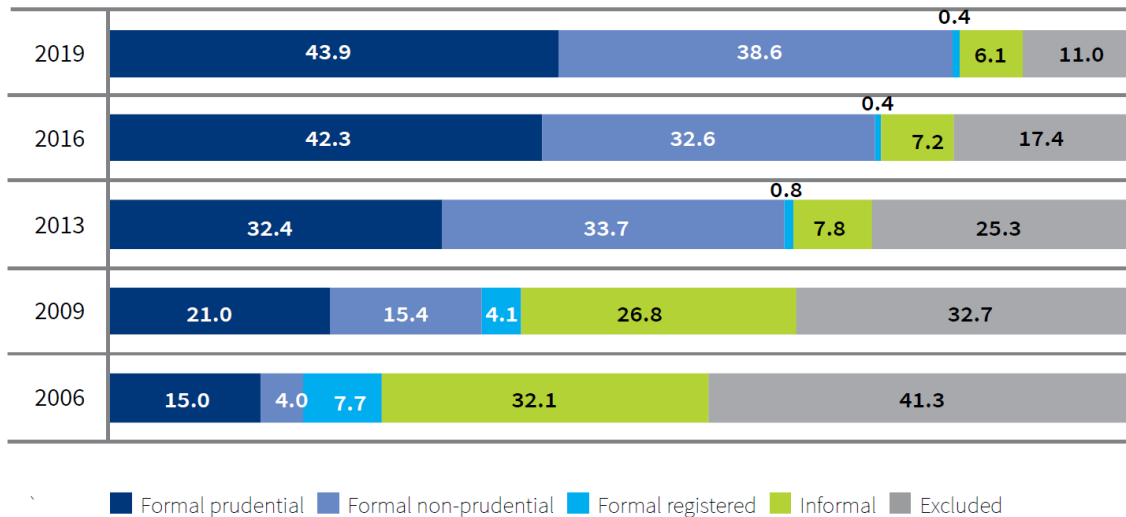


Understanding Kenya’s Remarkable Financial Inclusion Journey

David Cracknell



Source: FinAccess Household survey report (2019)

Patrick Njoroge, the Governor of the Central Bank of Kenya notes the importance of digital finance in achieving high levels of financial inclusion in Kenya noting that 83% of Kenyan’s are formally includedⁱ. The graphic above notes the highest level of institution an individual uses, 43.9% of Kenyans had an account in a formal, prudentially supervised institution – a bank, a microfinance bank, or a regulated SACCO; 38.6% had at least a mobile money accountⁱⁱ.

This blog provides a partial explanation of Kenya’s financial inclusion journeyⁱⁱⁱ.

Understanding the evolution of financial services in Kenya

In 2006 only 19% of Kenyans had an account in a formal institution. The transformation occurred in response to the growth of delivery channels – initially branches and ATMs, and later mobile money and agent banking. In 2004 - I authored “Electronic Banking for the Poor: Panacea, Potential and Pitfalls^{iv}. It explored three success factors from early electronic banking implementations namely:

1. A winning customer value proposition
2. Business cases that work for every stakeholder
3. A supportive retail and regulatory environment

M-Pesa’s adoption can be partially analysed using this framework.

Customer value proposition^{v,vi}: M-Pesa was designed in Kenya, for Kenya. The launch use case – “Send Money Home” responded to specific Kenyan demographics; but in addition, customers could now make bill payments far more conveniently than queuing to pay. To ensure that M-Pesa worked for customers the solution was pilot tested and refined over 18 months^{vii}. The user Interfaces and user experience (UI/UX) was thoroughly tested by a team assembled by Safaricom^{viii} working alongside *MicroSave* and *Faulu Kenya*. Menus could be simply written in English and Swahili and integrated into

the SIM Toolkit. Operations, customer care, and distribution channels were developed during this period and were able to scale quickly.

Multiple business cases: I contend that M-Pesa (when launched) had the luxury of not needing to make money^x. Two factors contribute to my opinion. Firstly, M-Pesa was a Vodafone not a Safaricom product – supported by GBP 1 million from Vodafone and GBP 1 million from DFID^x. Secondly, at the time of the launch of M-Pesa, Safaricom (a near monopoly) was losing market share to Kencell/Zain. M-Pesa created “stickiness” that helped to retain customers through offering a customer value proposition that was difficult for competitors to copy. Through M-Pesa – Safaricom was protecting its monopoly position and its core revenue per user. M-Pesa also took care to create a business case for its agents – through the expansion period, when transaction volumes were low – agents were paid KSh.100 for onboarding a new account.

Retail and regulatory environment: M-Pesa could not have launched without the support of the Governor of the Central Bank of Kenya (CBK), Professor Ndung'u. He provided space for the solution to develop – against the wishes of some policy makers and the Kenyan banking industry.^{xi} He provided a “test and learn” environment – at the launch of M-Pesa Professor Ndung'u gave a promise to regulate M-Pesa appropriately when the Central Bank understood what it was regulating^{xii}. There were three other significant factors. Firstly, the relative independence of the Central Bank of Kenya^{xiii}, secondly, the ability of the regulator to make minor amendments to laws through – annual Amendments to the Finance Act, thirdly, the pre-existence of a national identity which facilitated KYC and sign ups.

So, M-Pesa provided a high customer value proposition, met two key business cases, and grew in a supportive environment. However, in 2004, I could not foresee the importance and complexity of the digital finance ecosystem; competitive responses; the government as a digital finance actor, or the evolution of M-Pesa from product to a digital finance platform. These points are noted briefly:

The Digital Finance Ecosystem

- i. **Competitive responses – Agent Banking and PesaLink:** Financial inclusion in Kenya benefited significantly from a banking sector response to M-Pesa, based around agent banking, launched mainly through three banks led by Equity Bank. Further responses from Equity Bank included the development of an award-winning mobile app^{xiv} based around an MVNO solution which linked more than 64 fintech solutions^{xv}. A collective payment system response was launched by the banking sector in 2017, to facilitate real time micro payments from bank to bank, called PesaLink.^{xvi} However, the solution took five years to develop, could not include every bank for technical reasons, and in my opinion, was relatively expensive when launched with prices for transactions set on a bank by basis.
- ii. **Government as a digital finance actor:** With the rollout of digital finance ecosystem the Government has supported financial inclusion in multiple ways, through making social payments through digital platforms, through its eGovernment initiatives that enable accessing of services and payment of fees digitally, and through policy initiatives and legislation aimed at stimulating the sector. The Government of Kenya has a Digital Economy Blueprint^{xvii} paper and a policy framework on digital finance. Professor Ndung'u explores the governments' role extensively in his 2019 paper.
- iii. **Safaricom's monopoly position – M-Pesa's evolution from a channel to a platform:** From its launch in 2007 M-Pesa continued to evolve. It used its monopoly position to create its

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own ecosystem^{xviii}. It launched Lipna M-Pesa – for merchant payments in partnership with Kopo Kopo^{xix} which provided added value services to merchants. Wallet to bank and bank to wallet transfers facilitated merchant services enabling customers to easily top up their wallets. MShwari – a digital lending platform developed in partnership with NCBA Bank used relatively simple algorithms to provide one-month nano loans^{xx}. It launched Bolt – an Uber equivalent, in partnership with Craft Silicon. Eventually in 2017 it opened its API.

- iv. **Silicon Savana:** On the back of the digital finance ecosystem and largely international investors, a supportive software development industry developed – so called Silicon Savana. This contributed to Nairobi becoming a leading tech hub in Africa^{xxi} and a wide range of fintech based services riding on the M-Pesa rails.

References and Endnotes

ⁱ Njoroge, Patrick, (2020). How to build a financial system that works for people and planet. World Economic Forum, Available at: <https://www.weforum.org/agenda/2020/08/digital-finance-pandemic-development-africa> (accessed on 26th November 2020).

ⁱⁱ FSD-Kenya (2020). FinAccess Household Survey 2019. Available at <https://fsdkenya.org/publication/finaccess2019/> (accessed on 26th November 2020)

ⁱⁱⁱ A forthcoming 2020 paper by Professor Njuguna Ndungu provides a detailed inside perspective on the development of M-Pesa and Kenya's path to digital financial services.

^{iv} Cracknell, David (2004). Electronic Banking for the Poor – Panacea, Potential and Pitfalls, MicroSave. Available at <https://www.microsave.net/2004/10/13/electronic-banking-for-the-poor> (accessed on 26th November 2020)

^v Cracknell, David., (2012). Policy Innovations to Improve Access to Financial Services in Developing Countries: Learning from Case Studies in Kenya, Centre for Global Development. Available at https://www.cgdev.org/sites/default/files/archive/doc/LRS_case_studies/Cracknell_Kenya.pdf (accessed on 26th November 2020)

^{vi} Ndung'u, Njuguna (2019). Digital Technology and State Capacity in Kenya. Centre for Global Development. Available at <https://www.cgdev.org/sites/default/files/digital-technology-and-state-capacity-kenya.pdf> (accessed on 26th November 2020)

^{vii} Cracknell, David., (2015). The Safaricom M-Pesa Pilot Test. *MicroSave* Briefing Note 159, *MicroSave* Available at http://www.microsave.net/files/pdf/BN_159_Safaricom_M_PESA_Pilot_Test.pdf (accessed on 26th November 2020)

^{viii} Mainly Susie Leone, Pauline Vaughan (Safaricom), Nick Hughes (Vodafone), Paul Makin (Consult Hyperion)

^{ix} Lossmaking is a feature of many newtech ventures – Uber – WeWork – Jumia

^x Cook, Tamara., (2015). An Overview of M-Pesa. FSD Kenya. Available at <https://fsdkenya.org/an-overview-of-m-pesa> (accessed on 26 November 2020)

^{xi} Ndung'u (2019) and Ndung'u (2020) forthcoming.

^{xii} Comments at the launch event – Serena Hotel, Nairobi, 2007 and reported in Ndung'u (2019)

^{xiii} By comparison, the Bank of Uganda had to pass a specific law to launch agent banking, which took several years to go through the parliamentary process. Agent banking launched in Kenya in 2010, in Uganda in 2017.

^{xiv} Equity's mobile application won the Think Business Banking Award – for multiple years, including 2018-2020

^{xv} Capital FM,. (2018). Equity Group Spins Off Finserve as an independent Fintech Company. Available at <https://www.capitalfm.co.ke/business/2018/08/equity-group-spins-off-finserve-as-an-independent-fintech-company> (accessed 24 November 2020).

^{xvi} ISPL., (2020) How to Use PesaLink. Available at <https://www.ipsl.co.ke/pesalink> (accessed 26 November 2020).

^{xvii} Government of Kenya, Ministry of ICT (2019), Digital Economy Blueprint. <https://www.ict.go.ke/wp-content/uploads/2019/05/Kenya-Digital-Economy-2019.pdf> (accessed 26 November 2020)

^{xviii} Ndungu (ibid)

^{xix} Safaricom (2020). MShwari and KCB M-Pesa. Available at <https://www.safaricom.co.ke/personal/m-pesa/do-more-with-m-pesa/loans-and-savings> (accessed 26th November 2020)

^{xx} Nano loans still relied heavily upon prior performance, data availability, quality and predictive ability have taken time to develop according to Kevin Mutiso of the Digital Lender's Association of Kenya

^{xxi} Findexable (2020). Global Fintech Index 2020. Findexable. Available at <https://findexable.com/wp-content/uploads/2019/12/Findexable-Global-Fintech-Rankings-2020exSFA.pdf> (accessed on 26th November 2020)

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