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The Potential of Shared Platforms for SACCOs in Kenya

David Cracknell

The financial sector is undergoing digital transformation. Equity Bank in Kenya reports that 98% of its transactions are now outside the branch[1], whilst over 90% of KCBs transactions are digital. Beyond the banking sector over 38 million Kenyans use M-Pesa accounts. At scale, digital finance offers benefits to financial institutions in terms of lower costs, improved decision making, and faster processes. Customer's benefit from speed, efficiency, convenient access to services, and much less time spent on financial transactions.

Deposit taking SACCOs are responding to the digital finance revolution. The most common response has been to develop a website for communication purposes, and to offer basic financial transactions through an app connected to M-Pesa and to partner with a bank for ATM transactions.

A few SACCOs have started to offer easy access to small loans through a mobile interface based on simple decision-making rules[2]. However, outside some of the largest SACCOs, that have invested heavily in new systems – such as Police, Unaitus, and Harambee, it is difficult for SACCOs to meet the digital transformation challenge head on. This blog explains the challenge – and how it can be met through shared platforms.

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[1] Equity Group Holdings Investor Briefing H1 2020 Performance – slide 32, Equity Group Holdings [Viewed on 24 November 2020]. https://equitygroupholdings.com/investor-relations/

[2] Unpublished survey by the author 2019

The challenges SACCOs face

Many SACCOs struggle to respond to the digital finance challenge, for financial and technical reasons compounded by legacy systems architecture.

Financial: To keep up to date and to offer the latest products, SACCOs must periodically upgrade their banking platforms and integrate new apps. Many regulated SACCOs use systems supplied by local vendors based around ERPs typically Navision or Microsoft Dynamics. Relatively few SACCOs use established, but more expensive, core banking systems such as Banker's Realm. The choice of system is driven partly by financial considerations – ERP-based systems, whilst more affordable are replaced more frequently than core banking solutions. In addition to the costs of the core platform, the total cost of I.T. operations is even higher due to support costs, service charges, licences, and the need to integrate additional systems, such as apps.

Technical skills: Procuring, integrating, maintaining systems requires highly skilled staff. Smaller deposit taking SACCOs, and especially those based outside Nairobi can struggle to access and finance high quality information technology staff. They are in short supply and there is a competitive employment market for their services.

The pace of change: The financial sector is evolving more rapidly than at any other time. Payment cards were launched in 1950, ATMs in 1969, real time settlement in 2004, cheque truncation in 2010. By comparison, since 2010 there has been worldwide adoption of mobile money and agent banking, nano credit, merchant services such as Lipna M-Pesa, and a host of lifestyle services supported by these innovations. Digital finance supports services based on e-commerce, bill payments, foreign exchange, remittances, digital government and more. Its not easy to be responsive as an institution, but it is extremely easy for customers to shift some of their business to another provider.

Compliance: Given the widespread adoption of new technologies, the SACCO regulator has responded by releasing new guidelines on MIS in 2015 and on cybersecurity in 2018. These guidelines are updated as required, and additional guidelines produced. It is not easy for DT-SACCOs to comply with these guidelines. Compliance costs. However, lack of compliance can cost more especially when it comes to cybersecurity – with newspaper articles reporting SACCOs losing billions of shillings to fraud and theft. Beyond SASRA regulations, national laws are changing in response to the digital revolution including the Data Protection Act 2019. Compliance will become more challenging as more guidelines are issued.

Competition: However, it is competition supported by digital finance which in the medium term offers the most threat to Kenya's SACCOs. Competition comes from within the SACCO sector, given that many SACCOs have opened their common bond. Leading SACCOs such as Police SACCO, or Unaitus have spent hundreds of millions of shillings on their IT platforms and will be looking to grow through providing new services to new members – partly to leverage the investments they have already made.

Competition comes from banks and microfinance institutions – note that SACCO members paying loans through check off deductions already have bank accounts. Members can choose to move more of their banking services to more agile banks. But in addition, competition comes from mobile money providers or financial technology providers offering instant loans, or invoice discounting.

Introducing Shared Platforms

Shared platforms have their genesis in a fee-based model for software services. An example of this is Office 365, where for a low annual fee a user has a time-based license for Microsoft Office. The user does not have to purchase new software as upgrades are automatic and can use the same licence on multiple devices.

Likewise banking as a service or BaaS as it is sometimes called, offers financial institutions options to purchase access to a shared core banking platform and/or a range of services. To rent space, rather than to own it. The range of additional services is wide and can cover payments, loans, cybersecurity, clearing, card processing, agency banking, mobile money etc. Typically, BaaS platforms serve many different institutions, are cloud-based, data is siloed by institution and backed up on a real time basis.

The most common pricing methodology is on a per account or per member per year basis. Being careful to note definitions here, such as how dormant and/or closed accounts are treated, or multiple accounts held by the same member. Other pricing methodologies include transaction-based pricing, and/or a revenue share for certain services. The total fee will depend upon the range of services that the SACCO is taking up.

Advantages of Shared Platforms for SACCOs

Perpetual upgrades: Usually the BaaS service provider continually upgrades its solutions and offers the upgraded solution to all clients paying for that service. By comparison, SACCOs in Kenya typically upgrade EPR systems on a three to four-year cycle and banking systems on a five to eight-year cycle.

Improved security: A BaaS platform will usually meet international standards but must be configured to meet local regulatory requirements and laws. Indeed, there are separate categories of BaaS, called RegTech and Compliance as a Service. Given that established BaaS platforms need to comply with regulators from multiple jurisdictions, standards around identification, authentication and authorisation are high. However, an additional cybersecurity layer could also be offered from cybersecurity specialists such as Serianu in Kenya.

More predictable and regular financing cost: Given the pricing methodologies outlined, financing becomes a regular cost, monthly, quarterly, or annually, rather than a fixed cost. The core banking module is often priced on a per member per year service, and additional services are priced on revenue shares, fees could even be offset by small annual charges to members, combined with regular service charges. Offsetting these cashflows can have significant liquidity benefits to SACCOs.

Access to a range of additional services: The BaaS provider can tailor additional services to a local market. For example, offering access to agency banking services across SACCOs within its network. This would enable any participating SACCO to offer its members services through other SACCOs or their agents in the network. A range of payment services could be provided. Another example could be digital credit, where the BaaS provider collaborates with a third-party system provider to enable all SACCOs on the network to benefit from a digital credit platform. Technically access to the clearing system could be offered through the BaaS platform – though this would require other regulatory hurdles to be met and may require a banking partner.

Adopting Shared Platforms: Moving to any new platform is a process which often involves data cleaning and migration, this is time consuming, challenging and can be costly, particularly where full file records are transferred to the new core banking platform.

A final note on outsourcing

Moving to shared platforms implies that a SACCO is outsourcing key functions to third parties. However, outsourcing technology does not outsource responsibility for the application of the technology. Responsibility for outsourcing and its implications remains with the Board of the SACCO. Further guidance from SASRA may be forthcoming.

This blog is one of a series of blogs, should you wish to sign up to receive additional blogs, please write to David Cracknell at david@firstprinciples.consulting

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