‘Milking The Elephant’: Financial Markets as Real Markets in Kenya

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ABSTRACT

Financial liberalization policies in the 1990s were intended to raise formal sector interest rates, enhance competition and expand access for users. This article investigates patterns of provision and use in a local financial market in Karatina, Kenya, at the end of the 1990s after a period of financial and economic liberalization. It takes a holistic approach, examining both formal and informal financial arrangements and microfinance interventions. This is because the role of the informal financial sector is particularly important for poor people and has received relatively little attention in the discussion of the consequences of reform. The author does this using a ‘real’ markets approach that sees markets as socially regulated and structured. Significant provision by the mutual sector (formal and informal), and poor lending performance by the banking sector is explained through an examination of the characteristics of the services on offer and their embeddedness in social relations, culture and politics.

INTRODUCTION

Financial sector reform and adjustment policies have been in operation since the late 1980s and a considerable body of work has developed in theorizing and investigating their consequences. This work has mainly concentrated on examining the operation and consequences of reform for the formal financial sector. However, the majority of economic actors in low-income countries do not directly or significantly participate in the formal financial sector and since the scale of their transactions is small, the financial arrangements in which they do participate are generally regarded as irrelevant to formal financial sector reform.

While the analysis of financial sector reform programmes has on the whole paid little attention to their impact on poor people’s financial arrangements, the thinking behind these policies — the financial repression thesis — has considerably influenced the way in which interventions to provide financial services to poor people are designed and implemented. Donor interest in the provision of financial services through the development

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of self-sustaining microfinance organizations[1] (MFOs) has expanded significantly in the late 1990s. Despite this proliferation of interest and interventions, analysis that goes beyond the level of the direct impact on users to a broader concern with the financial market, is almost non-existent.

The objective of this research was therefore to investigate the operation of a local level financial market in a holistic way, exploring both the formal and informal dimensions of its operation, and to obtain a view of changes in service provision and use over recent years, especially to understand whether and how financial liberalization and the expansion of microfinance organizations in the market had created opportunities and expanded access for users. The research was underpinned by the view that markets are embedded in wider social institutions and that explanations of changing provision and use would require investigation of the wider social, cultural and political context.

This article first sets out a brief review of the underlying debates in policy and theory. After explaining the research methodology, key developments in the Kenyan financial sector in the 1990s are summarized. We then turn to the findings from this research. First the financial landscape in and around the small town of Karatina, in Mathira Division of Nyeri District in Central Kenya, is described. Two key features arise and require further explanation. First is the lack of borrowing using land as collateral and, second, the importance of user-owned financial services such as savings and credit co-operatives and informal group-based systems. The explanations for these features demonstrate the way in which financial markets are embedded in wider social, cultural and political relationships — that they are 'real' markets. The role of microfinance organizations is briefly reviewed before conclusions are drawn.

FINANCIAL MARKETS: POLICY, THEORY AND 'REAL' MARKETS

Since the late 1980s, Financial Sector Reform programmes have become an increasingly accepted component of economic reform in Africa and elsewhere. These programmes drew their theoretical origins from the financial repression thinking of McKinnon and Shaw, which suggests that the removal of interest rate ceilings improves the quantity of saving in the economy and both the quantity and quality of investment (Fry, 1995). Raising the interest rate in the formal sector improves the efficiency of investment through deterring low-yielding investments that would previously have qualified for funding (and especially in the case where investments may have been selected

1. I use here the term MFO rather than MFI because *organizations* are defined as legal entities or agencies. *Institutions* are defined as durable rules and norms governing how people behave. To become an institution, a rule or norm of behaviour (such as charging interest on loans) must be accepted across a community — such as the microfinance industry. The distinction between organizations and institutions is useful and fully *institutionalized* within the social sciences, if not in the world of microfinance.

by administrative systems rather than price selection). By raising output, savings are further generated since higher interest rates also produce less of a bias against future over present consumption (Fry, 1997).

One of the underlying 'stylized facts' of this analysis is that financial systems in developing countries are dominated by commercial banks (Fry, 1997). While it is true that commercial banks are the dominant institutional form within the formal financial sector, research has increasingly demonstrated the extensive and pervasive presence of informal financial arrangements in low-income economies as a whole (see, for instance, Wai, 1992). Indeed, the vast majority of transactions fall outside the regulated formal sector (Aryeetey and Udry, 1997). Since informal arrangements are more likely to be used by poor people, the size of individual transactions is relatively small, another reason why formal sector policy has tended to ignore them. Estimates of the size of informal financial arrangements are of course difficult but figures that are available suggest that informal arrangements have supplied anywhere between 30 and 95 per cent of the credit needs of rural or urban populations (Germidis et al., 1991). These figures also tend to exclude informal arrangements based in reciprocity between relatives and friends: if these were included, the extent and importance of informal arrangements would be even greater. But even without these, some evidence suggests that the size of flows circulated through informal finance within the household and non-corporate sector is substantially larger than flows channelled through formal institutions (Nissanke and Aryeetey, 1998: 279). This therefore suggests the need for relationships between the formal and informal sector to be better understood if financial liberalization is to deliver the benefits anticipated.

Policy discussions of financial reform in the early 1990s also took note of new developments in the technology of lending to poor people (Asian Development Bank, 1990; Callier, 1990; Germidis et al., 1991; World Bank, 1989). At that time, an increasingly rich body of detailed research into informal financial arrangements converged with insights from the new institutional economics and practical experience of lending to poor people. This resulted in a number of key departures from earlier thinking. First, that poor people can and will pay relatively high interest rates for loans and that their concern is for repeated access rather than price. Second, that poor people can and do save, and practical experience suggested that 'compulsory' savings requirements linked to loan access could provide funds for on-lending.[2] Third, that group-based methods (regularly found in informal arrangements) could reduce transaction costs and had the potential to

2. Although the capacity of poor people to save was recognized in this way, this did not lead to the availability of flexible savings services by MFOs. This is an area of current and ongoing debate, although the need for poor people to have access to savings is increasingly recognized. See Rutherford (1999); Wright (2000).

ensure that large numbers of people could be reached with the services. These developments gave rise to hopes that microfinance organizations could expand their outreach, reduce their costs as they grew in size, mobilize funds for on-lending independently of donors and hence become self-sustaining so providing services in the long term (Johnson and Rogaly, 1997).

The idea of building sustainable microfinance organizations further converges with financial repression thinking. The Ohio School had earlier criticized subsidized lending both through the state in the form of, for example, agricultural credit schemes, and NGOs taking the view that this was 'undermining' the market with cheap credit (Adams et al., 1984). Along with the proponents of financial repression they argued that subsidized credit led to allocative inefficiency and also argued that cheap credit could erode the in-built mechanisms of indigenous lending practices (Nagarajan et al., 1995). By contrast, building financial organizations that could cover their costs and be financially self-sustaining were viewed as widening the market for financial services in a sustainable way.

With the consequent proliferation of donor support to MFOs, concern has turned to assessment of the impact of these interventions. The approach favoured by the 'New World' proponents (Otero and Rhyne, 1994) is to analyse measures of outreach and sustainability of the financial organization, which involves examining the numbers and coverage of people reached, and measures of financial performance of the organization itself. This approach judges the intervention to be 'beneficial because it has widened the financial market in a sustainable fashion' (Hulme, 2000: 82). However, to draw the conclusion that expanding outreach and sustainability have widened the financial market seems somewhat premature if developments in that market have not been examined (Johnson, 1998).

The range of methodologies for examining the operations of markets spans neo-classical supply and demand analysis; the new institutional economics analysis of transactions costs; political economy analysis of power relations; and more ethnographic approaches which examine the social and cultural context of financial transactions. Political economists have been at pains to point out that markets are 'the hollow core at the heart of economics' (Crow, 1998: 2, quoting Lie, 1997), with 'no adequate tradition for analyzing actually existing markets' (Crow, 1998: 1). They have particularly sought to demonstrate that participation in markets is differentiated along axes of class but also recognize the role of variables such as gender, space and time. The political economy approach has given rise to extensive evidence that markets interlink and interlock, with powerful agents able to incorporate credit relations into the wider exchange and production relations of labour markets, trade, or asset accumulation (Bhaduri, 1977, 1981) — also described as 'financial repression from below' (McGregor, 1994). Alongside research using ethnographic traditions, this has clearly demonstrated the diversity, complexity and detail involved in their functioning. Financial 'landscapes'

are understood as rooted in agro-ecological conditions, socio-economic relations and political-administrative structures (Bouman and Hospes, 1994).

A related analytical development during the 1990s has been the increasing understanding and analysis of poor people's livelihoods (Ellis, 2000). This analysis seeks to understand the way in which people use the range of resources they have available — social, financial, physical, human, and natural — whose access and use is mediated by social relations and institutions, to construct livelihood strategies to address their livelihood needs for income and coping with risk. The implications of this for financial services has been the need to understand the way in which poor people therefore use a range of financial services, spanning formal and informal provision to meet their financial needs for accumulation, managing life-cycle needs and coping with emergencies (Johnson et al., forthcoming; Rutherford, 1999).

To pursue an understanding of the operation of financial markets we can draw on an institutionalist definition in which markets are 'a set of social institutions in which a large number of commodity exchanges of a specific type regularly take place and to some extent are facilitated and structured by those institutions' (Hodgson, 1988: 176). On the basis of her analysis of the influence of the social institution of gender on the local rice market in Eastern Guinea, Pujo concludes that as well as markets being social institutions in themselves, they are embedded in wider social institutions which encompass but are not restricted to markets, and hence 'markets should rather be defined as exchange processes (of commodities, services, money and labour) which are partially determined, regulated and perpetuated by a wide set of social institutions' (Pujo, 1996: 132).

The primary objective of this research was therefore to investigate the operation of a local level financial market in a holistic way, exploring both the formal and informal dimensions of its operation from the perspective of both providers and users, with a view to identifying and understanding the wider set of social institutions in which it is embedded, and specifically to discover the following: what financial services were available in the market and how they had changed over recent years; what factors determine the options available to users (in relation to socio-economic characteristics such as gender, age, ethnicity and religion) and the choices that they make; how have changes in informal sector provision responded to changing formal sector provision; and how can changing patterns of provision and use be explained?

Research Methodology

In order to explore both the supply and demand sides of a definable financial 'market', it was necessary to identify an appropriate location. Karatina is a small vibrant town in Central Province whose choice was driven by three key factors: first, the presence of formal sector financial

services; second, the presence of microfinance organizations over a period of time which would ensure their operations were adequately understood by users; third, the potential to identify Karatina as a town centre serving a reasonably well defined rural hinterland. Field research was undertaken in Karatina and two nearby rural sub-locations for a total of eight months in three visits over the period September 1999 to February 2001.

The methods used in the fieldwork comprised surveys and semi-structured interviews with providers, users and key informants. First, a supply-side survey was undertaken which involved: (a) in-depth interviews with thirty-seven formal sector financial service providers; and (b) the identification and interview of informal sector providers ranging from groups to moneylenders. Cross-sectional data on prices and volumes were collected along with details of products and services. Open-ended questioning explored trends and informants' explanations of changing provision. Second, a two-stage demand-side survey was undertaken. A random household survey of 150 households spread equally across the three key livelihood types in the area — tea farming, coffee farming and town-based enterprise and employment — collected basic household level information on livelihood profiles. These data were then used to identify a purposive sub-sample of sixty-eight in-depth individual interviews (based on location, age, sex, and marital status) in order to investigate both quantities and explanations of financial service use. This was therefore able to capture the extent of use of both formal and informal financial services.

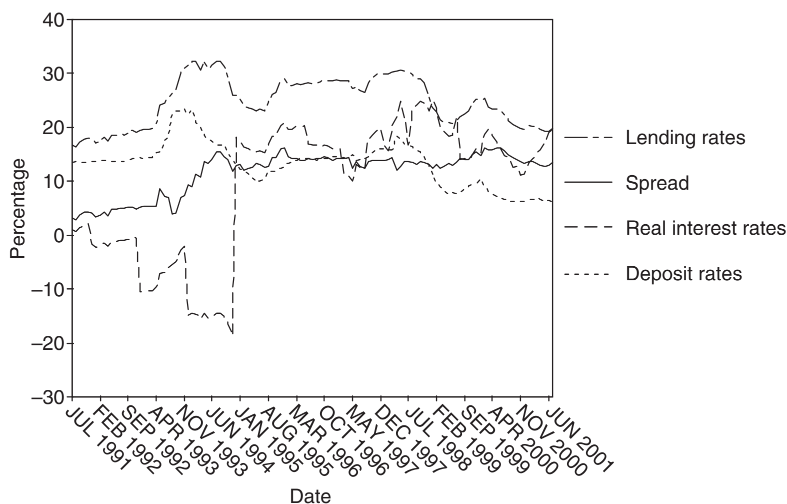
Data from the supply side were compiled to establish overall market dimensions and a detailed understanding of the products on offer. Quantitative data analysis of first round household and second round individual interview data was carried out. While the sixty-eight individual interviews were purposefully chosen, the data was pooled to examine patterns of access to and use of financial services. Where significant relationships were found, these were further tested using logistical regression analysis. Qualitative data were analysed to explain patterns and relationships thrown up by the quantitative analysis.

DEVELOPMENTS IN THE KENYAN FINANCIAL SECTOR DURING THE 1990S

Before turning to the study findings, it is important to summarize key developments in Kenya's financial sector during the 1990s. Compared to many African countries the extent of financial repression in Kenya in the late 1980s was moderate (Brownbridge, 1998). While interest rates, fees and charges were controlled and credit ceilings were in place, government interference in the financial system was not extensive. The main change under the Financial Sector Adjustment Credit of the late 1980s was the removal of interest rate controls, which came into effect in 1991, and the tightening of the regulatory environment in the wake of the 1980s banking crisis.

The effects of the removal of interest rate controls over the 1990s can be seen in Figure 1. Lending rates rose dramatically in 1993 and 1994 from the controlled level of 17 per cent to nominal rates of over 30 per cent. With accelerating inflation in 1992–3, it was not until 1994 that real interest rates again turned positive, but despite inflation these too have increased to between 16 and 27 per cent in the period 1994–7 (Ndung'u and Ngugi, 2000). While deposit rates at first also rose, they dropped faster than lending rates in 1995, resulting in an increase in spreads from approximately 5 per cent in the early 1990s to between 10 per cent and 15 per cent in the latter half of the 1990s. Spreads are expected to decline with increased competition under liberalization, but that has not happened here. The cause of these high nominal and volatile rates lies in developments at the macro level. In the wake of the withdrawal of aid funding prior to the 1992 election, the government sold treasury bills to fund the fiscal deficit. The Treasury Bill (TB) rate became the main determinant of bank lending rates, not least because investments in the real economy had become more risky relative to high TB rates with risk free returns.[3]

Figure 1. Interest Rates in the Kenyan Banking Sector 1991–2001



Source: Central Bank of Kenya

3. The 'Donde Bill' was passed by parliament in 2001 but never actually implemented. It sought to re-impose interest rate regulation with lending rates limited to 4 per cent above the TB rate and deposit rates to 70 per cent of the TB rate along with a clause that interest could not exceed the original value of the debt. It represented a backlash against what politicians and middle class Kenyans saw as the cavalier attitude of the banks to interest rates. But it can also be interpreted as a cynical attempt at self-preservation by politicians whose debts had spiralled out of control during the 1990s.

The other major concern for reform in the financial sector was the regulatory regime and the powers of the Central Bank. Over the 1980s and 1990s a series of banking crises had indicated the increasing fragility of the sector. The first of these occurred in the period 1984–9, during which twelve regulatory requirements for non-bank financial institutions (NBFIs) failed. The NBFIs were more liberal than those for banks with lower minimum capital requirements, and allowed higher interest rates on both deposits and loans (Brownbridge, 1998).

One reason for these failures has been the performance of the so-called 'political' banks — those that included prominent politicians amongst their shareholders, and used their connections with government to obtain deposits from the public sector (Brownbridge, 1998). This in turn influenced lending decisions, and ultimately led to the failure of borrowers to repay. In the context of their low-capitalization, evasion of Central Bank requirements, and reliance on public sector deposits, non-performing loans soon jeopardized their viability. The scale of these problems also increased. Brownbridge calculates that the NBFIs which were closed in the mid 1980s represented approximately 2 per cent of commercial bank and NBFI deposits; those closed in 1989 approximately 1 per cent; and those closed in the 1993–4 period represented around 10 per cent of deposits.

The late 1990s has seen the further development of these trends with the malaise now moving to the main commercial banking sector. Since 1997 the scale of non-performing loans in the banking system has escalated considerably, with the most serious problems facing the national banks: Kenya Commercial Bank (42 per cent of advances) and the National Bank of Kenya (70 per cent of advances). These two banks represent 23 per cent of total customer deposits in 1999 and in the period 1998–99 both banks virtually stopped lending. Prominent politicians and businessmen were revealed to owe the NBK Kshs 8.4 billion (US$ 139 m) in 1998 (see *Daily Nation*, 1998). Total non-performing loans in the banking sector as a whole increased dramatically from Kshs 56 billion (US$ 952 m) in 1997 to Kshs 97 billion (US$ 1.4 bn) in 1999 (which includes the portfolios of the thirty banks under liquidation), amounting to approximately 13 per cent of GDP. This increased level has been brought about by two factors — the first is poor economic performance, but second, the CBK introduced stricter guidelines on loan classification.

In summary, interest rate liberalization has led to high and volatile interest rates in the 1990s in the context of increasing economic and political uncertainty and macro-economic decline.[4] The malaise of bad debt portfolios and corruption in the commercial banking sector has grown and in the late 1990s affected the two largest Kenyan banks NBK and KCB, necessitating government intervention in the case of NBK.

4. Growth declined steadily from 4.6 per cent in 1996, turning into negative growth of 0.3 per cent in 2000.

RESEARCH FINDINGS

The Financial Landscape in Mathira

Karatina is a small town in the heart of an area known for its small-scale agricultural production in tea, coffee, dairy and more recently vegetables. The Government's Kenya Poverty Assessment (Government of Kenya, 1998) using 1994 data suggests that Nyeri District — the second richest in the country — does not experience absolute poverty in a year when the rains are good. This along with an extremely active and enterprising small business sector has made Karatina a vibrant town. Currently it has branches of four of the five main banks: Barclays, Co-operative, KCB and NBK and a building society (Equity). Nevertheless during the 1990s a number of banks and financial institutions have re-structured their operations, usually closing the branch in Karatina and moving accounts to Nyeri, the nearest large town which is also a provincial headquarters. The results of the supply side survey of these formalized financial service providers (see Table 1) indicated that formal sector banks and NBFIs accounted for 80 per cent of deposits by outstanding value, 64 per cent of outstanding loans by value and 49 per cent of the total number of savings accounts.

The microfinance sector comprises two types of organization. First, what I term here the 'mainstream' MFOs: these have generally been donor-funded such as K-REP (which transformed into a bank in 1999), Kenya Women Finance Trust (KWFT), Faulu, and the Small and Micro Enterprise Promotion programme (SMEP, whose origins lie in the National Council of Churches of Kenya). These microfinance organizations accounted for 1 per cent of savings by value, 4 per cent of loans by outstanding value and 2 per cent of the number of deposit accounts. Apart from these, there are three local NGOs that operate a programme in which women are encouraged to form accumulating savings and credit associations (ASCAs) and the organizations charge a management fee for assisting them to organize and run the system. Table 1 reveals that, in comparison to the mainstream MFOs, these services are estimated to have mobilized three times as much in savings and more than twice the value of outstanding loans.

The third main component of the formal financial sector is the savings and credit co-operatives (SACCOs). As a coffee growing area, coffee co-operatives have been a mainstay of financial service provision to coffee farmers for many years, though they are currently in a difficult period of transition and suffering the effects of low international coffee prices. Cash crop SACCOs (both coffee and tea) accounted for 36 per cent of the number of saving accounts. Employee SACCOs are a well-known phenomenon and small local employee SACCOs accounted for some 10 per cent of outstanding loan value although their outreach is understandably limited to 2 per cent of the number of savings accounts. Transport and business

Table 1. Savings and Loans Performance of Financial Institutions in Karatina, Kenya

(1998/1999 figures) (Kshs'000s)	**Note**	**Deposits**	**% of Total**	**Members/ savings accs**	**% of total**	**Loans**	**% of total**	**Number of loans**	**Average loan size**	**Loan-deposit %**
Formal sector:										
Banks		1,148,593	*73*	24,543	*24*	429,995	*55*	n/a	n/a	37
NBFIs	1	113,973	*7*	25,663	*25*	70,995	*9*	n/a	n/a	62
Parastatals	2	0		0	*0*	29,961	*4*	232	129	n/a
Sub-total		1,262,566	*80*	50,206	*49*	530,951	*68*			42
MFO sector:										
Mainstream MFOs	3	18,629	*1*	1,958	*2*	28,411	*4*	1,387	20	153
Management service MFOs	4	43,184	*3*	10,329	*10*	82,050	*10*	7,230	11	190
Sub-total		61,813	*4*	12,287	*12*	110,461	*14*	8,617	13	179
SACCOs:										
Cash-crop SACCOs		168,449	*11*	37,283	*36*	53,495	*7*	6,255	9	32
Employee SACCOs		90,150	*6*	2,277	*2*	80,117	*10*	1,888	42	89
Transport/Business SACCOs		12,560	*1*	396	*0*	11,448	*1*	164	70	91
Sub-total		271,159	*17*	39,956	*39*	145,060	*18*	8,307	17	53
TOTAL		1,576,909	*101*	102,449	*100*	786,471	*100*			50

Notes:
1. Data for these institutions is incomplete.
2. Data for Post Office Savings was not available, as balances are not held at a branch level.
3. Mainstream MFO's deposits are in the main mobilized by the MFO but deposited in the bank so are excluded from total deposits.
4. This total has been estimated based on averages from a sample of groups of one of the organizations.

Source: own data.

SACCOs are a new development in the SACCO sector of the 1990s and are developing especially fast among the *matatu* (a public transport vehicle) owners. As a whole the SACCOs sector accounts for some 17 per cent of savings by value, 39 per cent of the number of savings accounts and 18 per cent of outstanding loan value. In many ways ASCAs are simply a non-formal version of SACCOs — they are user-owned or 'mutual' mechanisms, often with very similar rules. Combining SACCOs with NGO-promoted ASCAs accounts for 20 per cent of deposits by value, 28 per cent of outstanding loans by value and 49 per cent of the number of accounts.

It was not possible to survey the informal sector and establish volumes in the same way. While moneylenders were identified their total volumes accounted for an absolutely tiny (0.001) per cent of the loan volume in the formal financial market — indeed, many informants thought that moneylenders were still illegal although it appears that the relevant Act was repealed in 1987. The informal sector is dominated in this area by rotating savings and credit associations (ROSCAs) with some independently run ASCAs.[5] The ways in which ROSCAs operate varies: some comprise groups of village women based on lineage relations who usually meet on a weekly or monthly basis and which provide the ROSCA payout either in kind as clothing or household items or cash; in others, a 'collector' administrates the group's transactions and members may not even know each other.

The in-depth survey of financial service use of savings products (see Table 2) indicated the importance of ROSCAs, which were used by 48.5 per cent of respondents, compared to 45.6 per cent for bank accounts and 33.8 per cent for rural SACCOs (that is, tea, coffee or dairy based). ROSCAs, as the most widely used service, were used significantly more by women (65.7 per cent) than men (30.3 per cent) but use appeared to be evenly spread by characteristics such as age, education and location (rural or town-based). Half of those without a main income source also used ROSCAs. These were married women who used money saved from housekeeping given to them by their husbands for ROSCA contributions. Using an expenditure-based measure of poverty indicated lower use (but not significantly so) among the poorest (less than Kshs 1413, approximately US$ 19, per adult per month) and the richest in the sample (those spending more than four times the poverty line). This pattern also appears in the data by landholding sizes where use falls to lower levels for those with less than 0.25 acres and is highest in the group with access to 1 to 5 acres. However, those who had no land used ROSCAs as frequently as the

5. ROSCAs are systems in which a number of people form a group and contribute an agreed amount on a regular basis. On each occasion the fund is usually given to one person who takes all of the money, until everyone in the group has received the money in turn. The order of rotation may be determined by ballot, by age or seniority or other social systems of preferment, or may be auctioned. ASCAs involve contributions into a central fund that is then lent to members at an agreed rate of interest. The interest is put in the fund until dividends are returned to the members.

Table 2. Frequency of Use of Financial Service Types (%)

(N = 68)	Savings accounts	Loans	Ratio of borrowers to savers
Banks/Building societies	45.6	7.4	16.2
Rural SACCOs	33.8	19.1	56.5
Employee SACCOs	10.3	8.8	85.4
Parastatal	0	1.5	N/A
Post office	8.8	N/A	N/A
MFO	7.4	7.4	100
NGO managed ASCA	5.9	7.4	125.4
Independent ASCA	8.8	5.9	67.0
ROSCA	48.5	48.5	100
Insurance group	39.7	N/A	N/A
Moneylender	N/A	0	N/A
Loan from friend or relative	N/A	17.6	N/A

Source: own data.

average because they mostly lived in Karatina town and none were below the poverty line.

By contrast, the socio-economic characteristics related to the use of a bank or building society account were quite different. They were used significantly more by those with a secondary rather than primary education, and those who lived in Karatina town rather than the two rural sub-locations, with those in the farthest sub-location from town using them least. Those in employment or business were more likely to have bank accounts compared to those with no main income source or those who relied on casual labour or agriculture. Employment was a mildly significant factor in the logistic regression and this is not surprising as employees often receive salaries through the banking system. Those with no land were most likely to have a bank account, and this was due to them being more likely to live in Karatina Town. Bank account use was positively related to wealth levels using indicators of expenditure, assets and landholding and the logistic regression also suggested the importance of expenditure levels.

Significantly more men (45.5 per cent) than women (22.9 per cent) used rural SACCOs. This is because men were more likely to have control of cash crop income than women. Their use was also significantly higher among the older age group (over 40 years) and those with a primary rather than secondary education. These patterns can be explained by the fact that the mean age of household heads in the two rural sub-locations was significantly higher (at the 1 per cent level) at 49 years, than in town at 34.5 years, and it is the rural households that have cash crops. These age differences result from at least two factors: first, people who have worked in employment or business return to the rural areas when they retire; second, with the extent of land sub-division, young people are now less able to derive an adequate income from the small farms they may be allocated, and are forced to seek employment or business opportunities elsewhere.

The wealth indicators of expenditure, assets and landholding, suggest that cash crop SACCO use was lowest amongst the poorest categories, rose in the middle groups and declined again in the wealthiest categories. This reflects a middle wealth stratum for whom cash crops are an important income source, whilst those with the smallest landholdings have insufficient space or insecure tenure, and the wealthiest are unlikely to be dependent on cash crop income. Also, tea farmers are not restricted to receiving their tea income from tea SACCOs, but can also receive it through bank accounts so that the wealthiest are more likely to receive it this way.

Of the sample, 39.7 per cent contributed to an insurance or mutual aid group making either regular or irregular contributions. These groups assist members in the event of emergencies, and especially death. Men in the rural areas often belong to these groups via their lineage and women's groups in the rural areas often also make such contributions. Ad hoc contributions for emergencies are also a common feature of many town-based ROSCAs. Landholding sizes produced the most noticeable pattern in relation to use of insurance groups. None of those with less than 0.25 acres (but not landless) belonged to such a group whereas all of those with 3 to 5 acres contributed. The explanation for this is not entirely clear, but as a result of small holding sizes all of these individuals were casual labourers and the variable nature of this income may have contributed to their decisions not to join clan-based insurance groups.

The demand side survey indicated that individuals used a mean of 2.46 savings mechanisms, 1.38 in group-based mechanisms and 1.09 in formal sector savings accounts.[6] Women used significantly more group savings mechanisms than men — a mean of 1.86 compared to 0.88,[7] though there was no significant difference in their use of formal sector savings accounts. With respect to loan sources, informants were most likely to have borrowed from a rural SACCO (19.1 per cent) or a friend or relative (17.6 per cent), with only 7.4 per cent having borrowed from the bank and 7.6 per cent from a mainstream MFO. In contrast to savings, the mean number of loan sources (excluding ROSCAs) was 0.85 with 35.3 per cent having not borrowed at all. The socio-economic characteristics related to borrowing from cash crop SACCOs are similar to those for saving in them given above: that is, age and education.

The second most important source of borrowing was from friends and relatives (17.9 per cent or 12 loans). Those who borrowed from their friends and relatives were more likely to be men than women; to be younger (under 40) and more educated (more than primary education). Logistic regression

6. Respondents were asked to report the places in which they had saved in the last two years and the sources from which they had taken loans over the last five years. The details of the latest loan from a particular source were recorded so that prior loans from that source were not enumerated.
7. See Johnson (2003) for an in-depth discussion of the gendered nature of ROSCA use.

results indicated that of these factors, education most increased the likelihood of borrowing while being older and a woman reduced the likelihood. This result is rather interesting because it suggests that young educated men make more use of this source and although the sample size is small, this is an unexpected result. Part of the explanation is likely to be that young men have limited access to land and cash crops with which to borrow from banks and cash crop SACCOs.

Five individuals (7.4 per cent — five loans) had borrowed from a bank or building society. It is important to examine these five loans in turn, since none of them involved land being formally used as collateral. One individual had borrowed against her salary with no collateral. Another was a loan to buy land using an existing title deed, but this was not formally charged but simply deposited with the lender as the loan was for the relatively small sum of Kshs 30,000 (approximatley US $400). Both the borrower and lender explained that the costs related to charging the land would have been far too high in relation to the sum being borrowed. Two further loans were from a bank that had introduced a specialized micro-enterprise loan scheme using stock and household items as collateral. These loans were to individuals and directly competed with MFO group-based lending products. The fifth bank loan was an overdraft from a national bank without security and appeared to have been secured against the income that the respondent received through her account from her husband, who was overseas. Hence none of these bank loans was either for longer than a year or formally secured against major assets such as land.

Use of MFOs (7.4 per cent — five individuals), on the other hand, was by those who were educated to secondary level or higher, in Karatina town and in business. Having a business is usually a criterion for membership. Saving in these groups is compulsory in order to access loans. The five individuals comprised three men and two women: of the four MFOs, only the Kenya Women Finance Trust programme is women only. Despite the extensive outreach of the managed ASCA programmes indicated in Table 1, the demand side survey indicated that 7.4 per cent had borrowed from these, all were women and all had expenditure levels above the poverty line.

A notable feature of Table 2 is the ratio in the final column between saving in a source and borrowing from a source. The proportion of savers in a bank who have borrowed is 16.2 per cent compared to rates of over 50 per cent for SACCOs and in the region of 100 per cent for ROSCAs, ASCAs and MFOs. This suggests that if loans are required then it is unlikely to be the bank from which it is obtained.

This brief overview of both provision and use suggests the following key points. First, that while the formal sector appears dominant in terms of volumes of savings, when it comes to numbers of accounts, this is more or less equally split between the formal sector and the mutual sector. Since this sector handles 20 per cent of deposits by value and 28 per cent of outstanding loans by value, the implication is — as would be expected — that

the 'mutual' sector is serving poorer clients than the formal sector. When the information from users is added to the picture, it becomes clear that informal group-based systems, especially ROSCAs, are extremely important mechanisms for financial intermediation. ROSCAs can also be classified as mutuals in that they are user-owned and managed.

Second, on the loans side, it was found that only 7.4 per cent had borrowed from a bank. This figure was lower than the frequency of borrowing from SACCOs, and friends and relatives. Five out of a total of fifty-two documented loan sources were banks, none of which involved land as formal collateral:[8] two of these were from a special microfinance programme within one of the banks, two were from a building society (with one secured through the depositing of a title deed but not its formal charging) and one was a bank overdraft. The only loan in the sample that had involved the mortgaging of land was to a parastatal.

Third, the data here also indicates, that although Karatina is one of the areas in which the MFOs have been longest established, their total activity is small even in comparison to local NGO programs of ASCA promotion and management. These findings confirm the importance of the informal sector and indicate that the majority of such mechanisms are mutually based in informal group systems. The implication is that, for the purposes of pro-poor policy design, it is important to understand the limited use of bank loans and have a better understanding of the role of both SACCOs and informal group-based systems. The next two sections deal with these issues in turn.

Land and Loans

The finding that only one loan out of fifty-two loans involved land as collateral, and that none of the loans from banks used land as formal collateral, requires further exploration. Land registration and titling was initiated in Kenya in the 1950s under the Swynnerton Plan and aimed at creating a land market that would also be supported by the financial market. This research further supports the view that this has not happened. The reasons for this failure are investigated both from the point of view of borrowers and lenders.

It is well known that land has been central to Kenyan politics since its appropriation by the British colonial government and that pressure on land eventually resulted in the Mau-Mau uprising in Kikuyuland — a contributing

8. As indicated above, one of these loans did involve the deposit of a title deed at the bank, but it was not formally charged as the loan was relatively small: the lodging of the title deed served to underline the importance of repayment, although the land could never have been sold by the bank. As one moneylender, who had taken titles in the past in the same way explained, someone would always eventually return to reclaim a title deed.

factor to independence. During the land reform process, which started in the 1950s, there was a trade off to be sought between economic and political objectives as is clear from Sorrenson's account (Sorrenson, 1967). He shows that the objectives of agricultural reform to create 'economically viable' holdings and the issuance of indefeasible land titles to raise credit, conflicted with the political objective of creating a politically stable and loyal Kikuyu middle class. Despite the concern to develop agriculture, the colonial administration understood that attempts to prevent fragmentation to ensure economically viable holdings conflicted with the customary inheritance system and desire for land as a source of support in old age. Further, the colonial government had realized in earlier debates the political problem of offering credit against land since, if foreclosed upon, this could be seen as a direct attack on land rights by the government. Early attempts at providing credit had therefore been based on the formation of credit co-operatives (Throup, 1988: 209). Subsequent studies have found little impact of land titling on agricultural growth. In their analysis, Place and Migot Adholla found that title had virtually no impact on the use of credit, but also that neither of the specified regression models showed high explanatory power, suggesting that 'our understanding of this market is poor' (Place and Migot-Adholla, 1998: 368). Pinckney and Kimuyu find that entitlement did not increase security of tenure or create increased investment incentives. Nor is there evidence to suggest that a selling out of inefficient farmers has operated in a way that increases ownership inequality (Pinckney and Kimuyu, 1994).

Data on land holdings in Mathira demonstrates the increasing problem involved in using land as collateral. First, only 39 per cent of households surveyed had a title deed in the name of the household head. This pattern is due to the age structure of Kikuyu society: a young man tends to be given a portion of his father's land on marriage, but at this stage he is rarely given the title deed.[9] Many old men fear that handing over their land is like 'wishing you were dead' and moreover they fear the irresponsibility of their unmarried sons who might dispose of the land. Second, the average size of owned holding was 1.41 acres. This is the result of fragmentation of holdings due to inheritance in the context of population growth. Fragmentation is especially apparent for households where the father of the household head owns the land, the average holding being 0.36 acres. An owned landholding of 1.41 acres would allow for a loan of approximately Kshs 500,000 (US$ 7000), since banks usually require that the collateral be double the value of the loan — enough to buy a reconditioned Japanese-made mini-van to operate as a *matatu*.

However, it is well documented that wealth accumulation in Kenya has not generally been the result of investment in agriculture. Rather, land is

9. The cost of sub-dividing to sons can also be substantial, estimated at approximately Kshs 20,000 (US$ 266) to sub-divide and re-register one title into between four and six separate titles.

used to leverage loans that are used for off-farm investment (Haugerud, 1989; Shipton, 1992). This, in turn, is used to generate wealth in order to buy land whose primary importance is social (Leakey, 1956). Land ownership, Haugerud argues, along with education and employment 'is investment in social relations with kin, neighbours, bureaucrats and politicians'; rural land rights remain important to all economic classes 'as a means of affirming descent group membership and securing access to other resources' (Haugerud, 1989: 74, 78).

The importance of land goes beyond the maintenance and acquisition of social status and relationships: it is also a key social safety net. In attempting to find means through which to promote the acceptability of land titling, a system of Land Boards was instituted by the colonial government (Coldham, 1978). The intention was to promote economic objectives in transactions involving the sale, charge, subdivision or transfer of land. However, the Land Boards were constituted of local representatives and it appears that the economic objectives of land reform have given way to social concerns, the key one being that the applicant and his family should not be rendered landless or without sufficient land to meet their needs. If this happened the family would become dependent on other lineage members. Hence, claims to land under pre-existing legal systems were not expunged by exclusive land titles and rather than prioritizing the productive use of land, the primary role of Land Boards is still seen as protection of the family's interests. One way in which this is now implemented is that a wife must also sign the application to the Land Board. During the research we heard of women refusing to sign the papers although clear instances could not be documented. However, it is also the case that few men are inclined to risk their key asset, which has great social and cultural importance, and to which other stakeholders in the land are not likely to agree.

Such constraints operate similarly for women who own land. The majority of these are widows. Where the land owned is *mbari* (homestead) land, the widow is effectively holding the land in trust for her sons, and they too must agree to a land transaction. Where sons do not own their own land but the land has been subdivided to them by their father, mortgaging their piece of land will require the agreement of all the other brothers and stakeholders in the land unless the relatively costly process of formal titling is undertaken.

Additional constraints to the use of land are cultural, such as the importance of burial in family land, and the fear that evil or misfortune will result from sale for personal gain — constraints that have also been cited by Shipton in relation to the Luo's disinclination to mortgage land (Shipton, 1992). These tendencies were apparent in discussions over the potential for mortgaging land: one old man cited a curse placed by his father on using the land as collateral; another informant cited how, when his cousin was kicked and severely hurt by a cow after he had mortgaged his land to raise university fees for his son, the relatives ascribed the misfortune to the land mortgage.

Constraints to land mortgage are not, however, solely on the demand side. Lenders are now extremely wary of lending against rural land, and one banker described it as a 'silent norm' that bankers avoid agricultural properties because realizing them in the event of foreclosure is a 'nightmare of a process'. There are three main reasons for this, which are not particular to Mathira. First is the increased likelihood that communities will oppose the auctioning of land, a problem that started to emerge in the 1980s as the banks extended their rural coverage. Difficulties have arisen as neighbours and families of defaulters whose land is to be auctioned either turn up at the auction with machetes and clubs or threaten prospective buyers (Shipton, 1992). The foreclosure process is not only problematic for the banks but also extremely costly to the borrower and seen as unfair since costs mount over which the borrower has no control, and the land can be sold at a rate far below its market value as long as it covers the debt.

A second hazard that has arisen in the 1990s has been the problem of false title deeds and the 'grabbing' of public land. In the mid-1990s this situation became a public scandal with many reports in the national newspapers on the subject (see, for example, Shaw, 1994). Klopp explains these developments in the 1990s as a response to the suspension of aid by donors in 1991 and the arrival of multi-party politics. While land has long been a patronage tool (Kanyinga, 1998), the loss of aid led to the search for new sources of patronage in the hands of the ruling elite with which to satisfy the greater bargaining power that the competition for political power produces (Klopp, 2000). This has led to increasing difficulties for banks in knowing whether land titles are in fact genuine.

The third main factor that has affected the acceptability of land as collateral in the 1990s has been land clashes in the Rift Valley and at the Coast in the run up to elections in 1992 and in 1997 respectively (Klopp, 2001; Ogachi, 1999; Southall, 1999). While Kenyatta had not been able to solve the land question, he was able to 'freeze' it through the political alliances and rewards that he offered after independence. Since the beginning of the Moi regime in 1978, 'the political elites . . . have disinterred and dusted off the land question as a political tool to fight those opposed to them' (Kanyinga, 2000: 56). This resulted in the resurgence of the *majimbo* (regionalist) project and ethnic differences that had earlier threatened the eviction of Kikuyus from the Rift Valley in the period immediately after independence. In the context of political liberalization these conflicts intensified and it was these areas that were the focus of 'ethnic clashes' in 1992 (Africa Watch and Human Rights Watch, 1993). Given the identification of the Kikuyus with opposition political parties, the violence was intended to drive out Kikuyus who had settled in the Rift Valley, and who now could threaten the electoral chances of loyal KANU politicians (Kenya Human Rights Commission, 1996).

In summary therefore, the anticipated role of privatized land holdings in gaining access to loans in the financial market has been fundamentally

undermined by political, social and cultural factors. Land is of primary importance to Kenyan politics and political liberalization in the 1990s has resulted in outright conflict over land in some areas. The role of land both in terms of social status and as a safety net affects both the logic of mechanisms for accumulation and the willingness to mortgage ever-smaller holdings. Its cultural importance further militates against risking the loss of family land.

Understanding the Role of Mutual Financial Mechanisms

Apart from the evidence above that mutual financial mechanisms were heavily used and secondary data that the SACCO sector had also been expanding, qualitative evidence also suggested that there had been a marked increase in the use of group-based informal finance in the late 1990s. What then are the causes of the popularity of these mechanisms and their apparently increasing use?

One contributing factor was the behaviour of banks, especially in 1999–2000. During this period many banks had sought to re-structure their operations to become more cost effective. This resulted in many raising their minimum deposit balances. The two main international banks attempted to target their services towards high net-worth individuals, Barclays leading the way by raising its minimum deposit to Kshs 10,000 (approximately US$ 133). This set off copycat moves by the other main banks and during 1999 and 2000, minimum balances rose in all the banks. Now, if a customer did not ensure that the amount in her/his account was above the minimum balance, then she/he was charged a monthly fee — usually around Kshs 100 — for the maintenance of the account. Since customers were not informed individually of the changes and only knew about this through visiting the branch or reading the newspaper, the effect could be that after a few months deductions had reduced the account balance substantially.

In the context of difficult economic circumstances, an advantage of mutual mechanisms over voluntary access bank savings accounts is the discipline they require in saving compared to the bank. When the economic situation makes it harder to have money beyond everyday needs, the discipline to save for necessary expenditure becomes not only harder but also more important. Velez-Ibanez reports comparable circumstances in Mexico where many live beyond their means; the forced savings element of ROSCAs which is supported by social pressure is important to them, as this circumvents the desire to spend already committed funds (Velez-Ibanez, 1983). Group-based finance offers not only the discipline of regular saving but also restricts access to the funds in ways that the bank does not. At the same time, to save very small amounts in the bank is hard because of the transaction costs involved in getting there, so that the low cost and

convenience of ROSCAs is again underlined. Against this background, lump sum payments that men used to receive from coffee or other business ventures have declined. This has led to more men finding that ROSCAs enable them to convert flows of income into lump sum payments required for school fees, farming inputs, investments and so on. While some men berated their own ability to participate effectively in ROSCAs, citing their 'don't care' attitude, others commented on how they had seen their wives helping a lot in the home as a result of their ROSCAs, and had followed their example.

Apart from the benefits of savings discipline and the costs of operating bank deposit accounts, the key to understanding the role of mutuals is the issue of loans. Borrowing from the banks is seen as increasingly problematic for a number of reasons. First is the issue of access, where potential borrowers find that the formal sector is not interested in lending to them. Getting a loan from a bank was described by one informant as 'like milking an elephant!' that is, next to impossible. While this was in part due to the poor investment opportunities, there were additional factors such as the high level and volatility of bank lending rates during the 1990s, which acted as a disincentive to borrowers when business opportunities were also higher risk. In this context borrowers had become especially wary of mortgaging land for fear they might lose it.

Mutually-based financial mechanisms offer products with a different set of characteristics from those provided by the banks and formal sector, and these make them more appropriate to the circumstances people face. In mutuals, the member's entitlement to a loan is very clear and as an informant explained: 'nobody is there to deny you a loan . . . it is not like a bank, because in a SACCO you have a right but in a bank it is not a right but a privilege'. Since members usually understand their entitlement they can also determine how to exercise it. The amount of the loan is also clear, as there are usually conditions that these are between two and four times the member's savings.

Second, in mutuals members set the interest rate on loans. While interest rates tend to be low in SACCOs (as a result of past regulation), members may set them as high as 10 per cent per month in an ASCA. Members know that not only will the interest rate not change without them knowing or voting for it, but also that the interest they are paying will accrue to them as dividends at the end of the year (although they may also have to share the losses of defaulting members).

Third, when circumstances arise which result in repayment difficulties, members have a range of options to deal with the situation that enables them to manage these crises. In SACCOs loan products include school fees and emergency loans to which members can turn if they face a problem. In informal groups, members have the opportunity to explain themselves and their situation ('voice'). This may result in negotiation of an alternative payment schedule; in some cases the member may be given an additional

loan to overcome the circumstances; or the member can use the social networks that arise in the group to gain support. Such support may be from the group as a whole and be financial or social. Some groups had insurance functions that assisted in the event of the death or illness of family members. However, in the case of the death of a member or their relative, it is not purely the financial support that is important, but also the social and cultural support that the group offers in attending the funeral and assisting with the arrangements. One large women's group had gone as far as to fine members if they did not attend a funeral when delegated to do so. Support in the event of problems may also be sought from other individuals whom the member has come to know through the group and again this might be financial or social support. In ROSCAs for example, it is common for members to arrange to swap places if one needs the fund that week and the friend is willing to swap. As one woman informant explained 'If I take my money to the bank then when I have a problem, who will help me?'.

Finally, the collateral involved in SACCOs and ASCAs is usually the member's own savings, and those of friends in the group who have guaranteed that person. Thus should a member default entirely, she/he is usually risking only her/his existing savings, or possibly future income from salaries or cash crops, and in some cases household items. Crucially, land is not at risk.

Hence it becomes clear that the savings and loan products that mutuals offer have a different set of characteristics to those of loans from banks and parastatals and this is a function of their different organizational form. These findings lead to an alternative approach to conceptualizing financial intermediation that offers additional insight into the ways in which poor people use financial services in relation to their livelihood needs.

Financial intermediation requires the conversion of savings into loans and a set of rules, monitoring and enforcement mechanisms to enable the organization to perform this function. The three key types of intermediary are banks and NBFIs owned by shareholders, mutuals owned by their members, and parastatals owned by the government.[10] For banks and parastatals, shareholders or the government appoint management who set the rules for deposit taking and making loans. Since their deposits may be raised from the public, the central bank usually regulates this process in the public interest and requires the bank to take collateral to address problems of moral hazard. Mutuals as user-owned mechanisms give their members voice in setting the rules, and members can pledge their own savings and gain guarantees from their friends as collateral. These differences in ownership structure also therefore result in key differences in characteristics of

10. MFOs when they are funded by donors and do not raise savings for on-lending essentially fit into the same category as parastatals. If they become sustainable and take deposits, they essentially become an organizational form consistent with commercial banks. A more detailed exposition of this approach to conceptualizing financial intermediation can be found in Johnson (2001).

products offered by each type of intermediary, that is, in both their price and non-price features.

The argument here is that mutuals in giving voice to their members are fundamentally different to other types of financial intermediary in which others determine the rules and enforcement mechanisms. As a result, one of the characteristics of mutuals is that people know their entitlement to loans and these represent a resource to which they can gain access. Moreover, having voice means that engaging in mutual finance mechanisms can mitigate the risks of borrowing compared to those inherent in other mechanisms. It is clear that choices to engage in mutuals have partly been driven by deteriorating economic circumstances and the effects that financial liberalization has produced in the 1990s, in which interest rates have increased and bank loans have become more difficult to obtain. However, it is the contention here that this has exposed rather than fundamentally altered these choices.

In that voice allows for negotiation, these characteristics of mutual financial mechanisms are clearly resonant with other research findings. As Sara Berry explains in relation to African agrarian change more broadly:

> negotiability is not just an inconvenience . . . but a pervasive feature of social and economic processes which calls for re-conceptualization . . . In rethinking African agrarian change we need to begin with historical and anthropological literature which represents law as social process, transactions as subject to multiple meanings and exchange as open-ended and multidimensional rather than single-stranded and definitive . . . If rules, transactions and values are ambiguous and negotiable, then economic activity cannot necessarily be explained in terms of decisive choices or efforts to gain exclusive control over goods and resources. If access to resources depends on one's ability to negotiate, people may be more interested in keeping options open than cutting them off, and in strengthening their ability to participate in and influence negotiations rather than acquiring exclusive control over resources and severing connections which are not immediately profitable. (Berry, 1993: 13–14)

This analysis therefore suggests that the organizational form of a financial intermediary matters because it is this that determines the characteristics of the financial services on offer and the relationship between savers and borrowers. Economists would call these characteristics 'non-price' factors. The appeal of these characteristics can be understood when viewed from a livelihood perspective of the need to mitigate risk and enhance access to resources and their embeddedness in wider social relations that allow for negotiation.

The Role of Microfinance Organizations

The limited coverage (2000 members) and volumes (2 per cent of savings by value, 4 per cent of outstanding loans) handled by the four main microfinance organizations in Karatina was indicated in Table 1. In the demand side survey only five people (7.4 per cent) had used them. The users in the sample were

concentrated in Karatina town, educated beyond primary school level and operating businesses. How then can this apparently limited coverage, by comparison to other mechanisms, be explained? First, it should be noted that the data given in Table 1 were for 1999 but that the problems of macro-economic decline led to increasing recruitment problems for the MFOs in the following two years and deteriorating repayment performance. The explanation given above of the relative advantages of mutuals over banks offers some clues. However, given that MFO lending is usually group-based this needs to be explored further.

It was suggested above that the organizational form of a financial intermediary affects the characteristics of the products they offer. Looked at from the point of view of organizational form, MFOs whose loan capital has originated from donors are similar to parastatals whose loan fund is the result of a transfer of funds from taxpayers (or donors in the past). The 'owners', in the form of the NGO, appoint the management and they in turn set the rules. While groups may be used as a delivery mechanism, the role of these groups is inverted by comparison to a mutual. In MFO groups the loan funds are external and the members are required to enforce repayment from others or risk the loss of their own savings. This appears to operate in the same way as a mutual in that individuals lose their funds if a member does not repay, but the social context of that loss is very different to a mutual in which individuals are essentially negotiating with each other over repayment of their own money.

By contrast the NGOs promoting ASCAs, overall, demonstrated higher levels of coverage extending further into the rural areas with approximately 10,000 members, mobilizing 3 per cent of savings by value and making 10 per cent of loans outstanding by value. The service these NGOs offer is the management of women's groups' funds (essentially ASCAs) for a fee, which covers the costs of the NGO. In a follow up study, there were found to be some problems with the model,[11] although its outreach and sustainability appear significant compared to the mainstream MFO sector.

The key reasons respondents gave for favouring the ASCA model were: its monthly meetings for savings and loan repayments; the assurance of access and the flexibility with which loans could be taken, including the fact that loan sizes could be very small; the ability to re-negotiate repayment should problems arise; the dividends gained from the interest they themselves paid. In the analysis of mutuality above we have stressed the aspect of voice and the potential for support in times of difficulty. By contrast, MFO repayment regimes are rigid and inflexible and members themselves suffer when others do not repay. This is especially problematic when all are

11. See Johnson et al. (2002) for more detail. The problem involves incentive structures in the operation of the system and especially in relation to division of responsibility between the group and the NGO on debt collection.

struggling to repay, but in a mutual it is possible to give others time to repay while not having to produce additional funds at the same time. Of course, there are MFO groups that operate more effectively under such circumstances than others and the same is true of mutuals, but the underlying logic is indeed different.

CONCLUSIONS

This research set out to map the financial landscape and to understand how it has been changing in response to financial liberalization. In order to do this it started by identifying the scale and nature of formal sector financial provision, and examined how this related to the services used by a sample of individuals. In pursuing this objective it took the view that financial markets are 'real' and embedded in wider social relations, culture and politics.

Financial liberalization in Kenya in the 1990s has produced widening interest rate spreads with high nominal and real interest rates. Banking crises have continued through the decade and spread from small banks to two of the four top banks. These crises are symptomatic of the patronage system and links of politicians to the banking sector and resulted in spiralling non-performing loan portfolios. Alongside this, the main banks with rural branches also raised their minimum deposit requirements. In this context it is not surprising that poor and rurally based people were deterred from approaching the formal sector for savings or loans, although many did retain bank accounts. Financial sector reform therefore appears to have done little to widen access or create new opportunities for users.

This research has revealed the widespread use of group-based financial intermediation and the SACCO sector and suggests that these have been experiencing renewal and growth in the 1990s. This can be explained in relation to a number of factors: the discipline of saving; the entitlement to loans; stable interest rates which members set and also receive their dividends from; the range of possible options in the event of facing repayment problems; and the fact that land is not used as collateral. In the context of their livelihoods and especially at a time of economic pressure, users preferred these non-price characteristics that clearly contrast to those of bank services.

Alongside this, there was clearly a lack of use of land as collateral despite the fact that this had been a core objective of land titling and registration dating back to the 1950s. In explaining the lack of cases of loans taken against land, the situation is unsurprisingly complex with a myriad of factors at work. These range from the impact of sub-division on land holding sizes, to the cultural importance of being buried there and the social status which land holding confers and which therefore cannot be risked. Land in Kenya has been at the heart of politics since the colonial period,

and this legacy is still at work today. While Kenya may in some ways be seen as a textbook attempt of introducing exclusive titles to land, this has failed and the result is a pluralistic legal system that constrains its use as collateral. This finding adds further evidence to a growing view that initiatives to extend land registration are inappropriate and must pay more attention to local systems of land tenure (see also Platteau, 1996).

The overall argument here is that the organizational form of financial intermediaries matters. User-owned mechanisms, whether formal or informal, have very similar characteristics to each other, in particular that they allow the exercise of voice. These characteristics are very different to those of banks, parastatals or even microfinance organizations, where others set the rules. This is not to naively imply that the internal dynamics of user-owned mechanisms are necessarily equitable. Rather, that the way in which these types of financial intermediary operate enable their members to negotiate and use their social networks and political influence and this is one of the causes of their widespread use.

MFOs have mimicked a range of features of group-based systems — savings discipline, ease of loan access and not using land as collateral. But members do not set the rules and the scope for negotiation in the context of default is much more constrained as it involves others actually contributing in your place rather than simply holding onto funds that are already lent. At a time of economic pressure this is much harder to do. This is a tentative explanation of the relatively poor performance of MFOs in the region.

In attempting to understand financial markets it is therefore essential to consider the ways in which different types of financial intermediaries operate. The argument here can be taken further to say that economists have neglected the form of financial intermediaries — their ownership structure, the characteristics of their products (especially non-price factors) and the relationship this produces between savers and borrowers. All financial intermediaries require rules, monitoring and enforcement mechanisms and it is through a systematic analysis of how these relate to wider social, political and cultural structures that the performance of the market can be better explained.

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