu for example. [...] They were also one of the first to embrace the mobile platforms as a means of disbursing and collecting money. This has helped them fuel growth.” (Nzioka, European Investment Bank)

It is important to note that in virtually all cases, mobile banking platforms are leveraged by financial service providers to enhance the delivery of their current service offering. The following quote supports this by showing that mobile banking technology has enabled MFIs to speed up their disbursements. (Recall that a key performance criterion for MFIs is the efficiency or speed with which money is disbursed to clients.)

“Technological developments have also helped us tremendously, for example to automate and increase the disbursement speed [...]” (Carson, Premier Credit)

Lastly, to gauge the disruptive potential of an innovation, it is important to consider its target market. In the case of mobile banking platforms, interview data suggests that they will be used primarily for disbursing smaller-size loans to mainstream markets:

“[...] with M-Pesa and other technologies coming up, small lending has now moved to phones.” (Kimani, Jamii Bora)

“[...] my personal opinion is that banks are disbursing microloans but not to micro clients.” (Karoki, KWFT)

Taking into consideration all of the above, the data appear to indicate that mobile banking, though radical in its ability to deliver financial services, is not a disruptive innovation in microfinance. Indeed, the data suggest that (i) mobile banking platforms’ target market is largely composed of today’s mainstream customers, and that (ii) mobile banking platforms enable MFIs to improve along actual key drivers of performance.

ALGORITHMIC CREDIT RATING

Another technology-led innovation that emerged from the interviews is algorithmic credit rating. As the following quote illustrates, this technology leverages data sourced primarily from phones to predict individuals’ creditworthiness:

“[We] attribute instant credit scores for MFI clients. Our algorithms look at demographics, financial transactions, call volumes and texting volumes to predict creditworthiness.” (Masue, First Access)

As a result of the recency of the innovation, a principal business model is still to emerge from the field. The following quote from First Access, a data analytics company specialized in designing such algorithms, provides a stellar insight into the still-developing nature of the business:

“In Africa we don’t really have any direct competitors. The closest to our model are ‘Tiaxa’ and ‘Cignifi’. ‘Branch’ is also doing something similar to us, but they also cover the lending side. So their product attributes a credit score to an individual, and then also disburses the money to him. Versus our competitors our main USP is that we offer a customized credit scoring algorithm. So we group borrowers in risk categories based on your data and your client and your needs.” (Masue, First Access)

From an uptake perspective, results are mixed, with certain MFIs praising the technology and others rejecting it.

Proponent: *“[...] big data will be the biggest thing for us. For example, leveraging data to prevent bad debt and predict creditworthiness more accurately.” (Obara, Platinum Credit)*

Opponent: *“[...] surely algorithms do not know our client as well as we do. So for now, we will certainly stick to the old-fashioned way of assessing clients.” (Carson, Premier Credit)*

Suppliers of the technology are also recognizing the difficulties of selling their product to MFIs:

“Another important challenge is that instant credit scores are a new idea or concept. MFIs in Africa however tend to be quite conservative so they have been quite reluctant to adopt our technology.” (Masue, First Access)

Notwithstanding these reservations, proponents of the technology are expecting much from it. In particular, algorithmic credit scoring is expected to decrease MFI costs in two ways. First and foremost, the interview data show that advanced algorithms should help to reduce the number of non-performing loans. Secondly, automating and digitalizing the credit assessment process should cut into operational costs. The following quote best supports this:

“[Algorithmic credit rating] technologies, I believe, will help reduce non-performing loans from their current level of 5 – 10%, to less than 5%. [...] Moreover, big data will allow MFIs to bypass face-to-face interaction entirely. This will lead to sector commoditization, whereby anyone with spare cash and a smartphone will be able to be his/ her own MFI.” (Obara, Platinum Credit)

“Cost of lending is a challenge to all MFIs, and bringing this down is key to remaining competitive. In that sense, our solution is very attractive.” (Masue, First Access)

By reducing costs in the two aforementioned ways, algorithmic credit rating technology enables lower interest rates to be charged by MFIs:

“[Algorithmic credit rating technologies] will bring down the mark-up MFIs attach to their products. All in all, I expect monthly rates will decrease from 5 – 7% today, to 3%.” (Obara, Platinum Credit)

The innovation, when applied appropriately, can also speed up the creditworthiness assessment process considerably. The next quote for example suggests this:

“[Branch and other similar platforms] are innovative in their ability to bring together P2P lending and quick disbursement.” (Masue, First Access)

Finally, the data overall appears to indicate that algorithmic credit rating technology is and will be used to target mainstream microfinance clientele. Moreover, as the following quotes underline, the technology could be used to target microfinance clients by both incumbent MFIs as well as commercial banks:

“In the foreseeable future, we are definitely not considering becoming a MFI [...] That is primarily because of a conflict of interest that would arise: how can we disburse loans ourselves, and at the same time try to sell our technology to other MFIs?” (Masue, First Access)

“[...] retail banks [will reach] down into poorer segments of the population. [...] the marginal cost of serving microfinance clients is very low for [commercial banks], especially when they can broaden their reach using mobile and algorithmic technology.” (Satchu, Rich Managment)

In the light of these findings, the data appears to suggest that the up-and-coming algorithmic credit rating technology is a radical and sustaining innovation. Indeed, as with mobile banking platforms, the algorithmic innovation principally targets existing microfinance clients by enhancing the service offering of MFIs along actual performance dimensions.

MICROFINANCE RETAIL INNOVATIONS

The last innovation that interview data revealed are the so-called ‘microfinance retail innovations’. At the core of these innovations is a retail product which companies sell using microfinance (i.e., microcredit is leveraged to lower entry costs for potential customers). Table 8 in appendix provides a more detailed overview of two flagship Kenya-based microfinance retail innovators: M-Kopa and Sanergy. Whereas M-Kopa retails solar panels, Sanergy produces and franchises portable toilets. The following quotes illustrate their link with microfinance:

“If you boil it down, what we are is a finance company. What we’ve done is to give the customers some collateral and a line of credit.” (Hughes, M-Kopa, as cited in Faris, 2015)

The main premise behind these innovations is that they are able to have a sustainable social impact, which is then magnified when microfinance is leveraged to make the product more accessible to poor and/or rural populations. The European Investment Bank, an external funding partner for a handful of Kenyan MFIs, also perceives these innovations as such:

“[...] we have introduced ‘Impact Investing 2.0’, a program which encourages the [European Investment Bank] to take on more risk, without the constraint of needing to achieve self-sufficiency. Through the program, we believe that we can really begin to support out-of-the-box projects. In Kenya [...] we are looking at M-Kopa and Mobisol, two companies providing the rural poor with solar panels that allow them to charge a phone and power several light bulbs.” (Collin, European Investment Bank)

Note that various MFIs are also partaking in the effort to bring to market such products:

“ECLOF [...] introduced a line of financial products they call WASH. [...] [which] aim to improve the hygiene of people in rural areas. KWFT has also introduced a line of products geared toward people in agriculture. They sell them solar panels and biogas installations on loan, and through these, people are able to electrify their homes. Some are even able to sell some of the electricity they generate.” (Karanja, AMFI-K)

The main impact of microfinance retail innovations is that they shift the focus from institutional efficiency to social impact. Put simply, a new key performance dimension – both for companies retailing these innovations as well as direct stakeholders – is the social impact that the products are having on clients. The following quotes underline this:

“[...] certain wholesale MFIs will not give MFIs a loan if they are not able to provide them with information related to their social impact.” (Karanja, AMFI-K)

“Yes, for the [European Investment Bank] there has to be an impact. Partner MFIs have to show that through their operations they are able to have a social impact, for example by increasing clients’ incomes and improving their standards of living.” (Nzioka, European Investment Bank)

“Getting to [the stage of distilling best practices related to tracking and improving social performance] has however been quite tough, because even consultants and experts didn’t understand the importance of measuring social performance.” (Karanja, AMFI-K)

As might be expected, this novel way of serving the poor also causes frustration among microfinance incumbents; especially with regard to how new entrants go about creating and capturing value. Recall that one of the current key performance dimensions is ‘understanding of the client’. The following quote illustrates how differently incumbents and new entrants account for this in their way of bringing to market microfinance retail innovations:

“I don’t want [M-Kopa] here at all. You see, M-Kopa sells its solar product at KES 18,000 (~\$180) and attaches to it a mobile module that allows it to shut down the system as soon as the client fails to make one instalment. Especially in rural areas, you cannot do this. What about if the person had to go to hospital, or needed to pay school fees that month? We sell the same product – even more performant I would say – but we sell it at KES 8,000 (~\$80), and we take the time to understand our clients, and their reasons for not paying. You see, M-Kopa just doesn’t have the same connectedness with clients.” (Karoki, KWFT)

Given the above, it is hard to contest that microfinance retail innovations are a potential form of disruptive innovation for the microfinance industry. Indeed, instead of putting forward speedy disbursements or intimate client knowledge, the products aim at having and tracking social impact. In their purest form, as with M-Kopa for example, the innovations are even frustrating industry incumbents – a tell-tale signal of disruptive potential (Christensen & Raynor, 2003).

ECONOMIC INFLUENCES

In closing the findings section, it serves to underline several elements of the case study which could potentially impede the transferability of results to other cases. For microfinance, and Kenya in particular, this refers mainly to the economic context in which microfinance is playing out.

The Kenyan economy has known strong growth, and this is projected to endure with the World Bank for example forecasting growth rates of roughly 6% through 2018 (World Bank, 2016). The economy benefits from stable demographic expansion of 2% per year (Central Intelligence Agency, 2016) and, more importantly, from sizeable recent infrastructure investments (The World Bank, 2016). Moreover, speaking specifically of the microfinance sector, Hug *et al* (2016, p.17) note that “Net commodity importers such as Kenya will be less affected by global headwinds. As a consequence, their microfinance markets are expected to expand robustly.”

In addition to facing stable economic growth, Kenyan MFIs also operate in a political environment which incentivises innovation and strives for a level playing-field, as attested by the following quote:

“we are currently supporting the government in the drafting of the “Financial Services Authority Bill” which will seek to regulate market conduct of especially credit-only MFIs. [...] We strongly believe in this bill, as it is also supported by the new Central Bank Governor who has made it a priority to streamline standards and products in the financial sector.” (Karanja, AMFI-K)

It should also be noted that the Kenyan economy relies heavily on micro, small and medium enterprises (MSMEs) for both growth and employment. As a result, the market for MSME

financing is in full expansion and, at present, remains largely underserved. Calice, Chando and Sekioua (2012) for example find that “Banks [in East Africa] consider that the SME lending market is large, not saturated and with a very positive outlook.” Furthermore, a report by Invest In Africa and Strathmore Business School concludes that “Access to finance, linkage with big businesses and limited effective corporate governance are the major barriers to Kenya’s SMEs growth. [...] The cost of financing is the single largest challenge identified, followed by access to financial markets.” (Kangethe, 2016¹³)

Considering that MSME financing constitutes the higher-end of microfinance, this Kenyan context violates an unstated assumption of disruptive innovation theory, namely that “the size of the market for sustaining innovations is fixed and foreseeable.” (Dombrowski & Gholz, 2009, p.113) In fact, it is upon this assumption that the main takeaway from disruptive innovation theory rests: that it is strategically misinformed for incumbents to discard low-end developments and instead retreat into profitable upstream market segments. The implications of this finding are discussed below.

5. DISCUSSION

The novelty of the topic under study being disruptive innovation in microfinance, it serves to reflect on the findings presented above, so as to fit them within the existing body of literature. Specifically, this chapter elaborates on how the present study contributes to the understanding of (i) recent developments in microfinance and (ii) disruptive innovation theory and, to the extent possible, (iii) how the two aforementioned topics inform one another.

The first research question posed in this study is whether mission drift – i.e., the abandonment of the social mission by social enterprises – can be ascertained among Kenyan MFIs. The findings of this study don’t allow us to provide a conclusive answer, but instead shed light on the complexity of the Kenyan MFI landscape. Indeed, while at times mission drift does appear to occur, as in the case of Jamii Bora bank, the data also supports other theories that explain why the average loan size – the principal measure for depth of outreach of MFIs – has been on the rise. For example, in line with the findings of Armendáriz and Szafarz¹⁴ (2009), the case of KWFT shows that it is

¹³ The original report, entitled “Barriers to Kenyan SMEs growth & investment” (2016), is not freely available to the public. Instead, the quote used is borrowed from Kangethe, who published the most cited summary of report (on CapitalFM). The findings he presents were verified and successfully supported in various other media outlets.

¹⁴ Note that the paper sampled MFIs from Latin America and South Asia.

difficult to differentiate between mission drift and cross-subsidization (i.e., where profitable upstream markets are tapped to subsidise low-end activities). Interestingly, the data further reveal the existence of a handful of MFIs, typically young in age, which were set up with entirely commercial intentions. That is, these institutions never explicitly vowed to help alleviate poverty, backing earlier findings that “microfinance [has] largely converged on the mainstream financial sector. [...] without really intending to serve the poorest of the poor.” (Cull, Demirgüç-Kunt & Morduch, 2007 as cited in Brière & Szafarz, 2015, p.27)

Though inconclusive with regard to the mission drift argument, the results of this study do contribute to the microfinance literature in at least two ways. First, the sheer diversity observed among Kenyan MFIs helps to support the claim that “microfinance has changed dramatically during the last decade.” (Brière & Szafarz, 2015, p.2) Secondly, the large differences in terms of the importance Kenyan MFIs attribute to their social impact also suggests that research errs in conflating MFIs that subscribe to a bottom-line with those that do not. This is particularly salient in the case of next-generation MFIs like Platinum Credit and Premier Credit, which in fact were never intended to explicitly serve a social bottom-line. Under such circumstances, can the MFI really be criticized for seeking higher profitability upmarket? Rather, it would serve future research well to try to differentiate between different forms of microfinance.

The second research question suggested looking at Kenyan microfinance through the lens of disruptive innovation, so as to understand whether ongoing developments are encouraging or discouraging mission drift. In order to answer the question, it was first necessary to identify the current performance drivers in the Kenyan microfinance industry. A review of the data appears to indicate that there are two key performance drivers¹⁵ in Kenyan microfinance, namely (i) understanding of the customer and (ii) disbursement speed. It was also suggested that price is becoming increasingly important. In other words, in contrast to popular expectations that microfinance should alleviate poverty and have a powerful social impact (see for example Robinson, 2001), it appears that this is not a key performance driver for Kenyan MFIs. Hence, considering that social objectives were the *raison d'être* for the first MFIs (see for example Yunus & Jolis, 1999), the finding that they are no longer central to next-generation institutions certainly buttresses Brière and Szafarz's (2015) claim that the industry has changed. However, as the findings of this study suggest, emerging business models like microfinance retail innovations might once again put social impact at the forefront of microfinance.

¹⁵ The finding that several drivers of performance can coexist in a given industry supports arguments made by Paap and Katz (2004).

As revealed by the scan for innovations, it appears Kenyan microfinance harbours both sustaining and disruptive innovations. On the one hand, sustaining innovations such as mobile banking were shown to enhance performance of MFIs along key dimensions and to help MFIs capture value in more upstream markets. On the other hand, the disruptive innovation (i.e., microfinance retail innovations) was found to emphasize ‘social impact’ as a performance driver for poorer and more rural market segments. Similar findings are widespread in the disruptive innovation literature and in fact form the basis for the entire theory (Christensen, 1997; Christensen & Raynor, 2003; Govindarajan & Kopalle, 2006a; Yu & Hang, 2010). In short, the findings of this study lend support to the principal story told by disruptive innovation theory, namely that innovations are potentially disruptive when they offer a new value proposition to an emerging customer segment (Govindarajan & Kopalle, 2006a).

Given the above results, the third research question seeks to understand what the practical implications are of sustaining and disruptive innovations for Kenyan MFIs. Unfortunately, this cannot be done in a straightforward way because microfinance in Kenya violates the assumption that “the size of the market for sustaining innovations is fixed and foreseeable.” (Dombrowski & Gholz, 2009, p.113) Indeed, it was shown that MFIs are increasingly geared toward the market for MSME finance, which could be considered an upstream segment of microfinance. They do so because the market is booming: “Banks [in East Africa] consider that the SME lending market is large, not saturated and with a very positive outlook.” (Calice, Chando & Sekioua, 2012, p.7) The corollary of this finding is not *per se* that disruptive innovation theory has no place in Kenyan microfinance. It certainly remains important for all industry stakeholders to recognize and understand the implications of emerging business models that do the job of serving the poor differently. Rather, in support of Dombrowski and Gholz (2009), the findings of this study suggest that the decision to invest in sustaining innovations, which allow MFIs to go after more profitable clients like MSMEs, could also be strategically sound.

Bearing in mind these considerations, the response strategy framework proposed by Charitou and Markides (2003) sheds light on how various industry stakeholders should respond to microfinance retail innovations. The framework prescribes strategies according to two dimensions: ability and motivation.

Ability in this case refers to the assets, both tangible and intangible, that MFIs have at their disposal to embrace the innovation (Charitou & Markides, 2003; Christensen, Anthony & Roth, 2004).

Rangan *et al* (2011) argue that the successful¹⁶ roll out of innovations at the bottom of the pyramid critically relies on scale. Archival documents relating to the success story of M-Kopa and its large salesforce certainly corroborates this (see table 8 in appendix). Hence, it could be argued that larger MFIs, with their larger geographic footprint and client base, are more able to embrace microfinance retail innovations. A case in point is KWFT, the largest MFI in the country, which was found to already have such products to its portfolio. Moreover, the study shows that the four MFIs which were identified to place special emphasis on tracking their social impact are all larger-than-average institutions (see table 7 in appendix for further details).

Where MFIs are likely to truly differ however, is in their motivation to embrace microfinance retail innovations. Motivation is primarily determined by “how strategically related the new business is to the existing one: The more strategically related the new business is, the more motivated the company will be to respond.” (Charitou & Markides, 2003). This study suggests that most MFIs will not be motivated to embrace the potentially disruptive microfinance retail innovations. The first reason is that many Kenyan MFIs apply a minimalistic approach to delivering microfinance. Thus, adding microfinance retail products to their portfolio would require that they review their approach to service delivery. However, given their current level of success, research by Assink (2006) suggests that this is unlikely to happen. The second reason is that many MFIs are focusing on lending to enterprises, an upstream market for which microfinance retail innovations, in their current stage at least, are probably unattractive.

Conversely, the findings also suggest that a handful of MFIs will be very motivated to embrace the potentially disruptive innovation. This is probably because they seek to maximize their social impact, a dimension along which microfinance retail products allegedly perform well. Motivation can also be expected to be high for MFIs which target poor and rural individuals, since that is also the initial market for microfinance retail products. The case of KWFT competing against M-Kopa in selling solar panels is a good example of this.

Thus, in answer to the third research question, this report carries two implications for microfinance practitioners. First, it underlines the need for MFI executives to clearly define and understand their target market¹⁷. What are the needs of this market, and what jobs are customers seeking to complete with the solicited product/service? Then, with this definition in mind, executives should evaluate whether microfinance retail innovations pose a threat to their business.

¹⁶ Given that MFIs and social enterprises are expected to serve a double bottom-line, success here refers to positive financial returns and large social impact.

¹⁷ A useful reference for tools to gather powerful customer insights are proposed by Reinhardt and Gurtner (2011)

If they do, then the extant literature recommends adopting the innovation, either by integrating it into the current business model or by setting up a separate business unit to pursue the new opportunity (Charitou & Markides, 2003; Christensen, Anthony & Roth, 2004). Kim and Min (2015) for example find that integration only makes sense when the firm possesses strong complementary assets and few conflicting assets. This perhaps explains why KWFIT has been successful at integrating microfinance retail innovations into its product offering.

However, if the needs of the current target market do not coincide with the value proposition of microfinance retail innovations, then theory suggests that the MFI should ignore the innovation and instead seek to strengthen its own value proposition (Charitou & Markides, 2003). This strategy might for example be relevant for smaller, higher-end, credit-only MFIs such as Platinum Credit. In particular, the rapidly growing market for MSME finance could be targeted by emphasizing rapid disbursements, which this research suggests would also help differentiate MFIs from commercial banks. Note also that sustaining innovations like mobile banking and algorithmic credit rating would then serve to further reinforce the value proposition of MFIs that decide follow this growth avenue.

Finally, this report also shed light on the impact that a double bottom-line has an organisation's ability to detect potentially disruptive innovations. This topic merits particular attention because it helps to test an implicit assumption of disruptive innovation theory, namely that incumbent firms succumb to disruptive threats because they are profit-seeking. Indeed, it is the effort to maximize economic returns that leads incumbents to focus extensively on mainstream and upstream customer segments, and to overlook or discard low-end developments. In that sense, one might expect social orientation to go hand-in-hand with a better understanding of low-end markets (Datar *et al*, 2008); and thus, to increase the likelihood of detecting potentially disruptive threats (Govindarajan *et al*, 2011). For MFIs, this would imply that the more minimalistic the approach to delivering financial services, the less likely it is that disruptive threats will be detected.

The findings of this study do appear to support this. For example, executives from MFIs which employ minimalistic service delivery approaches (e.g., Jamii Bora, Premier Credit and Platinum Credit) all exclusively and consistently recognized the two sustaining innovations, namely mobile banking platforms and algorithmic credit rating technology. Conversely, organisations which explicitly cater to a social bottom-line appear to be more aware of low-end market needs. For example, KWFIT has already embraced the potentially disruptive microfinance retail business model. All in all, these results support similar findings by Datar *et al* (2008).

6. FUTURE RESEARCH AVENUES

This study has touched upon numerous aspects of both microfinance and disruptive innovation theory, and in doing so, has hinted at various noteworthy avenues for future research. The following paragraphs discuss two potential research streams.

The first potential strand of research concerns the impact of MFI diversity on mission drift. More specifically, in support of Brière and Szafarz (2015), this study showed that the extant body of literature may mistakenly conflated microfinance (which boasts a social objective of helping customers out of poverty) with mainstream finance provided in a micro format. Or, as noted by one interviewee:

“[...] banks are disbursing microloans but not to micro clients. [...] I could request a \$100 loan, which would be labelled as microfinance. But I am not a microfinance client.” (Karoki, KWFT)

This insight calls for future research in two ways. First, research could help to distinguish between and to define both forms of microfinance – an exercise which will certainly require extensive effort. Then, armed with datasets that better reflect the real world context, research could help to understand whether both types of microfinance differ, and if so, how?

Another potential strand of future research could test the link between the subscription to a double bottom-line and disruptive innovation capabilities. Indeed, recall that the data of this study suggested that socially-oriented MFIs were better at detecting disruptive innovations. The potential implications of this link should not be underplayed, as indeed it would provide strong support for adopting double bottom-lines, both within and outside of the realm of social enterprises. Future research could contribute to the understanding of this phenomenon in two ways. First, it could do so by providing further case study evidence to complement these initial findings. It would be particularly interesting to investigate the link between social orientation and disruptive innovation in other contexts, for example outside of microfinance, or even outside of the social enterprise sphere. Secondly, it would be beneficial for future research to test this link econometrically, so as to ascertain its statistical significance. It is recommended that the econometric model be designed to account for key organisational capabilities such as those identified by O’Reilly and Tushman (2008), Assink (2006) and Govindarajan and Kopalle (2006b). Doing so would help to avoid potential issues of endogeneity that could arise from a strong correlation between innovation capabilities and perceived social orientation.

7. LIMITATIONS OF THE STUDY

The findings of this case study research of disruptive innovation in Kenyan microfinance should be treated carefully and with appropriate consideration given to the various constraints and limitations that were faced.

First, the study relies on insights from MFI executives to evaluate the ongoing innovations in Kenyan microfinance. However, disruptiveness is essentially a market-based construct (Govindarajan & Kopalle, 2006b), and should therefore ideally be studied from the viewpoint of consumers. Doing this appropriately, though, requires a very complex methodological approach, as was demonstrated theoretically by Reinhardt and Gurtner (2011). Instead, it was deemed more realistic to gain deep insights from a handful of seasoned MFI practitioners. However, it would certainly be beneficial to complement the findings of this study with demand-side data.

In a similar vein, this study would benefit greatly from a more comprehensive quantitative grounding. Given the current sparsity of reliable quantitative data on Kenyan microfinance, the study had to rely mostly on qualitative data. However, as data collection and reporting in the Kenyan financial sector improves, for example through initiatives like *The Microfinance Exchange* (MIX) and *Financial Sector Deepening – Kenya* (FSD), quantitative models might soon be able to provide complementary insights into innovation in microfinance.

A third constraint of the study results from the interview approach, which asked experts for their thoughts on innovations in an open manner. In other words, in line with the qualitative research methodology of this study, the experts were generally asked “*Which innovations do you see as important in the microfinance industry?*” as opposed to force-feeding an innovation and probing for their opinion of it. However, it is likely that this interview approach shed light on fewer key innovations than those that are actually impacting the Kenyan microfinance market. For example, crowdfunding has often been hailed as a disruptive business model in microfinance, but because of a lack of data on the subject, it was ignored in this study. Put simply, this report rigorously analyses an initial set of innovations, but readers who wish to use the findings for real life applications should beware the existence of other innovations in the market.

Lastly, for reasons of practicality, the scope of this research was limited to only MFIs based in Nairobi (though some operate a nation-wide network). This geographic focus could indeed have an impact on the findings of the study, especially considering that smaller MFIs typically concentrate on wealthier and more densely-populated regions (AMFI-K, 2014). Furthermore, given the contacts were available for this study, the sample consists exclusively of commercial

shareholding-type MFIs. Archival documents from AMFI-K however indicate that other forms of MFIs exist too, such as NGOs. The issue with including such institutions in the sample is that they are often based in more remote and rural locations. Thus, in light of these constraints, this study would benefit greatly from additional research which either employs a broader scope or complements the current findings with new insights from more rural MFIs.

8. CONCLUSION

The aim of this research is to contribute to the discussion surrounding microfinance mission drift, specifically by analysing innovations in the Kenyan microfinance industry at the hand of disruptive innovation theory.

In answer to the mission drift question, this research provides mixed results. Indeed, whereas some Kenyan MFIs are probably drifting away from their social mission, others appear to be cross-subsidizing their low-end operations, and others, still, were seemingly never set up with social intentions in mind. Building on these findings, an important contribution made by this study is to point out the complexity of the MFI landscape, at least in Kenya, and to consequently call for a finer categorization of MFIs according to the importance they accord to social objectives. Doing so should allow future research to more accurately study the social impact that microfinance institutions are intentionally generating, or alternatively, the social impact that other MFIs are unintentionally generating.

Then, looking at the industry through the lens of disruptive innovation, three insights are distilled. First, in support of the conflicting findings about MFI mission drift, the innovation scan revealed the existence of both sustaining innovations (i.e., mobile banking platforms and algorithmic credit rating) and of disruptive innovations (i.e., microfinance retail innovations) in Kenya. Note though that sustaining innovations were clearly more prominent on the microfinance scene.

Secondly, the analysis surprisingly indicated that, at present, social impact is not a key performance dimension in the Kenyan microfinance industry. In other words, most MFIs currently are not actively seeking to increase their social impact. The findings do however suggest that social impact is being brought (back) into the spotlight, in part thanks to the potentially disruptive microfinance retail innovations.

Thirdly, using extant literature on optimal responses to disruptive threats, recommendations are provided to microfinance practitioners. For example, Kenyan MFI executives are encouraged to clearly define and understand the needs of their target market, so as to determine whether microfinance retail products constitute a threat to their business. If they do, then it is recommended that the MFI adopt the innovation. If not, then the MFI is encouraged to strengthen its own value proposition – for example quick disbursement of funds – and to appeal to the booming micro, small and medium enterprise financing business in Kenya.

In closing, the study also briefly touches upon how the subscription to a double bottom-line (i.e., seeking both positive financial returns and social returns) impacts on MFIs' ability to recognize disruptive threats. Initial findings appear to indicate that having a social bottom-line does in fact increase the likelihood of detecting disruptive innovations, probably because having social priorities makes MFIs more attentive to their clients' needs. Given the potential benefit for both social and commercial enterprises, future research is called upon to further investigate this relationship between bottom-line priorities and disruptive capabilities.

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10. APPENDIX

QUANTITATIVE DATA

KENYAN MICROFINANCE MARKET: DESCRIPTIVE STATISTICS

Table 3: Key statistics for the Kenyan microfinance market show that it is growing

Summary: The number of institutions reporting to AMFI increased by 10 percent per annum. The bulk (~65%) was made up of credit-only MFIs. Three banks are accounted for in the report – Equity Bank, Jamii Bora Bank, and K-Rep. Total outstanding gross loan portfolio was Ksh 53.8bn with MFBs commanded just over 50% of this portfolio. Note that three institutions weighed particular heavily in the overall market: Equity Bank (Kenya’s second largest commercial bank), KWFT (Kenya’s largest microfinance bank) and Faulu (second largest microfinance bank). Together, they made up 74% of the total loan portfolio of the sample.

	2011	2012	2013	CAGR ¹
Number of MFIs	29	32	35	10%
Credit-Only	19	21	23	10%
MFBs	6	7	9	22%
Banks	3	3	3	0%
Gross Loan Portfolio (Ksh billions; microfinance only)	34.8	41.8	53.8	24%
Credit-Only	6.6	9.2	12.0	35%
MFBs	16.5	20.6	28.2	31%
Banks	11.7	12.0	13.6	8%
Active borrowers (Microfinance only)	728,628	780,658	808,399	5%
Credit-Only	221,902	267,369	279,825	12%
MFBs	383,412	385,509	390,732	1%
Banks	123,314	127,780	137,842	6%
Average Outstanding Loan Balance² (Ksh; microfinance only)	47,784	53,496	66,605	18%
Credit-Only	29,743	34,409	42,884	20%
MFBs	43,035	53,436	72,172	30%
Banks	95,017	93,617	98,976	2%
Active clients (lending + deposit-taking + other)	829,161	927,236	1,062,621	13%
Credit-Only	266,462	342,187	368,740	18%
MFBs	562,699	585,049	693,881	11%
Banks	na	na	na	na
Number of Branches	382	566	698	35%
Credit-Only	151	164	220	21%
MFBs	65	105	199	75%
Banks	166	292	279	30%

Own construction, based on data from AMFI-K Sector Reports (2012, 2013, & 2014)

1. Compound Annual Growth Rate (CAGR).

2. Weighted Average

Table 4: Profitability in the microfinance sector is on the rise, driven primarily by lower operational and funding costs for MFIs and MFBs.

Summary: For the sector overall, return on assets remained unchanged at 4.8%. The data nevertheless shows a gradual improvement in the profitability of non-bank MFIs (i.e., credit-only MFIs and MFBs). Part of this may be attributed to the rise in portfolio yields. The data on yields also highlights the important divide that exists between rates charged by banks and those charged by MFIs and MFBs. One factor contributing to this disparity is the cheaper source of funding to which commercial banks have access.

The data also show a serious reduction in operating costs, especially for banks. Two elements may provide an explanation for this. First, regulation introduced in 2009 permits banks to serve customers through third-party agents (a concept known as agency-banking). Especially for banks, which rely heavily on a costly network of branches to reach customers, this Act provides opportunities to reduce operational expenses per client. Another element is the continued adoption of mobile money platforms like M-Pesa, which reduces the need for physical money transportation infrastructure and speeds up the money delivery process.

	2011	2012	2013	CAGR
Return on Assets^{1,2}				
Whole Sector ³	4.8%	4.5%	4.8%	0%
Sector without Banks ³	1.3%	1.8%	2.0%	24%
Portfolio Yield⁴				
Whole Sector ³	22.0%	25.6%	22.4%	1%
Sector without Banks ³	33.9%	37.8%	35.7%	3%
Operational Expenses Ratio⁵				
Whole Sector ³	17.3%	16.8%	13.9%	-10%
Sector without Banks ³	27.6%	28.0%	25.3%	-4%
Provision Expenses Ratio⁶				
Whole Sector ³	1.5%	1.4%	1.4%	-3%
Sector without Banks ³	-0.3%	1.2%	2.0%	na
Funding Expenses Ratio⁷				
Whole Sector ³	4.5%	6.7%	4.3%	-2%
Sector without Banks ³	9.1%	9.7%	8.1%	-6%

Own construction, based on data from AMFI-K (2012, 2013, & 2014)

1. ROA calculated before donations
2. ROA can be positive despite expense ratios exceeding portfolio yield. This is due for example to non-lending related to income
3. Weighted average
4. Interest and fee revenues on loan portfolio / Gross outstanding loan portfolio
5. OPEX / Gross outstanding loan portfolio
6. Loan loss provision expenses / Gross outstanding loan portfolio
7. Interest and fee expenses on funding liabilities / Gross outstanding loan portfolio

Table 5: Financial inclusion of Kenyans is on the rise, but important divides endure

Summary: Financial inclusion in Kenya has risen from 60.7% in 2006 to 74.6% in 2013. However, more significantly, much of the former 'informal' provision of finance has migrated to formal forms – the share of the informal sector has indeed shrunk from 33.3% in 2006 to a mere 7.8% in 2013, with consumers migrating toward non-prudential/registered and prudential providers. In the case of non-prudential providers, the success can largely be attributed to mobile banking platforms. On the other hand, the jump by ten percentage points from 2009 to 2013 noted for prudential providers is due to the transformation of key credit-only MFIs and SACCOs into deposit-taking institutions.

Financial inclusion has especially deepened in urban areas, rising from 58% to 84.2% in just seven years. Over the same period, inclusion in rural areas only increased by eight percentage points, from 61.6% to 69.4%. Microfinance in Kenya has not been very helpful at reaching out to the financially excluded rural dwellers. This is reflected in the divide that exists between various wealth classes: in 2013, less than half of Kenya's poorest 20% had access to finance whereas over 90% of the richest 40% did have it.

		Access Strand				Financial Inclusion ⁶
		(% of individuals who use the stated access strand)				
	Survey Year / Wealth Class	Excluded ²	Informal ³	Formal other ⁴	Formal prudential ⁵	
Overall	2006	39.3%	33.3%	12.4%	15.0%	60.7%
	2009	31.4%	27.2%	19.3%	22.1%	68.6%
	2013	25.4%	7.8%	34.1%	32.7%	74.6%
Rural	2006	38.4%	37.0%	13.1%	11.5%	61.6%
	2009	34.5%	30.0%	18.5%	17.0%	65.5%
	2013	30.6%	9.8%	34.4%	25.2%	69.4%
Urban	2006	42.0%	22.2%	10.3%	25.5%	58.0%
	2009	20.1%	16.8%	22.2%	40.9%	79.9%
	2013	15.8%	4.3%	33.3%	46.6%	84.2%
Wealth ¹	Poorest 20%	55.3%	11.9%	24.9%	7.9%	44.7%
	20 - 40%	29.1%	12.8%	40.7%	17.4%	70.9%
	40 - 60%	24.1%	9.1%	39.2%	27.6%	75.9%
	60 - 80%	9.9%	4.8%	40.5%	44.8%	90.1%
	Richest 20%	5.7%	1.1%	26.6%	66.6%	94.3%

Own construction based on Central Bank of Kenya & FSD Kenya. (2013)

1. **Excluded:** no access to any structured form of financial services
2. **Informal:** unregulated forms of structured provision (informal groups, employers, moneylenders)
3. **Formal registered:** providers that are registered under a law or government direct interventions (Credit only MFIs and SACCOs, Kenya Government)
Formal non-prudential: providers which are subject to non-prudential oversight by regulatory agencies or government departments (Mobile phone financial service providers, Postbank)
4. **Formal prudential:** providers which are prudentially regulated and supervised by independent statutory regulatory agencies (commercial banks, insurance providers, microfinance banks & deposit-taking SACCOs (since 2013))
5. Calculated as 100% - % excluded

KENYA MICROFINANCE: INDUSTRY STRUCTURE

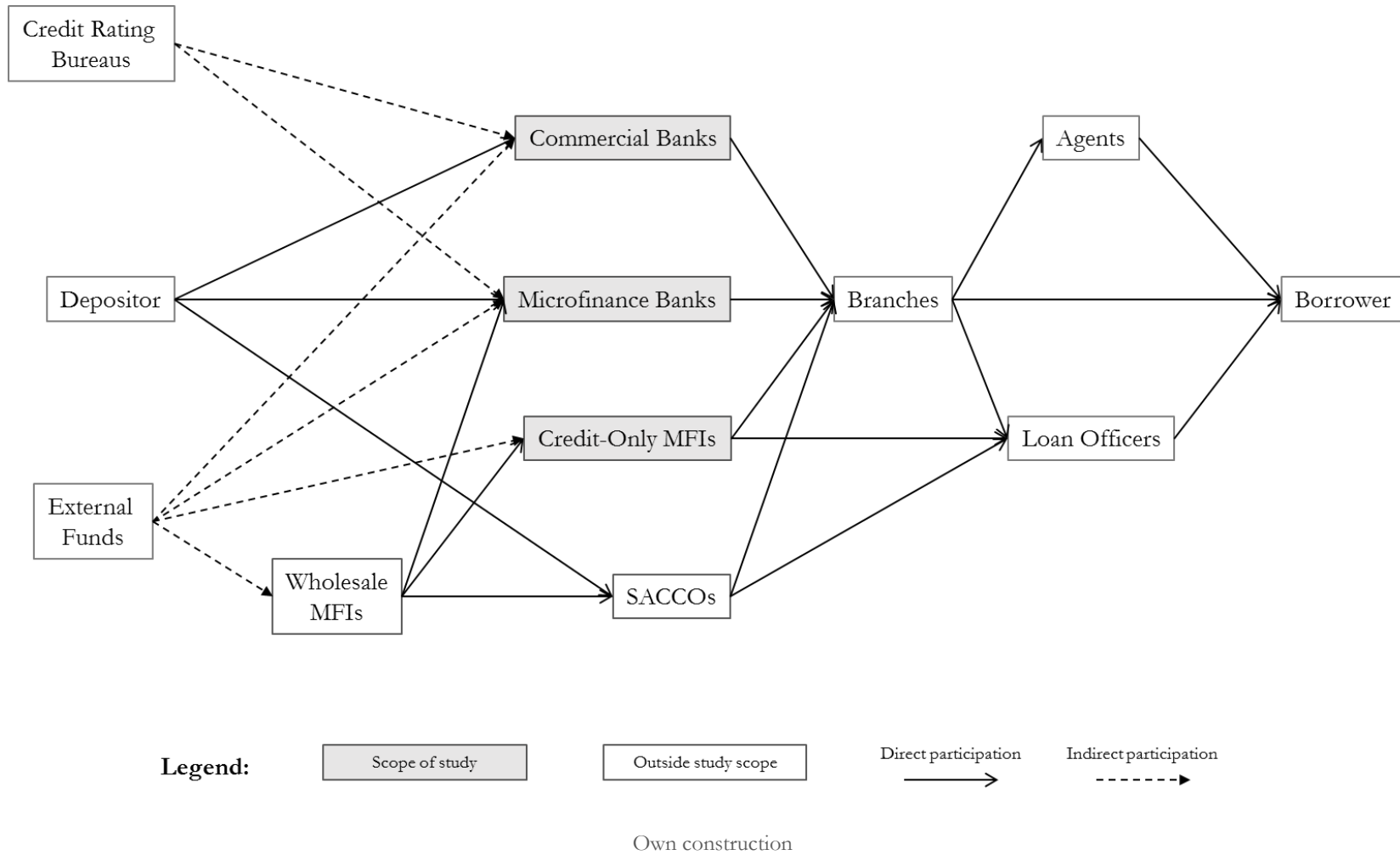
Table 6: The Kenyan microfinance market is composed of five broad types of institutions, ranging from credit-only financial institutions to full-fledged banks.

Institution Type	Number of Institutions	Definition
Credit-Only MFIs	30 ¹	Microfinance institution that is only allowed to extend credit facilities to clients
Microfinance Banks	13 ²	Microfinance institution that is allowed to disburse loans <i>and</i> collect deposits from clients
Commercial Banks	42 ³	Financial institution that caters to the general public by lending and collecting deposits
Wholesale MFIs	4 ⁴	Institution that collects and receives money which it lends on to microfinance institutions
Savings and Credit Cooperative Societies	~2,000 ⁵	Co-operative that offers financial services with major focus on mobilization of funds and provision of affordable credit to its members who are both the owners and users.
Deposit-taking SACCOs ⁷	181 ⁶	The Deposit Taking Saccos provide basic 'banking' services and are licensed and supervised under the Sacco Societies Act of 2008.
Non deposit-taking SACCOs ⁸	1,995 ⁵	Non-Deposit taking Saccos provide a limited range of savings and credit products, are registered and supervised under the Cooperative Services Act, CAP 490.

Own construction

^{1,2,3} Central Bank of Kenya; ⁴ AMFI-K (2014); ⁵ Soft Kenya; ⁶ SASRA (2016); ⁷ Only includes licensed DT'S; ⁸ Only includes active non-deposit taking SACCOs

Figure 4: Structure of the Kenyan microfinance market



ZOOM ON SOCIAL IMPACT TRACKING MFIS

Table 7: The MFIs that best track their social impact also appear to be larger than average

Summary: In 2013, the median MFI in Kenya operated 10 branches with 92 staff, booking a gross loan portfolio of \$4.95 million with roughly 11,000 active borrowers. In comparison, the four social tracking MFIs identified in an interview with Mrs. Karanja from AMFI-K are larger. Especially KWFT vastly surpasses the median figures.

Institution ¹	Branches	Staff	Gross Loan Portfolio (in USD million)	Active Borrowers
Median²	10	92	4.95	10,984
BIMAS	20	124	5.00	11,407
Difference	+111%	+35%	+1%	+4%
ECLOF	17	189	7.00	17,168
Difference	+79%	+105%	+41%	+56%
KWFT	27	2,408	173.00	256,640
Difference	+184%	+2517%	+3395%	+2236%
Letshego	13	149	9.80	13,842
Difference	+37%	+62%	+98%	+26%

Own construction; based on Association of Microfinance Institutions-K (2014)



1. Data reported are for the financial year 2013.

2. The median was used to avoid giving equal weight to outliers, such as Equity Bank and KWFT.

QUALITATIVE DATA

MICROFINANCE RETAIL INNOVATIONS: M-KOPA & SANERGY

Table 8: M-Kopa and Fresh Life: two different types of microfinance retail innovations

	M-Kopa	Fresh Life (Sanergy)
Main Product	 <p>Solar Panels</p>	 <p>Portable toilets</p>
Description	<p>It includes a solar panel, two LED bulbs, an LED flashlight, a rechargeable radio, and adaptors for charging a phone. The kit comes with a two-year warranty, and its battery is designed to last at least four years.</p>	<p>Sanergy builds a network of high-quality “Fresh Life” branded toilets and franchises them to local micro-entrepreneurs. Sanergy employees collect waste from the toilets daily and deliver it to a central processing facility where the waste is converted into organic fertilizer for farmers.</p>
Price	<p>~\$200 Loan granted by M-Kopa and repaid via M-Pesa</p>	<p>~\$500 Loan granted via Kiva, the online crowdfunding platform</p>
Achievements	<p>M-Kopa estimates that 80 percent of its customers live on less than \$2 a day. Three-quarters of them rely on small-scale farming as their primary or secondary source of income; the rest run small businesses. Energy accounts for a significant amount of their spending.</p>	<p>Since their pilot phase in 2011, Sanergy has scaled to over 170 franchised toilets in three of Nairobi’s slum areas, with over 8,000 uses per day. The toilets have been used more than 1,000,000 times, and Sanergy has safely removed more than 500 tons of waste from the community.</p>

Sources: Faris (2015) for M-Kopa information; Schiller (2015) for Sanergy information

Disruptive Innovation in the Kenyan Microfinance Industry

1. Administration

- Date and Time
- Participants (Name, Organisation & Title)
- Duration of Interview

2. Introduction to Organisation

- Name
- Key statistics
- Vision and Mission
- Successes and Challenges

3. Perspectives on Kenyan Microfinance Industry

- Size and growth prospects
- Competition and Ancillary Industries
- Trends

4. Key Success Factors

- Key Processes
- Key Activities

5. Main Fears and Obstacles

- Innovation-led
- Competition-led
- Regulation-led

INTERVIEW NOTES & TRANSCRIPTS

Platinum Credit Ltd - OBARA, Ignatius

Date & Time	11 June 2016, 10AM
Interviewee & Title	Obara Ignatius; Director at Platinum Credit Ltd and owner of Quest Holdings
Method	In Person

Marius: Good morning Ignatius. Can you tell me a little about Platinum Credit?

Platinum Credit is a commercial credit-only MFI that provides two products: consumer lending and lending to small businesses. We do not receive any donor or subsidy funding. We operate in three countries: Kenya, Tanzania, and Uganda. In Kenya specifically, we now have a loan portfolio of around \$27m and around 25,000 active borrowers. This translates into roughly 5% of the overall market for microfinance.

Our success is derived from our go-to-market strategy. We believe the best way to provide services is by going through employers. We offer salary advances and salary-backed loans to employees. We are especially strong with civil servants.

Our portfolio yields are 40 – 65% per annum, with sourcing of funds costing us 18 – 26% per annum. So we make a return of about 30%. Our distribution costs are also much lower than others, especially retail banks. Whereas a satellite centre might cost us \$1,200 - \$2,000 per month, banks pay over \$20,000 per month to operate their branches.

Another strength of ours is rapid disbursements. In this area, we are always one step ahead of the game. In fact, today, we are disbursing 50% of requests in less than 12 hours.

M: In analysing your data, I found that since 2012 your profitability has increased considerably, together with a rise in the average loan size per borrower. How did this happen?

That is mainly the result of the introduction of our asset financing product in 2014, which was hugely successful. The product has a 98 – 99% payback rate and the outstanding loans grow at 40% year-on-year.

Thanks to the success of such products, I expect that Platinum Credit will continue to do well. Over the next years I expect the gross disbursement amounts will increase at ~35% per annum.

M: That is very rapid growth indeed. What are the key success factors to being so successful in this industry?

I would say there are three central factors. The first is quick disbursement, so as to maximize the amount lent out and maximize returns. The second is efficient collection. Indeed, the scale achieved by quick disbursement only makes sense if collection is efficient and cheap enough to not eat away at your profits. Finally, availability of cash is crucial. These three components can quite easily be achieved with good governance and proactive leadership, both of which we have at Platinum.

M: It seems to me like Platinum Credit is active in the higher-end segment of the microfinance market. What is your take on the financial vs. social objective debate?

Deep outreach is possible but you need to mark-up appropriately on your costs. Unfortunately, the deeper you go (i.e., the more rural your operations), the higher your cost per borrower and therefore, the higher your interest rates should be.

If your objective is to bring people out of poverty, then microfinance is not the way to go. Rather, you should provide educational programs and programs that help the poor generate some form of income. Bill Gates' chicken project is a good example of this. In fact, I am thinking of doing something similar myself.

M: How do you perceive microfinance *vis-à-vis* commercial banking?

You must understand how microfinance came to be. In Kenya, in 1984 when the first commercial banks were set up, people could not open an account with less than KES 20,000 (~\$200). This pushed several people to found banks for the unbanked. Equity and KCB grew this way, and are now the biggest commercial banks in the country.

One important note as well is that Platinum clients are banking with commercial banks. So the two are definitely linked, but I would say they complement each other more than they compete with one another.

M: In terms of innovation, what are the main up-and-coming innovations that will affect the market?

M-Pesa and subsequent mobile platforms have shaken this market considerably, and I expect them to continue doing so over the years to come. That said, big data will be the biggest thing for us. For example, leveraging data to prevent bad debt and predict creditworthiness more accurately. Such technologies, I believe, will help reduce non-performing loans from their current level of 5 – 10%, to less than 5%. In doing so, they will bring down the mark-up MFIs attach to their products. All in all, I expect monthly rates will decrease from 5 – 7% today, to 3%.

Moreover, big data will allow MFIs to bypass face-to-face interaction entirely. This will lead to sector commoditization, whereby anyone with spare cash and a smartphone will be able to be his/her own MFI. Already today we are seeing the likes of Branch and Kiva do this.

Another innovation is the agency-banking act of 2009 which allows banks to hire agents to take deposits. This has disrupted the distribution scene.

M: All of these innovations appear to favour commercial banks, by making it easier for them to serve the microfinance market. Are you considering transforming into a bank anytime soon?

Yes and no. We are aware of the risks these innovations pose, and I assure you, we are ready to convert into a bank at any point in time. At present though, this doesn't seem to be in our interest. Like I said before, Platinum Credit's main selling point is its rapid disbursement. By transforming into a bank, we would be subject to various rules and

regulations which would make such speeds unsustainable, if not impossible. Furthermore, regulatory supervision would force us to balance our portfolio, so we wouldn't be allowed to expand as quickly into our market as we have done so far.

M: Does that mean that we should expect to see a mature multi-faced microfinance industry in the future? That is, will all of these different business models continue to coexist?

Not necessarily. There are now many MFIs in the market... too many perhaps. So in the coming 5 years I expect quite some consolidation, either by merger and acquisition, or by exit of the least successful players. Consolidation will especially happen between credit-only MFIs, because they need to achieve larger scale to be profitable. At the same time, we are seeing commercial banks targeting poorer segments of the population, so they might also participate in the consolidation trend.

First Access – MASUE, Peter

Date & Time	14 June 2016, 10AM
Interviewee & Title	Masue Peter; Business Development Associate at First Access
Method	Skype Call

Marius: Good morning Peter. Can you tell me a little about First Access? What is it you do exactly?

First Access is a data analytics company based in the US but operating in Africa. Currently we are 12 staff: 4 in Dar es Salaam (Tanzania) and 8 in New York (USA). Our founders have all had prior experience in the microfinance field, and they came to one conclusion: a major challenge that remains to be dealt with are the high interest rates. The mission they set for themselves – and for us by extension – is bringing these rates down by decreasing the cost of lending for MFIs.

The way we do this is through customized algorithms that attribute instant credit scores for MFI clients. Our algorithms look at demographics, financial transactions, call volumes and texting volumes to predict creditworthiness.

M: Which markets do you operate in?

Currently we are conducting business and/or prospecting clients in Tanzania, Kenya, Uganda and Nigeria.

M: In these markets, who are your main competitors and what are your unique selling points against their technology?

In Africa we don't really have any direct competitors. The closest to our models are Tiixa and Cignifi. Branch is also doing something similar to us, but they also cover the lending side. So their product attributes a credit score to an individual, and then also disburses the money to him.

Versus our competitors our main USP is that we offer a *customized* credit scoring algorithm. So we group borrowers in risk categories based on *your* data and *your* client and *your* needs.

M: You mentioned that Branch does both back- and front-end loan disbursement. Is that something you, at First Access, are also considering as growth paths?

In the foreseeable future, we are definitely not considering becoming a MFI or disbursing loans the way Branch does. That is primarily because of a conflict of interest that would arise: how can we disburse loans ourselves, and at the same time try to sell our technology to other MFIs?

Growth could however come from back-end capability development. Again, we are an analytics team, so there are surely other IT-based challenges that our teams can help solve.

M: You also mentioned that your USP is based on customization. Does this not hamper your ability to scale? For example, how long does it take for you to process a client request?

Scaling has not proved problematic so far, mainly because we use a flexible base algorithm around which we construct customized solutions.

It takes us approximately 1 month to process a client request. We start with data consultation, where our aim is to figure out whether the data is good and correct. If necessary, we advise the client on how to modify his data collection processes. Once the data is good, our engineers work on the customization. Because of this one-to-one service, as well as general disparities in MFI size and location, our pricing structure is also customized.

M: As with any innovation, surely as you attempt to scale First Access you are encountering drivers and barriers to success. Could you tell me which are the main ones?

We notice two key drivers of success. The first is the rise of Credit Rating Bureaus since 2013. Credit Rating Bureaus help us by making it easier to access information and data about customers. They also formalize the data, which again helps us. Another key driver is the very rapid evolution of the MFI environment. Cost of lending is a challenge to all MFIs, and bringing this down is key to remaining competitive. In that sense, our solution is very attractive.

I can also share with you two important barriers we are facing as we scale. The first, as with many things in Africa, is working with governments on getting First Access technology approved for financial institutions. Another important challenge is that instant credit scores are a new idea or concept. MFIs in Africa however tend to be quite conservative so they have been quite reluctant to adopt our technology.

M: Instant credit scoring is poised to be one of the disruptive forces to hit the microfinance industry. Which other innovation do you perceive as having such an impact?

I don't think any other innovation is as disruptive as ours. However, other noteworthy cases are IT platforms that aim at quick money disbursement, such as Branch. They are innovative in their ability to bring together P2P lending and quick disbursement.

Association of Microfinance Institutions-Kenya (AMFI-K) – KARANJA, Caroline

Date & Time	15 June 2016, 10AM
Interviewee & Title	Karanja Caroline; Programmes Manager-Membership & Capacity Building at the Kenyan Association of Microfinance Institutions (AMFI)
Method	In Person

Marius: Good morning Carol. Tell me a bit about AMFI. Who are you and what is it you do exactly?

AMFI today counts roughly 40 members:

- Commercial banks (i.e., Equity Bank, Post Bank (deposits only), Jamii Bora, K-Rep)
- Microfinance Banks¹⁸ (MFBs) (e.g., KWFT, Faulu)
- Wholesale MFIs (organisations that lend money to MFIs)
- Credit-only MFIs (e.g., Platinum Credit)
- Developmental organisations
- Savings and Credit Co-Operatives (SACCOs)

AMFI is structure around 4 pillars:

1. Advocacy and Lobbying
2. Capacity Building
3. Networking and Linkages
4. Research and Knowledge Management

M: I would like to come back to your members for a second. You mentioned that all MFBs are members of AMFI. I have noted in the data that their numbers are rising quite quickly. Is that a trend that you are noticing in the market: credit-only MFIs transforming into MFBs?

¹⁸ Note that all of Kenya's MFBs are members of AMFI.

Indeed, their numbers have been rising. However, most of the MFBs are actually newly set up entities, as opposed to credit-only's transforming into MFBs. This is because transforming into an MFB has proven to be quite a challenge for them, not least because of compliance issues such as capital requirements.

M: Can you tell me some more about the four pillars?

Advocacy and lobbying is quite an important part of what we do, especially of late. Although we cannot enact legislation on our own, our members count on us to contribute to the drafting of regulation for the sector. I can especially mention two things here.

First, from a lobbying perspective, we are trying to reduce the differences in risk classification between MFBs and retail banks. Microfinance is still considered as riskier than commercial banking, and this is hurting the MFBs in terms of cost of funding.

Second, we are currently supporting the government in the drafting of the “Financial Services Authority Bill” which will seek to regulate market conduct of especially credit-only MFIs. This bill will for example aim at deterring unlawful lenders from charging exorbitant interest rates (e.g., 60% per month) and protecting unknowing clients. We strongly believe in this bill, as it is also supported by the new Central Bank Governor who has made it a priority to streamline standards and products in the financial sector.

Networking and Linkages is all about bringing together key players in the microfinance industry. For example, we organise mandatory quarterly meetings which are attended by the CEOs of each of our member institutions.

Capacity building is all about bolstering the capabilities of our member institutions. Recently, we have focused mainly on risk management, corporate governance, and social performance. We begin by assessing the needs of our members. Then we hire consultants or industry experts to deliver the seminar or workshop. These workshops are often based around internal and external (local and international) benchmarks and best practices.

Lastly, research and knowledge management is supposed to deliver insights into the industry. However, this is a very big challenge for us.

M: Which innovations do you think will impact the market in the coming years? And how do these affect your four pillars?

One innovation is the increased use of mobile phones for banking purposes. I'm sure you have heard of M-Pesa, M-Shwari, etc. These technologies allow MFIs to bypass infrastructure problems – which used to be a huge challenge – and change the delivery model completely.

Also from a regulatory point of view we are seeing change. One notable case is that of the “Agency-banking Act” of 2009 which allows banks to use agents for money-collection, thus limiting the need for setting up an expensive network of branches.

Another innovation that we are witnessing of late is the importance of tracking and improving social performance. Specifically, we look at whether these institutions are delivering on their promise and mission. For example, certain wholesale MFIs will not give MFIs a loan if they are not able to provide them with information related to their social impact.

M: Can you tell me more about social performance? Who are the best in class? How is the capacity building effort around this going?

As best in class MFIs, I can think of four: ECLOF, BIMAS, KWFT and Letshego. We are now trying to distil best practices from their operations, and imparting this knowledge onto other MFIs. In fact, a few weeks ago we held a training on this which was attended by around 20 MFIs.

Getting to this stage has however been quite tough, because even consultants and experts didn't understand the importance of measuring social performance. Therefore, we decided that strategically it would make more sense, and we would have a bigger impact, if we first trained consultants in this field. We then used them to train the MFIs.

Note that the government has also been very supportive in this field, for example by facilitating the empowerment of women in the counties.

M: Can you give me a concrete example of what MFIs are doing around social performance?

Sure, ECLOF is doing great in this area. They introduced a line of financial products they call WASH. This stands for water, sanitation, ... Through these products, they aim to improve the hygiene of people in rural areas.

KWFT has also introduced a line of products geared toward people in agriculture. They sell them solar panels and biogas installations on loan, and through these, people are able to electrify their homes. Some are even able to sell some of the electricity they generate.

M: So these WASH products are in fact consumption loans? Or is there a way clients can generate income with what they buy/receive?

The loans are indeed geared toward consumption. But they help women make more money from their small businesses by allowing them to do what they did before much faster. For example, they no longer have to walk to collect water. Instead, these products allow them to have water nearby. Because this frees up time for them, they can spend more time manning their shops.

M: I would like to now briefly discuss one specific case, namely Jamii Bora. The numbers reported in your annual sector reports seem to indicate that they are climbing up-market, forgetting about their past in microfinance. What is your take on this?

Jamii Bora is indeed losing touch with the microfinance market. In fact, I'm not sure what is happening with them. Recently for example, I heard that they are planning to shut down their flagship low-cost housing project. This project was initiated by the founder of the company, back in days, to help people in the streets get affordable housing. It's quite sad that this will be discontinued.

M: What can we expect from the Kenyan microfinance industry in the coming 5 – 10 years?

Three things:

1. Broader outreach, with MFIs building a national presence thanks to mobile technologies.
2. Deeper outreach, with MFIs tracking and seeking to improve their social performance.
3. More consolidation at an MFI level, so as to gain critical scale and reduce the cost of borrowing. We believe that the new central bank governor will be particularly supportive in this field. Moreover, we are noticing investment vehicles, such as Centum, acquiring and merging banks and other financial institutions.

Jamii Bora Bank - KIMANI, Samuel

Date & Time	16 June 2016, 12PM
Interviewee & Title	Kimani Samuel; Jamii Bora CEO Kagama Eliud; Jamii Bora CFO
Method	In Person

Marius: Good afternoon Samuel and Eliud. Can you tell me a little about Jamii Bora? What is it you do exactly?

Jamii Bora Bank was born from the merger of City Finance Bank and Jamii Bora Kenya, with the latter being much bigger. The original entity was started by a Swedish lady, Ingrid, who helped 50 street families and got them to start saving. With the pool of deposits grew the loan disbursement activities, which originally worked only through group lending.

Since 2012 however, we have changed our business model, now becoming an enterprise bank. That is, a bank for micro, small, and medium enterprises. We did this for two reasons. First, there has been a shift in the microfinance business, with many MFIs now focusing on businesses as opposed to people. This builds on the fact that banks today are more willing to finance microenterprises without collateral. Instead of requiring collateral, we look at stocks and cash flows to assess creditworthiness.

Furthermore, we see that traditional lending is dying because it is too expensive and makes no economic sense to pursue with a formal institution. Indeed, with M-Pesa and other technologies coming up, small lending has now moved to phones.

M: Given what you have just described to me, would you not say that you are abandoning your social mission for financial gains?

Not really. Let me be clear: we are here to make money. That said, we believe that by providing small loans to enterprises, we are able to help the owners make a better living for themselves. Socially-oriented MFIs on the other hand keep on giving, but with limited impact.

As a full-fledged bank, we are also able to accompany our clients as they progress and become wealthier. This is something that most MFIs cannot do: once their clients graduate – meaning they come out of poverty – they can no longer provide them with the loan size they require.

Lastly, I would say our impact is bigger than that of smaller MFIs because as a commercial bank we cannot accept payment delays. So we are very sharp and tough on enforcing lending agreements. This pressure shapes our clients' behaviour and teaches them the essentials of good governance.

M: You just mentioned a learning-by-doing effect brought about by your loans. What about actual education of your clients? Is that something you do actively?

Absolutely. Education is central to what we do, especially in developing economies. In fact, if you do not do it, you will face serious challenges down the road. At Jamii Bora, education of clients is done in two ways. First, we use partners which train our SME customers. We also train our relationship managers to advise their portfolios on wise business practices. In doing so, these managers also become more alert to possible defaults or loan servicing difficulties. Periodically, we also host workshops in classrooms.

M: As a bank, you are now competing against the likes of Equity and KCB (the two largest commercial banks in Kenya). What sets you apart from them?

We believe that we have a better understanding of the micro-enterprise and SME sector, because that is where our roots lie. Moreover, we have developed a strategy that helps us target and develop capabilities in specific sectors.

Eliud: We have identified 6 key sectors for growth. In doing so, we are now able to allocate people and resources to building capacity around these sectors. Our three main ones for example are (i) Trade, (ii) Hospitality, and (iii) Schools & Churches.

M: Why those sectors?

They are big and growing quickly. Also, we have merged stakeholders according to their banking needs. Trade for example is mainly borrowing-driven. Schools and churches on the other hand are deposit driven.

M: The microfinance industry is attracting quite some innovations. Take me through them. Which ones do you pay close attention and why?

I would speak of two innovations. The first one is one that we are about to bring to market with the Kenyan Post. The Post is introducing what they call M-Post which is basically a mobile post box. Whenever a package has been delivered to you, you receive a message which asks you whether you want to collect it yourself or whether it should be dropped off. If you select the drop off option, the Post will deliver it to you. Jamii Bora has partnered with M-Post in such a way that when you register an account with M-Post, the system will automatically ask whether you want to open a mobile bank account at Jamii Bora. If you say yes, our system will access the IPRS of the Post and get access to your ID details.

M: That sounds quite revolutionary. But so if I create such an account, I can bank with Jamii Bora both through my phone *and* through your network of branches?

No, this system will only allow you to bank through your phone. To gain access to our branch services, you will be asked to fill out more paperwork. In fact, that also brings us to the main challenge we will face with this innovation: getting *funded* accounts – i.e., accounts that have money deposited on them.

M: You spoke of a second innovation?

Yes, the second one we must remain vigilant against is M-Pesa. We have seen M-Pesa give rise to numerous financial products such as M-Shwari (mobile loans) and now coming is M-Akibu (government bonds issued for as little as KES 3,000 and available only via phone). This poses a threat for us because it attacks both our lending and our deposit-taking activities. Moreover, unlike a branch network which is very expensive to run, such services are able to offer services at minimal cost.

Premier Credit Ltd. – CARSON, Tim

Date & Time	17 June 2016, 4PM
Interviewee & Title	Carson Tim; CEO of Premier Credit Ltd.
Method	Phone Call

Marius: Good afternoon Tim. Can you tell me a little about Premier Credit?

We are a commercial credit-only MFI that lends capital, usually between KES 25,000 – 35,000 (\$250 - \$350), to micro and small enterprises.

We have 660 staff members, mainly loan officers, that help us in disbursing 12,000 loans per month, for a gross loan portfolio of KES 95m.

M: As MFIs seek to increase their financial returns, they are often criticized for forgetting about their social mission of helping the poor. What is your take on this?

First off, I should emphasize that we are a *commercial* institution, and we want to run our institution as a business. That said, we are certain that in doing business the way we do, we help people prosper. For example, we disburse loans to salespeople on the road who sell, say, carrots for KES 200. And through us, they are able to access the funding needed to build working capital and strengthen their asset base.

M: If you go as far down the economic pyramid as the carrot salesperson, surely you must take on quite some risk?

This is where our strength lies. We work hard to understand how our clients' business and cash flows work, and through that, assess their creditworthiness. This is done by our loan officers. The key element they assess is the stability of the client. They do so by looking at the age of the store/business, the client's bank or M-Pesa statements, and by questioning the client's supplier network. This is a very old-fashioned approach to appraising clients' creditworthiness, but it works well.

M: Your business model seems to work well, but can it be scaled?

Yes and no. It can be scaled when you focus on specific geographical areas that can be surveyed by our loan officers. Technological developments have also helped us tremendously, for example to automate and increase the disbursement speed, or to transfer funds to more rural clients. Mobile platforms have really been a fantastic innovation for us.

M: What is your take on algorithmic credit scoring technologies?

We think these technologies will come to complement what we do, but surely algorithms do not know our client as well as we do. So for now, we will certainly stick to the old-fashioned way of assessing clients.

M: Do you consider microfinance banks your competitors?

Not really. KWFT, Faulu and the likes are pushing upscale. Our most direct competitors are the 15 or so mobile lending platforms (e.g., M-Shwari, Branch, Jumo, ...). However, because they are not on-site with clients, their default rates are around 10 times higher than ours. In 2015 for example, our default rate was 1.8% whereas theirs was 11 – 12%.

Rich Management CEO – SATCHU, Aly-Khan

Date & Time	20 June 2016, 1PM
Interviewee & Title	Satchu Aly-Khan; CEO of Rich Management
Method	Phone call

Marius: Good afternoon Aly-Khan. I was hoping to get your expert opinion on some matters concerning microfinance in Kenya. First off, we are witnessing microfinance institutions transforming into full-fledge banks and moving upmarket in the process. What do you make of this development?

Overall I would say that this is a positive development because it confirms that microfinance is a viable business. Of course, the challenge as they grow is that it becomes tougher to service poorer clients because they typically require more sophisticated and customized supply chains.

M: Kenya has recently lost two commercial banks due to fraud and liquidity issues. Is this also something that is present at a Microfinance Bank (MFB) level?

No, right now it appears most MFBs are solvent and liquid. One notable exception is Rafiki, but this is because it was the microfinance arm of Chase Bank, one of the banks that went down this year. But overall these MFBs appear to be quite healthy, and as long as they remain well-capitalized they shouldn't have any problem to continue growing.

M: One frequent criticism addressed to MFIs is that they charge too high interest rates. Combine that with the extremely retail banking rates in Kenya, and you get a frightening picture. What do you expect in terms of rates over the coming years?

Indeed, MFI rates are considerably higher than those of commercial banks. I expect that the pressure and scrutiny under which MFIs fall will increase, and thus lead to a reduction in interest rates.

M: Does that mean that we should expect profitability levels to decline?

No, I think profitability will either stay untouched or even increase. First, efficiency has increased and will continue to do so. Also, as the sector continues to assert its sustainability and credibility in the Kenyan economy, I believe cheaper money will be offered to MFIs. Lastly, we should not forget technological improvements such as algorithmic credit scoring models which help MFIs decrease the number of non-performing loans. Take KCB (i.e., Kenya Commercial Bank, the country's largest commercial financial institution) for example, they have now built a \$9M portfolio book around these automated systems.

M: Microfinance vs. Retail banking: what can we expect over the coming years?

I think MFIs will face increased pressure from retail banks reaching down into poorer segments of the population. This is particularly salient given that retail banks operate a fixed-cost-heavy business model. Therefore, the marginal cost of serving microfinance clients is very low for them, especially when they can broaden their reach using mobile and algorithmic technology.

European Investment Bank – NZIOKA, Nicholas

Date & Time	21 June 2016, 9AM
Interviewee & Title	Nzioka, Nicholas; Senior Project Officer at the European Investment Bank Collin, Catherine; Head of Regional Representation Eastern and Central Africa at European Investment Bank
Method	In Person

Marius: Good morning Catherine and Nicholas. Tell me a bit about the European Investment Bank (i.e., EIB). Who are you and what is it you do exactly?

Catherine: The EIB is the investment bank of the European Union. Its shareholders are the EU member states. Its main activity is to provide lending facilities for public and private projects. Projects cover everything, from large-scale energy production projects to the extension of lending facilities to financial institutions. Altogether, our gross loan portfolio is €70bn, with 10% disbursed overseas.

Several years ago, we also introduced the ‘Impact Investing’ program which provided us with €500m in additional funding capacity, to be invested in riskier projects under one condition: our investment activities needed to be financially self-sufficient. Although it was a step in the right direction, the fact that we needed to ensure self-sufficiency limited us in our willingness to take on risk.

M: Where does MFI come into this portfolio?

Catherine: Microfinance is seen as a department of its own at the EIB. We believe that the approach to dealing with MFIs versus other financial institutions, and certainly versus other types of projects, needs to be different. One major reason for this is that the loans ultimately disbursed to the clients are very small, which is something we are not used to. So we operate with specialised microfinance teams for microfinance, and specialised finance teams for commercial/retail finance. Interestingly, we are noticing that for large commercial banks like KCB and Co-Op, we are often needing to send mixed teams because these banks increasingly deal with both high-end and low-end (i.e., microfinance) clients.

Nicholas: Our gross loan portfolio for microfinance in Kenya has been €51m over the past five years. We mainly lend to four front-end institutions: Faulu (€14m), K-Rep (€7m), Co-Op Bank (€20m), and Family Bank (€10). We also provide loans for wholesale MFIs that then lend on to other MFIs, such as KWFT and others.

Our lending mainly comes in the form of long-term loans (7 years). More precisely, we provide the institution with a loan in euros, which they convert into local currency. The loan is then repaid in instalments and in the local currency, at an interest rate of 9 – 12% p.a. Pricing depends on the cost of funds, the credit risk we attribute to the institution, and a currency exchange risk premium.

Our loans are used to grow the gross loan portfolio of the partner institutions. Basically, they are free to use the money as they wish, so long as they respect our ethical guidelines which asks them to invest in legal and ethical sectors. For example, they cannot use our loans for the tobacco industry.

Since we are a public entity, we must also report to the European Union. To do so, we ask of our partners that they report on the type of loan extended to the clients, the sector which is funded by the loan, the number of employees sustained by the financed microenterprises, the average loan amounts, the nature of the enterprise – small, medium or large, which we proxy with number of employees – the demography of the business owners – female, youth, etc. This data enables us to track our success, to report to the EU, and it even helps us to design new and more targeted products.

Finally, in addition to providing financial support, the EIB also helps MFIs with technical assistance, by providing training in, say, credit assessment (aimed at loan officers) or good business practices (aimed at micro-enterprises). These trainings are not carried out by us, but instead we recruit external consultants.

M: How do you select the institutions you work with?

In two ways. First and foremost, our lending behaviour is demand-driven, meaning that the institutions come to us, requesting lending facilities. If after our assessment we believe they are creditworthy, and that they will help further the EIB in its mission, then we provide them with loans. Additionally, we also look at past experience. That is, have we worked with these institutions in the past, at EIB level or more generally at a European level? If that is the case, then we will actively try to help them.

Note also that the EIB has an evaluation team that supports our operations team. They might help us in assessing impact that these institutions are having.

M: You mentioned that MFIs have to report back to you on the use of funds. What are some interesting takeaways you gather from the data?

For example, we know that most of our funds are being used to provide short term credit facilities to support traders' working capital requirements. We also know that the average loan amount in recent times is around €2,500, although contractually they are allowed to extend loans for up to €50,000.

M: Is it easy for MFIs to provide you with those data?

Yes. We provide them with an excel template which they need to populate. Most of the MFIs in Kenya have advanced Management Information Systems (i.e., MIS) so getting this information is quite simple for them.

M: You also mentioned something about designing new products? What exactly do you mean at the EIB when you talk about ‘different products’?

Our main product is known as a ‘MFI loan’. But recently data has helped us design a new product which we call ‘Smallholder Microfinance Facility’. It is targeted at smallholder farmers, helping them pay for inputs and increase their presence along the value chain.

M: But the terms of the loan are the same?

Indeed, they are exactly the same. The only difference is that our new product restricts MFIs to use the funds solely for the purpose of funding smallholder farming.

M: I would now like to turn toward innovation in microfinance. Which innovations do you, as the EIB, see as potentially disruptive for the microfinance sector?

The most obvious ones are mobile platforms. They help MFIs and banks to significantly increase their efficiency. Take Faulu for example. They operate a large network of channels for disbursing and collecting money. They were also one of the first to embrace the mobile platforms as a means of disbursing and collecting money. This has helped them fuel growth. Another fantastic example is KCB, which used to have roughly 5m clients in 2014. When they introduced KCB Mobi, their mobile banking platform, they doubled their client base to 10m over the span of one year!

Another interesting development has been crowdfunding. As the EIB, we funded a Danish microfinance crowdfunding platform named MyC4.

M: What about social impact? For example, poverty alleviation... Is that something the EIB pays attention to?

Nicholas: Yes, for the EIB there has to be an impact. Partner MFIs have to show that through their operations they are able to have a social impact, for example by increasing clients’ incomes and improving their standards of living.

Catherine: Furthermore, since two years we have introduced ‘Impact Investing 2.0’, a program which encourages the bank to take on more risk, without the constraint of needing to achieve self-sufficiency. Through the program, we believe that we can really begin to support out-of-the-box projects. In Kenya and the region for example, we are looking at M-Kopa and Mobisol, two companies providing the rural poor with solar panels that allow them to charge a phone and power several light bulbs.

M: So you ask the MFIs for reports on client income?

No. Rather, we assess sectors that have benefited from the loans. Are they growing? Do people within the sector seem to prosper? Then we also ask the MFIs about the impacts of their loans. Recall also that I mentioned an evaluation team. They support our operations by sampling clients and asking them questions related to their income and quality of life.

Kenya Women's Finance Trust (KWFT) – KAROKI, Veronica

Date & Time	23 June 2016, 8.30AM
Interviewee & Title	Karoki, Veronica; General manager of research and product development at KWFT Bank
Method	Phone Call

Marius: Good morning Veronica. Could you tell me a little about KWFT?

Veronica: we were founded in 1981 as a credit-only MFI. As we grew, we began needing access to cheaper funds, so in 2010 we transformed into a deposit-taking MFI. This gave us access to cheaper funds, but also enabled us to bring new deposit-related products to our clients. It is only since 2014 that we are known as a Microfinance Bank. We lobbied for this new name (i.e., Microfinance Bank vs. Deposit-Taking MFI) because we realised that it was confusing clients.

As our name suggests, our business focuses on women, particularly low-income earners. More recently we have also begun expansion into the SME market, but this only represents 25 – 30% of our portfolio. Our business is primarily (~80%) conducted in rural parts of the country. In fact, we have the largest reach by far, with a presence in 45 of the country's 47 counties, through 242 offices.

On the private banking side, we operate through both individual and group lending. Group lending is at our root, so today it still accounts for 70% of our number of borrowers, and 50% of the gross loan portfolio. Clearly, this is mainly focused on rural areas. Individual lending is also there, and it is growing. Currently, only 30% of our borrowers receive money under this structure, but they represent 50% of total loans, mainly because the average loan size tends to be bigger. Individual loans are mainly disbursed in rural-urban and urban areas.

M: You mentioned individual loans being bigger than average group lending loans. I expect this is also the case with SME lending. This is interesting because in the data that is available on your organisation, you notice quite starkly that the average loan balance per borrower is on the rise. Are you not afraid that this means that you are abandoning your core clientele?

Not really. First, and this is quite important here in Kenya, you need to take into account inflation. Inflation on its own should warrant an increase in average loan size year-on-year. Secondly, our clientele is growing. As mentioned before, we are expanding into the SME markets, and growing our urban footprint. This enables us to disburse larger

loans and increase profitability levels overall. But it does not mean we are losing focus on the rural markets. If you look at our network on-the-ground for example, this is mostly deployed in rural areas.

M: What would you say are your main sources of competitive advantage versus other MFIs or commercial banks?

We have several. First, our focus on women has enabled us to truly understand this market, and develop products that cater to client needs. We are also very good with group lending, in part because we place a lot of emphasis on management of group cohesion. Third, we have a very large product portfolio that is designed to be highly relevant to client needs. You see, KWFT has got a very strong customer relation network on the ground, and this enables us to pick up on client frustrations, needs, etc. As head of research and product development, it is my job to collect those insights and transform them into successful products. One example of this is our micro housing loan. Research showed that 70% of rural houses are built and renovated incrementally. Realizing this, we decided to develop a loan that allows for just that: building your house incrementally. Today, this product commands a KES 2bn (~\$20m) portfolio.

M: The houses that are built or renovated are, I assume, for private use. This means that they will not help the loan recipient generate more income. So which funds do you expect them to use to service their loan?

The most important aspect is proper due diligence at the outset of the transaction: we make sure that our loans don't impoverish the client by looking at his/her capacity to repay. But even beyond that, at KWFT we value having a mix of financial, social, and environmental impact. Helping rural families improve their housing infrastructure has obvious social benefits. From a financial perspective, it helps them decrease their health costs and enhances their psychological well-being, which ultimately translates into higher productivity and better living standards.

M: You mentioned the housing loan product. Are there any other innovative products that you have brought to market recently?

Lately we have done quite a lot in terms of agricultural loans. This ranges from asset finance, to increase farmers' productivity and yields, to micro-insurance, to even financing biogas fertilizer installations. Our market research has helped us devise adequate products for each region of Kenya. This is important because the type of agricultural product and activity that goes on differs from area to area.

M: Which innovations are you wary of at KWFT? That is, which innovations do you perceive as a threat or an opportunity?

The main one is the digitalization of processes and loans. Digitalization increases efficiency and makes banking more convenient for the client.

M: Digital solutions are also making it easier for commercial banks to downscale into microfinance. Is that something that scares you – the entry of commercial banks into your playing field?

It certainly scares us. That said, my personal opinion is that banks are disbursing microloans but not to micro clients. In other words, through M-Shwari, I could request a \$100 loan, which would be labelled as microfinance. But I am not a microfinance client. So I think it remains to be seen just how successful banks will be in the microfinance market.

M: You mentioned earlier that you sell biogas installations on loans. This sounds a lot like an up-and-coming innovative business: M-Kopa. Do you perceive them as competitors?

Not at all. In fact, I don't want them here at all. You see, M-Kopa sells its solar product at KES 18,000 (~\$180) and attaches to it a mobile module that allows it to shut down the system as soon as the client fails to make one instalment. Especially in rural areas, you cannot do this. What about if the person had to go to hospital, or needed to pay school fees that month?

We sell the same product – even more performant I would say – but we sell it at KES 8,000 (~\$80), and we take the time to understand our clients, and their reasons for not paying. You see, M-Kopa just doesn't have the same connectedness with clients.