

COMMUNITY – LEVEL IMPACTS OF FINANCIAL INCLUSION IN KENYA WITH PARTICULAR FOCUS ON POVERTY ERADICATION AND EMPLOYMENT CREATION

Written by

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May 2017

Abstract

In the last decade, Kenya has implemented numerous innovative finance solutions that are transforming its financial, economic and social landscape. Some of these initiatives include the launch of mobile-phone financial services in 2007, enactment of the microfinance banking legislation in 2006, the roll out of the agency banking model in 2010, and roll out of shariah compliant services in 2005, among others. These innovations offer immense possibilities for achieving inclusive economic growth, sustainable development, and poverty reduction. Further, the outcomes, with respect to financial services, have evidenced ‘early days’ impact on poverty. This paper provides highlights on Kenya’s journey regarding inclusive finance. It discusses the various reforms and initiatives and consequential impacts of financial inclusion efforts in transforming the lives of the Kenyan populace, with particular focus on impact on poverty reduction and employment creation. The paper also discusses the lessons of embracing innovative and inclusive finance across Kenya, including some of the key risks, and suggests some recommendations/next steps to moving financial inclusion to new frontiers while reducing poverty, creating employment and advancing sustainable economic development.

1. Introduction

Whereas financial inclusion is defined as ‘universal access, at a reasonable cost, to a wide range of financial services, provided by a variety of sound and sustainable institutions’³, financial inclusion efforts primarily seek to ensure that all households and businesses, regardless of income level, have access to, and can effectively use, the appropriate financial services they need to improve their lives’.⁴ However, approximately 2 billion people across the globe do not use formal financial services and more than 50% of adults in the poorest households are unbanked⁵.

In 2013⁶, 10.7% of the world’s six billion people, approximately 767 million people, lived on less than USD 1.90 a day compared to 12.4 percent in 2012. It is also estimated that 389 million people, who account for half of the total number of the world’s extreme poor, and more than the poor in other regions combined, live in Sub-Saharan Africa.⁷ Majority of the poor are locked out of the formal financial system; with little or no access to formal financial services that can help them increase their incomes and improve their lives.

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² We acknowledge the support of colleagues in the Bank Supervision, Banking and Research Departments of the Central Bank of Kenya for providing input into the paper. In particular we acknowledge Harun Mahianyu, Lucy Kabethi, John Kipkirui, Reuben Chepng’ar, Amos Lupembe, Talaso Rasa, Richard Kioko, Elizabeth Onyonka, Stephen Wambua, Camilla Chebet and Julienne Lauler, who provided input into various sections of the paper.

³ <http://www.un.org/esa/ffd/topics/inclusive-finance.html>

⁴ <http://www.cgap.org/about/faq/what-financial-inclusion-and-why-it-important>

⁵ <http://www.worldbank.org/en/topic/financialinclusion>

⁶ This is the latest period in which the most comprehensive data on global poverty is available from the World Bank.

<http://www.worldbank.org/en/publication/poverty-and-shared-prosperity>

⁷ <http://www.worldbank.org/en/topic/poverty/overview>

While there are so many poor and unbanked people across the globe, there is some glimmer of hope for them in the promise of finance. There are positive linkages between financial inclusion, poverty reduction and sustainable development. Increased access to finance increases access to markets which facilitates access to credit and supports a savings/investment cycle. This allows for capital accumulation and asset building which enables the poor to reduce their vulnerabilities to poverty. Safe havens for savings by the poor also reduce their vulnerability to periodic economic and social shocks. The provision of credit and savings mobilization to fund investments are thus needed to alleviate poverty, create wealth and employment in developing countries. Financial inclusion is not a panacea for poverty eradication. However it can clearly play a role in reducing poverty and the impact thereof, as well as boosting wellbeing⁸.

2. Lay of the Land and Problem Statement

Kenya's population currently is estimated at 46 million, comprising of approximately 52% females and 48% males; and 37% and 63% of the population living in urban and rural areas, respectively⁹. The country's poverty rate is estimated to be close to 40 percent of the population living on less than a dollar per day and 33.6 percent living on less than USD 1.90 a day as highlighted in 2005¹⁰.

In the past decade, Kenya, like many developing nations, was characterized by high poverty incidences and high levels of exclusion. The financial sector fell short of meeting the financial needs of the Kenyan populace and financial sector growth was stunted. The sector had missing markets and missing institutions; and even the existing markets themselves were segmented, leading to market inefficiencies. Despite having a good number of commercial and microfinance banks, the sector tended to focus on a narrow range of products and customers and served varying market niches, an indication of a highly segmented market.

These problems were exacerbated in previous years when access to financial institutions reduced. During the period between 1998 and 2002, there were quite a number of mergers and acquisitions which were largely triggered by the need to meet the increasing minimum core capital requirements. Further, cost pressures and performance targets were driving most institutions to re-evaluate and incline their business models towards 'higher margin' clients, who in those days were mostly corporate clients. In a bid to reduce costs, enhance efficiency and recoup the benefits of the synergies from consolidation of the industry, most financial institutions, particularly multinational banks, were quick to reduce the duplication of their footprints and access points across the nation. The number of branches reduced from 692 in 1998 to 466 in 2002 – an annual decrease of 9.4 percent over a four-year period¹¹. The decrease in financial access was particularly stark in some regions, and particularly in rural areas, which experienced an annual decrease in the brick-and-mortar locations of 16.7 percent 14.2 percent and 13.2 percent, respectively. The closure of the branches did not go unnoticed as local banks, such as K-Rep Bank Limited, Kenya Commercial Bank Limited, Equity Bank Limited and Family Bank Limited, quickly stepped in 2003 to enhance their physical presence across the country, particularly in rural areas. By 2004, the declining trend had reverted as the number of branches increased from 466 in 2002 to 532 by the end of 2004.

Despite these slight improvements, access to financial services still remained a challenge. In 2006, the first national Financial Access Survey was conducted to establish the extent of data available to

⁸ <http://www.worldbank.org/en/topic/financialinclusion>

⁹ 2016 FinAccess Household Survey, February 2016

¹⁰ <http://povertydata.worldbank.org/poverty/country/KEN>

¹¹ Central Bank of Kenya – Bank Supervision Department Annual Reports (1998 – 2002).

determine the levels and barriers to financial access in Kenya¹². The barriers to financial inclusion were largely grouped into two broad categories, which are mutually self-reinforcing:

- *Supply-side barriers;*

The high costs of accessing financial services (monetary and time-wise); minimum bank balance requirements, high ledger fees (costs for maintaining micro-accounts), and physical barriers stemming from the distance between people's homes to financial institutions' branches or financial touch points, greatly hindered access to financial services. Further, the lack of traditional physical collateral, the provision of inappropriate products not suited for customers with low and irregular income, perceived high risk and lack of information increased costs and premiums placed on the poor and low income borrowers by banks.

- *Demand-side barriers, which included:*

- Lack of income, low incomes and lack of permanent income flows or employment;
- low education and financial literacy levels; and
- cultural, religious and social barriers.

It was in view of these impediments, it became necessary to reform the financial sector to adequately meet the needs of the Kenyan citizenry. One of the ways of enhancing financial inclusion was to catalyse the development of innovative, less complex and cost effective financial instruments through policy reforms and initiatives in order to better serve the unbanked and underserved segments of the population.

3. Reforms were needed

A country cannot tackle poverty and foster economic development when the majority of its people have limited access to financial services. To achieve equitable economic growth and development, it is necessary that the majority of a nation's populace have access to appropriate and affordable financial services and products in order to enhance their quality-of-life. Kenya thus undertook various financial sector reforms in recognition that a strong and stable financial system is key to driving forward economic growth and poverty reduction. Two such important reform agendas were encapsulated within the Economic Recovery Strategy for Wealth and Employment Creation (ERSWEC) of 2003 to 2007 and the current economic blue print, Kenya Vision 2030 of 2008 to 2030.

- *ERSWEC (2003 – 2007)*

This strategy was envisioned to reverse decades of slow economic growth that had adversely undermined the well-being of Kenyans. It was aimed at empowering Kenyans and providing them with 'a democratic political atmosphere under which all citizens could be free to work hard and engage in productive activities to improve their standards of living'. The Strategy identified key policy actions to achieve accelerated economic growth, poverty reduction and job creation based on four pillars: i) macro-economic stability; ii) strengthening of institutions and governance; iii) rehabilitation and expansion of physical infrastructure; and iv) investment in human capital of the poor. Its implementation was expected to translate into sustained economic growth, wealth creation and poverty reduction, and a broad improvement in the well-being of Kenyans¹³. Having a vibrant and integrated financial sector was critical in supporting the economic recovery.

- *Vision 2030 (2008-2030)*

Kenya's Vision 2030 strategy is aimed at transforming Kenya into an industrialised, middle-income country providing a high quality of life to all its citizens by 2030. The Vision is built on three pillars

¹² <http://fsdkenya.org/publication/financial-access-in-kenya-results-of-the-2006-national-survey/>

¹³ <http://siteresources.worldbank.org/KENYAEXTN/Resources/ERS.pdf>

(economic, social and political) which are anchored on the principles of macroeconomic stability; continuity in governance reforms; *enhanced equity and wealth creation opportunities for the poor*; infrastructure; energy; science, technology and innovation; land reform; human resources development; security and public sector reforms¹⁴. The Vision 2030's goal for equity and poverty reduction is to reduce the number of people living in absolute poverty to the tiniest proportion of the total population. Specifically, the financial services sector is one of six priority sectors that will see the Vision achieved by deepening the financial markets through enhancing its access, efficiency, and stability.

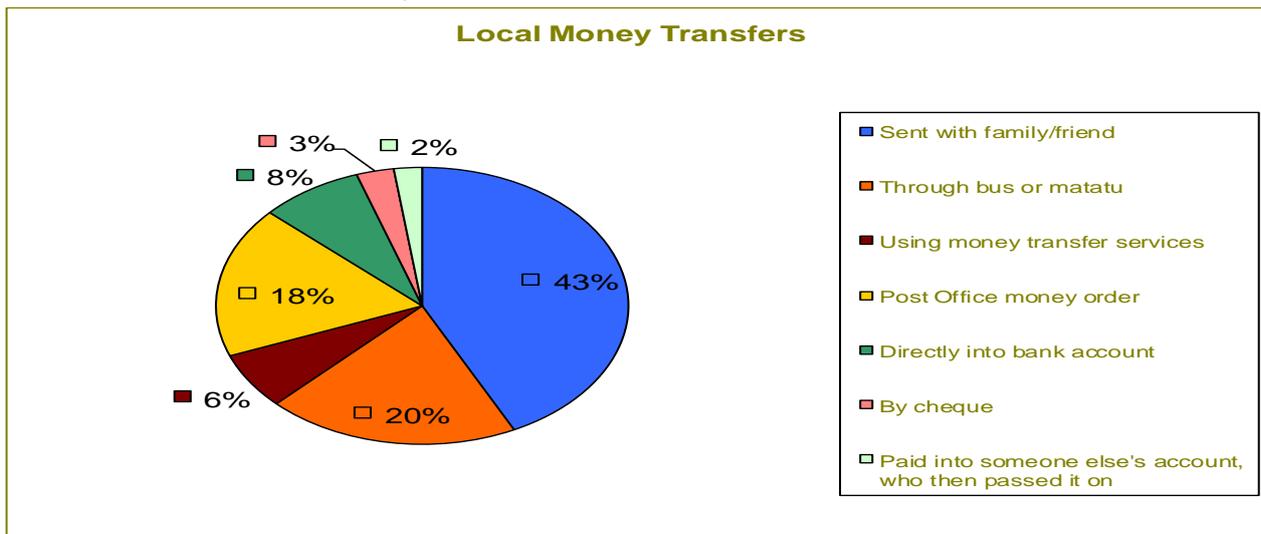
4. The Reforms

Under Kenya's strategic agendas, a number of reforms and initiatives were employed, resulting into dynamic innovations and transformations in the financial sector and financial access landscape. These are outlined here-below.

a) Sending Money Back Home: The revolution of Digital Financial Services

Prior to the rollout of digital financial services, remitting money was not only expensive but it was also cumbersome. As per the pie chart 1 below, individuals sent money transfers through friends (43 percent), public transportation (20 percent) or the local postal office (18 percent). These were hardly secure, efficient or convenient modes of transfers.

Chart 1: Mode of local money transfers



FinAccess Household Survey, 2006

Rolled out in 2007 as a money transfer platform, the advent of mobile-phone financial services in Kenya, presented an opportunity to dramatically reduce time and costs (efficiency) and reach greater scale (outreach) to more low income and poor people in far-flung areas in a cheaper, safe and more convenient manner¹⁵. This innovation, which was conceived in the backdrop of similar innovations in Philippines, such as G-Cash (2001) and Smart Money (2004), soon become a widespread success.

This digital revolution allowed people to make financial transactions remotely at the comfort of their localities and without disrupting their business operations. They were able to manage time as they no longer had to travel long distances to bank outlets and avoided the risks of transporting physical cash

¹⁴ <http://www.vision2030.go.ke/about-vision-2030/>

¹⁵ <http://web.worldbank.org/WBSITE/EXTERNAL/NEWS/0,,contentMDK:20433592~menuPK:34480~pagePK:34370~piPK:116742~theSitePK:4607,00.html>

from one place to another. More significantly digital finance opened up new avenues for those who did not have access to cheap and convenient finance to have the opportunity to interact with financial services.

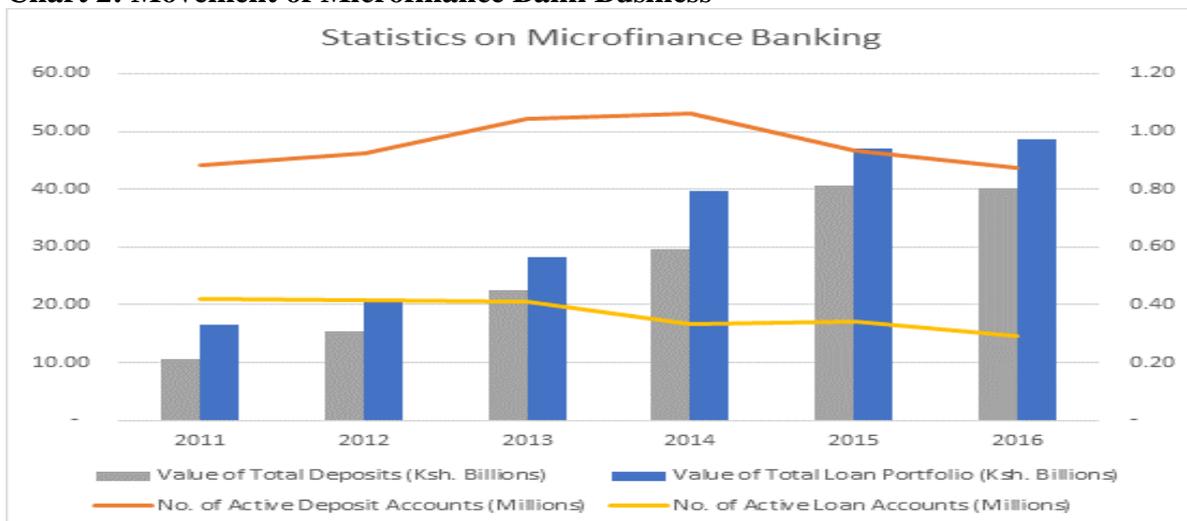
Over the years, Kenya has seen an unprecedented increase in the uptake of mobile phones and MFS in the country. The use of mobile-phone financial services (MFS) has more than doubled from 23.4% in 2009 to 67.5% in 2015. As at December 2016, there were 161,583 agents handling over 30 million customers and had processed 456.7 million transactions valued at Kshs. 1.2 trillion (USD 11.2 billion) in aggregate. It is worth noting that the mobile platform is a high volume, low value retail payments platform. Although the mobile transactions represent over 85 percent of the total number of transactions in the payment system, they represent about 9 percent of the total value of transactions¹⁶.

b) Taking Microfinance to the Community: The emergence of microfinance banks

Microfinance institutions showed great promise in reaching the poor and rural populations in Latin America and Asia in the late 1990s and early 2000s. In Kenya, a good number of microfinance entities also existed, providing various financial services to the rural, peri-urban and low income population. These entities were registered under different Acts of Parliament; however, they lacked standardised and appropriate legislation and regulatory oversight. To support the microfinance industry, there was need to develop an enabling legal and regulatory framework to enhance governance, transparency, high performance standards, discipline, competition and efficiency in the microfinance subsector. These considerations culminated into the enactment of the Microfinance Act, 2006, which was operationalised in 2008.

The development of the Act was informed by knowledge exchange visits to Bolivia and Mexico in 2007 and numerous interactions with regulators within the African region, like Bank of Uganda, as well as research institutes and development partners. The licensing of microfinance banks, whose primary focus is the low income households and micro, small and medium enterprises (MSMEs) in the rural and peri-urban areas, has played a critical role in promoting financial inclusion in Kenya. As at December 2016, CBK had licensed 13 microfinance banks with 113 branches, 105 marketing offices and 2,066 banking agents. Collectively, the microfinance banks had 0.87 million deposit accounts valued at Ksh. 40.22 billion (USD 398.9 million) and 0.29 million loan accounts with an outstanding loan portfolio of Ksh. 48.57 billion (USD 469.6 million). The bar chart 2 below illustrates these developments.

Chart 2: Movement of Microfinance Bank Business



¹⁶ Central Bank of Kenya, 2017.

Through the Act, Kenya has witnessed the significant growth and development of the microfinance industry, which plays a pivotal role in deepening the financial markets by expanding access to affordable and appropriate financial services and products to majority of Kenyans.

c) Democratising Banking: The agency banking model

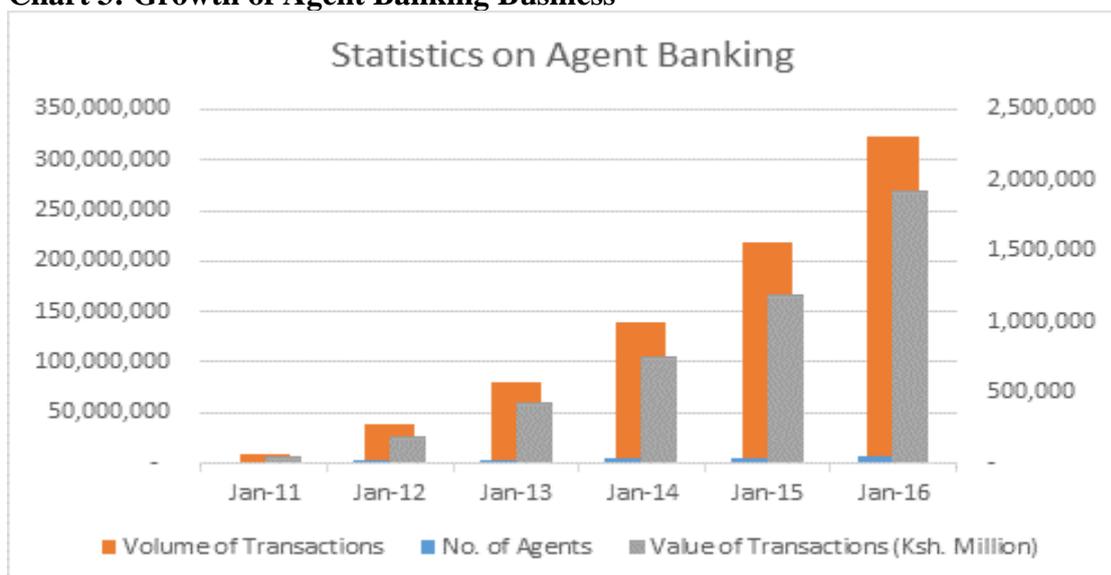
Kenya’s banking sector experienced a slowdown in the expansion of brick and mortar branches, from the 1990s, and had limited reach. Most of the under-banked and unbanked Kenyans were not inclined to access banking services as they perceived them to be too “elitist, targeting the more sophisticated and employed segments of the population. The Central Bank of Kenya (CBK) thus sought to develop more customer friendly, convenient and lower cost delivery channels for Kenyan consumers.

In October 2009, CBK, together with the Kenya Bankers Association (KBA) and the National Treasury, conducted a knowledge exchange tour of Brazil and Colombia to gain indepth hands-on learning experience on agent banking. This exchange lead to the development of the Agent Banking Guidelines for commercial banks and microfinance banks, in 2010 and 2012, respectively.

The Guidelines allow commercial banks and microfinance banks to partner with third party enterprises (undertaking a legally recognised business activity) to offer specified banking services on their behalf. The agent banking model has enabled commercial and microfinance banks to expand their reach to areas they would otherwise have not, due to such limitations as the viability of establishing a brick and mortar branch, establishment costs, and lack of infrastructure. Agency banking also takes banking services to the convenience of consumers who can now save on transport costs and time taken to visit bank outlets.

Since rollout of agency banking in May 2010, 18 commercial banks and 5 microfinance banks (MFBs) had contracted 53,833 and 2,068 agents, respectively. These agents have managed over 322 million transactions (cumulatively from 2010 – December 2016) worth over Ksh. 1.9 trillion (USD 18.65 billion) over the same period. The bar chart 3 below illustrates the growth over this period.

Chart 3: Growth of Agent Banking Business



Central Bank of Kenya, 2017

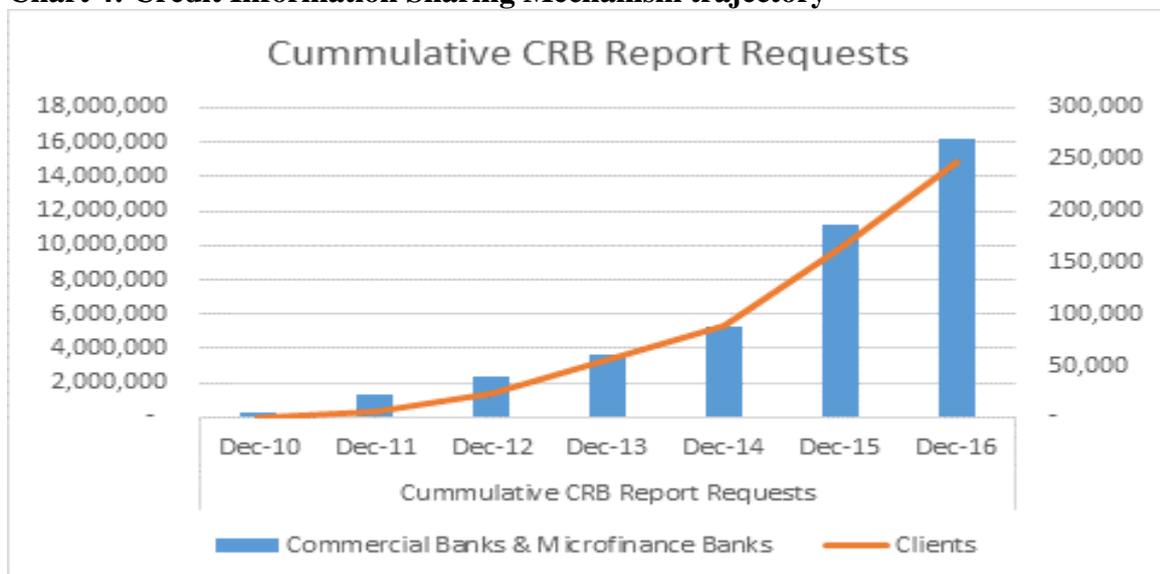
d) Expanding Access to Credit: Credit Information Sharing (CIS) Mechanism

Prior to 2010, Kenyan banks were faced by the twin problems of information asymmetry and huge search costs as they appraised credit applications. These problems arose as banks were not sharing credit histories of their customers among themselves. The problem with this is that high risk premiums were placed on consumers, consequently increasing their cost of credit. The development of Credit Reference Bureau Regulations in 2008 and licensing of credit reference bureaus from 2010 thus provided an opportunity for individuals and businesses to rely on good credit history as an alternative form of collateral, to secure cheaper credit facilities from banks. This was especially useful for those who were locked out of formal financial system for lacking traditional/ physical collateral.

The Credit Information Sharing Mechanism (CIS) requires banks to share both positive and negative credit information through licensed credit reference bureaus (CRBs). Other than enabling banks to enhance the soundness of their credit appraisals based on the readily available credit histories, the CIS mechanism also enables the borrowing public to negotiate for better credit terms and conditions based on their good credit histories. The borrowers are also able to use their good credit history as information collateral, which serves as a substitute to physical collateral. In order for the CIS mechanism to achieve the optimum desired benefits, efforts are on-going to bring on board all credit providers to ensure that the borrowers' credit histories are sufficiently comprehensive; reflecting all their borrowing history.

So far, three credit reference bureaus (CRBs) have been licensed by CBK to collate credit histories and avail credit reports to the lenders. Since the introduction of the credit information sharing mechanism in July 2010, cumulative number of credit reports requested by commercial banks, microfinance banks and customers from the three CRBs as at December 2016 was 15,597,122, 584,775 and 248,026, respectively. The bar/line chart 4 below shows the growth trajectory.

Chart 4: Credit Information Sharing Mechanism trajectory



Central Bank of Kenya, 2017

e) Service Niche Markets: Shariah Compliant Banking

Islamic banking (Sharia compliant banking) was introduced in Kenya in 2005 with the principle objectives of developing the market for banking services and boosting financial inclusion. It was specifically aimed at expanding financial services to users whose access was restricted by non-availability of banking services that were compliant with their religious beliefs.

In Kenya, the adopted delivery models for the provision of Islamic finance products by the commercial banks are:

- **Fully-fledged Shariah Compliant banks:** being a wholly Shariah compliant banking institution that operates as a stand-alone entity.
- **Shariah Compliant Window:** being a window within a conventional bank through which customers can conduct business using only Shariah compatible instruments.

The market for Islamic Banking services in Kenya has been on a growth trajectory since the services were introduced in Kenya in 2005. As at December 2016, there were two full-fledged Islamic banks and a number of conventional banks offering financial products through Shariah compliant Windows. Fully shariah compliant banks now control 1 percent of the banking sector market share. A third fully shariah compliant bank from the United Arab Emirates was licensed in April 2017. The continued growth of the Islamic banking market has made it necessary to put in place an enhanced supervisory framework for Islamic banking, catering to its unique aspects.

f) Connecting Kenyans to Money Markets: To Promote Savings and Investments

In Kenya, we are currently rolling out two mobile phone based initiatives that are aimed at increasing public participation in the money markets;

- **M-Akiba** – was officially launched by the National Treasury on 23rd March 2017. M-Akiba enables the public to purchase government bonds from as little as USD 30 using their mobile phones.
 - As at 5th April 2017, 102,632 investors had registered on the M-Akiba platform with 5,691 investors subscribing for the total initial value on offer - KShs. 150 million (USD 1.45 million).
 - It took 14 days for the M-Akiba bond to achieve a 100 percent take-up rate, with 65.6 percent of the 5,691 investors subscribing for amounts between KShs. 3,000 –KShs. 10,000 (USD 28.99 – USD 96.66).
- **Treasury Mobile Direct (TMD)** – the pilot phase was successfully rolled out in November 2015. This initiative seeks to increase retail investors’ participation in the current primary auction process for government securities. The services that will be provided under the TMD project include;
 - information dissemination;
 - account status inquiry;
 - bidding for Kenya Government Securities; and
 - payment/ settlement through mobile money platforms.

5. Transformational Outcomes

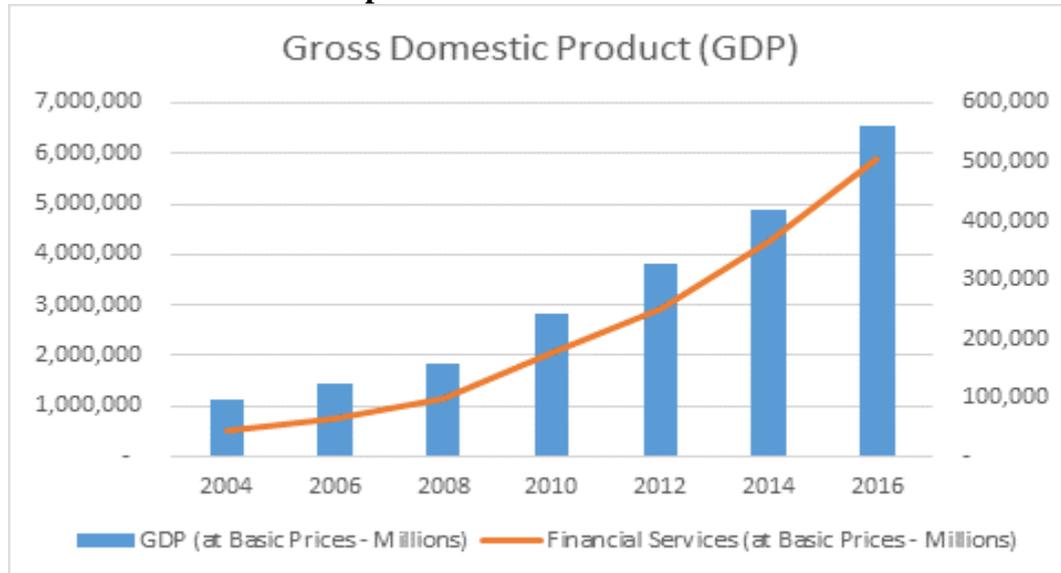
As a result of the initiatives and reforms within the banking sector, we have witnessed tremendous growth and transformation in efficiency, stability and outreach of financial services. The effects of the innovative and inclusive finance have an impact on increasing access to financial services which have conversely assisted in reducing poverty and creating employment.

a) Expansion of the Banking Sector to serve all niches better

Over the last few years there has been significant progress. Kenya’s GDP expanded by 5.8 percent in 2016 compared to 5.7 percent in 2015. Overall growth of the financial services sector decelerated from 9.4 per cent in 2015 to 6.9 per cent in 2016, largely due to a decline in growth in the banking sector from 10.1 per cent in 2015 to 7.1 per cent in 2016 which was attributed to uncertainty associated with

the capping of interest rates that came into effect in September 2016. However, the contribution of the financial services sector to GDP continues to increase as access to financial services increase. In 2016, the financial services sector contribution to GDP had increased to 7.1 percent from 3.2 percent in 2006; an annual increase of 8.3% over a ten-year period.^[1] Chart 5 below illustrates these developments.

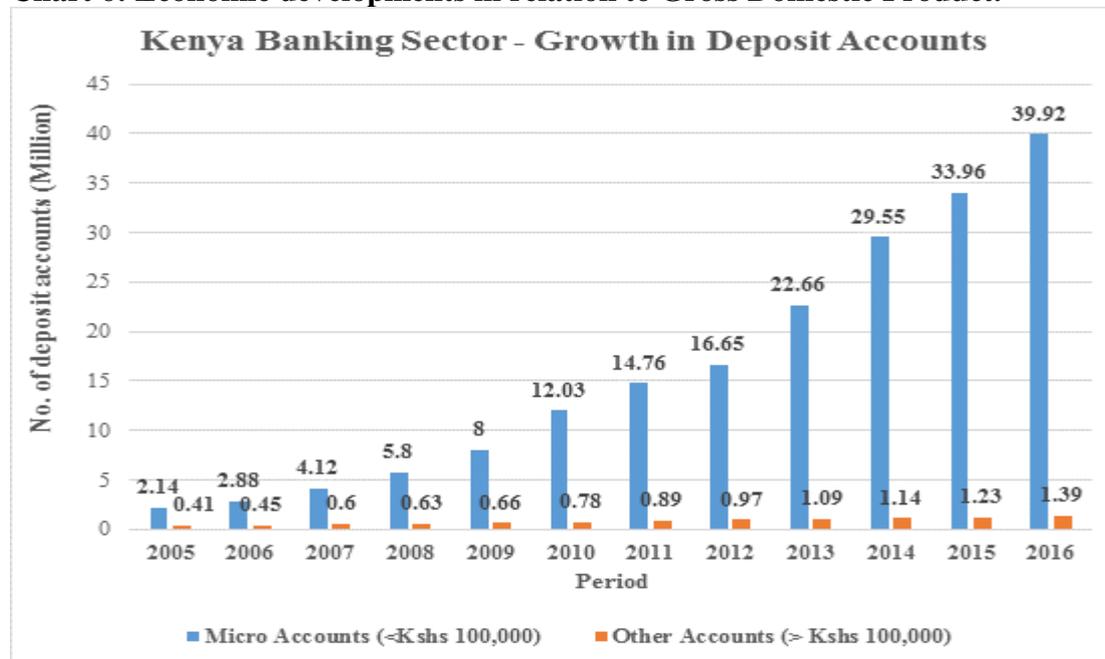
Chart 5: Economic developments in relation to Gross Domestic Product.



Economic Survey, Various

The banking sector growth was also quite impressive as per chart 6 below with the number of accounts increasing significantly. Important to note is that micro-accounts dominate the banking sector; these are accounts with balances below Kshs. 100,000 (USD 1000).

Chart 6: Economic developments in relation to Gross Domestic Product.



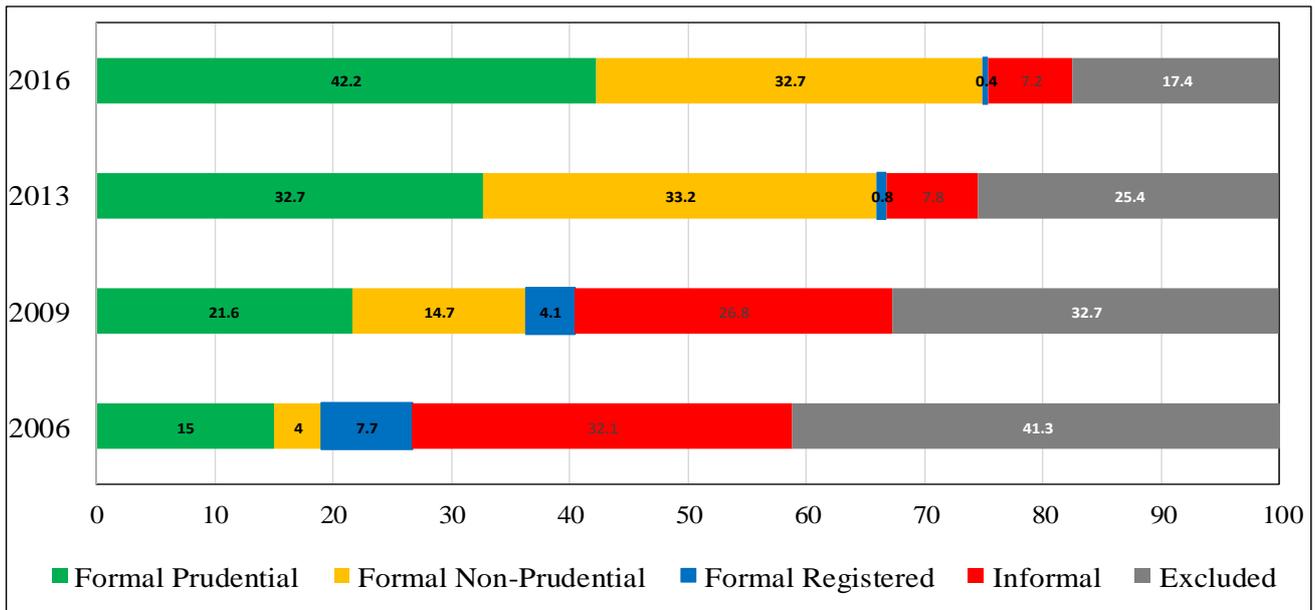
Central Bank of Kenya, 2017

[1] http://www.knbs.or.ke/index.php?option=com_content&view=article&id=369:economic-survey-2016&catid=82:news&Itemid=593

b) Increasing access to financial services as demand and usage has increased

There has been an increase in the level of financial inclusion through formal financial institutions, whilst the population with access to informal financial services, as well as those excluded from any financial services, has decreased. The impact of financial service provision is being felt more, in terms of reach and depth, and with regard to expanding the supply of affordable and appropriate financial services and products to more Kenyans, including the poor. Overall, 75.3% of Kenyans are now formally included from 26.7% in 2006; an over 50% increase in the last 10 years. Illustrated in Chart 7 below; is a depiction of these developments.

Chart 7: Increased Access



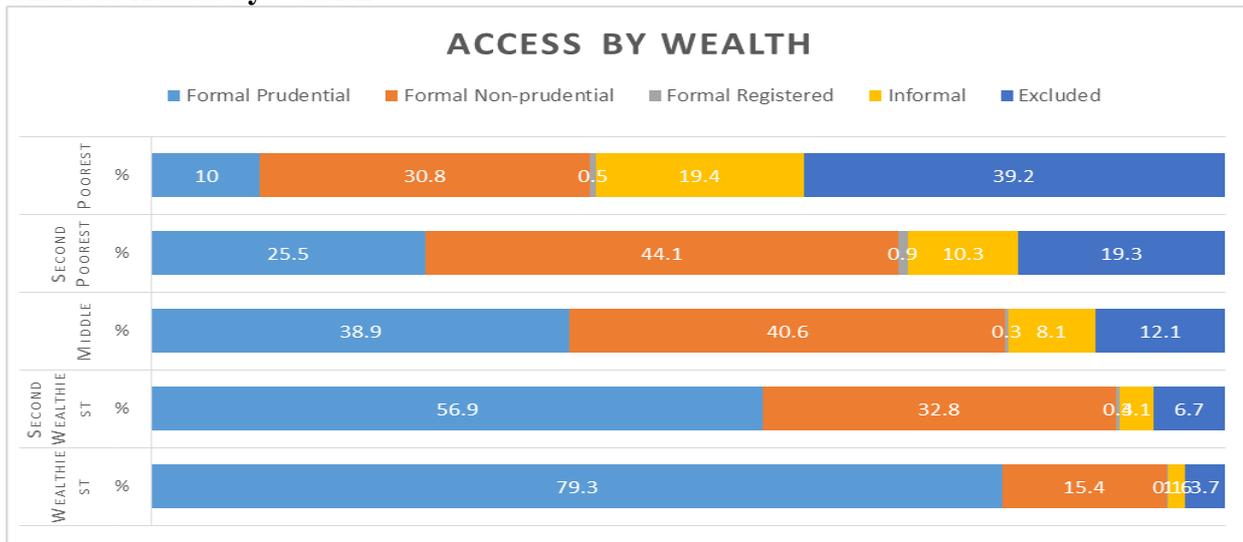
(FinAccess Reports, 2006, 2009, 2013, 2016)

We are also seeing increased demand for:

- Credit – consumers are increasingly able to access credit through traditional banking facilities as well as integrated payments and banking platforms.
- Payments – consumers are increasingly accessing financial services that are instantaneous, secure, reliable and accessible from anywhere and anytime.
- Insurance – Digital finance is increasingly making the provision of micro-insurance possible.
- And other financial services such as capital markets and pensions products.

The survey also established that financial access has indeed expanded across the economic divide in Kenya over the last decade. However, the middle class and the wealthy have been the most impacted by these demonstrated outcomes as in the chart 8 overleaf.

Chart 8: Access by Wealth



(FinAccess Report, 2016)

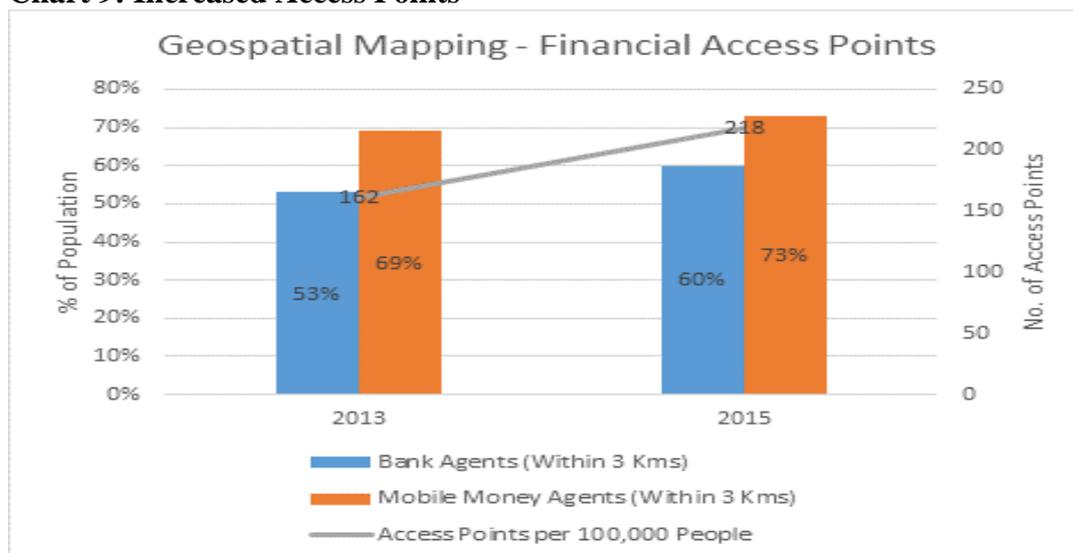
The Kenyan public and private sector therefore are continually listening, innovating and designing policies and financial services and products that are well suited to meet the needs of the poorest consumers.

c) Increased supply of financial services to majority Kenyans

There has also been an increase in the number of financial access service points reaching larger segments of the Kenyan populace. A GIS Spatial Mapping of financial access touch points in Kenya was conducted in 2015 to digitally map out the financial access touch points in the country. It established that financial services access touch points per 100,000 people had increased in 2015 to 218 compared to 161.7 in 2013. The percentage of the population living within a three (3) kilometres distance of a financial services access touch point was 73% in 2015 compared to 58.7 percent in 2013 and 86 percent of the population were within 5 kilometres of a mobile money agent.¹⁷ Further it showed that the 60 percent and 73 percent of the population accessed bank and mobile money agents in 2015, respectively, compared to 53 percent and 69 percent, in 2013, respectively The chart 9 overleaf provides an illustration of the changes.

¹⁷ FinAccess Geospatial Mapping Survey, FSD Kenya, 2015

Chart 9: Increased Access Points



FinAccess Geospatial Mapping Survey, 2013 and 2015

Although there are great gains that have been reached in expanding access to financial services, it is noted that the greatest beneficiaries in the financial developments have not been the poorest customers but rather clients in the middle and lower middle class groups. We, however, continue to put efforts into developing even more inclusive financial systems to ensure the poor and low income are served with appropriate financial services.

d) Lowering Barriers to Entry and Transacting in the Banking Sector to enhance access

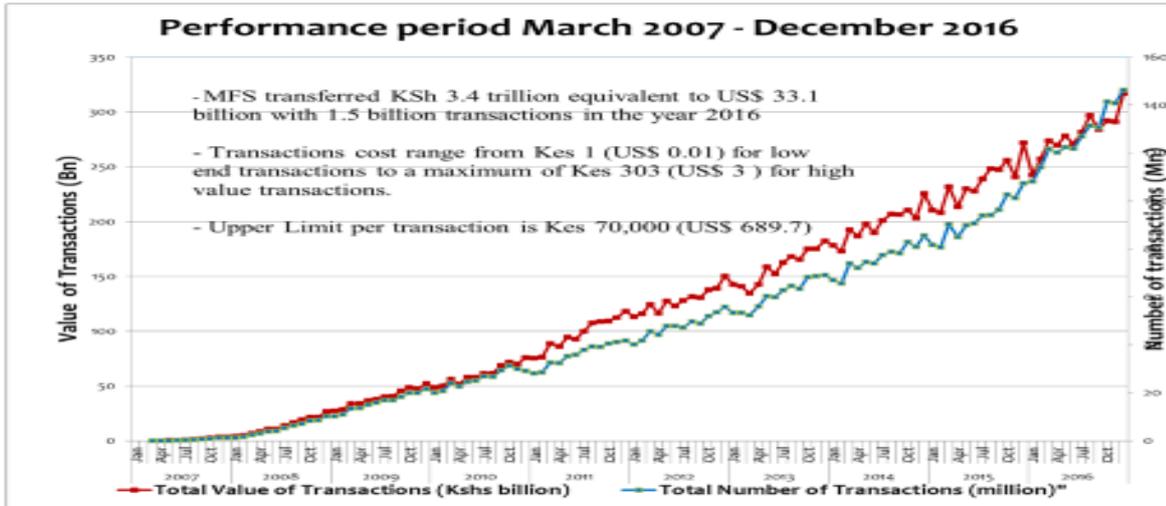
The Central Bank, over the years, has worked with the banking industry to reduce the barriers that impeded the low income and the poor from accessing financial services. These include:

- Waivers on charges as well as reduction of ledger fees and other product charges. For instance, in the past decade, banks have reduced transactional fees and charges on a number of products and for services. They also waived charged on deposits.
- Banks are now required to align anti-money laundering requirements to the risk profile of their clients. To this end, they are now using alternative methods of identifying and authenticating clients without excluding them from accessing financial services. The creation of an Integrated Population Registration System (IPRS) by the Government has enhanced the credibility of national identification cards.

e) Unprecedented growth in mobile-phone financial services.

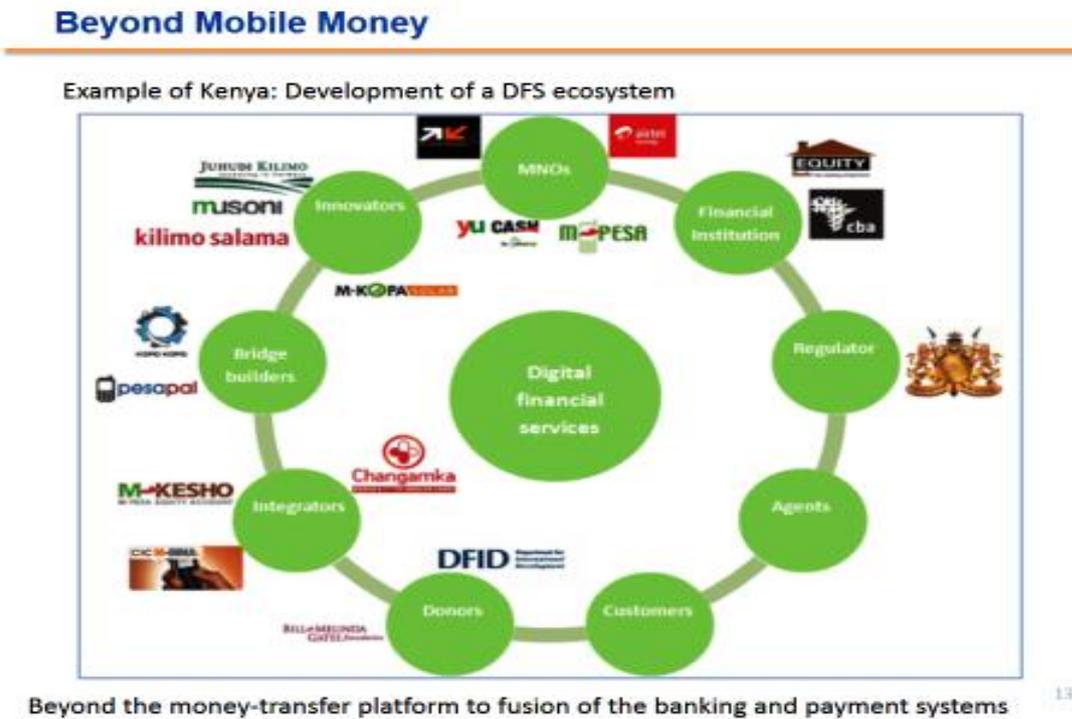
The uptake of mobile-phone financial services has gained great traction in providing an alternative platform for retail payments. The line chart 10 overleaf provides detailed indicators mapping the development of MFS in Kenya over the last decade.

Chart 10: Advancements in MFS over the last decade.



Beside the growth in number and values of customers and transactions, there is an increased fusion and integration of payment and banking services to form a robust digital finance ecosystem. Telecommunications companies are increasingly partnering with banks to allow their customers to link the mobile platform directly to their accounts leveraging on mobile phone technology. A new emerging trend is banks also acquiring mobile virtual network operator (MVNO) licenses from the communications regulator. MVNOs leverage on the infrastructure of mobile network operators to roll out telecommunication services. Below is a diagram that shows the formation of the various relationships within the ecosystem.

Diagram 1: Development of Ecosystem.



f) Reduced gender gap in ownership and usage of mobile phone services.

According to a report done by *Groupe Speciale Mobile Association (GSMA)*, due to the advancements of mobile money, which provide women a distinct reason to own and use a mobile phone, Kenya has a

relatively small gender gap of about 7 percent.¹⁸ The GSMA study attributes the small gender gap in Kenya to the success of mobile money, which provides women and their families a distinct reason to own and use a mobile phone. The study ranked Kenya's women among the most connected in the world. In contrast, there is a sizeable gender gap in mobile phone ownership and usage in low- and middle-income countries. There is evidence to suggest that women in those countries are on average 14 percent less likely to own a mobile phone than men. For instance, gender gaps in Mexico and Egypt are 6 percent and 2 percent respectively, and reported at 41 percent in Niger and 21 percent in Jordan. The study noted that countries with higher per capita GDP generally have smaller gender gaps in mobile phone ownership. Jordan, however, is a middle-income country whose high gender gap is likely due to the social barriers women face relative to their male counterparts. More generally, successfully targeting women would not only advance women's digital and financial inclusion, but also deliver significant socio-economic benefits to families and households.

g) Early indications of poverty reduction

A study done in Kenya established that digital finance supports efforts to reduce poverty and manage risks in low income households. Significantly, low-income households and vulnerable groups have created their own social networks which have enabled them to diversify risk within their social pools, and thereby also enhanced their resilience to unexpected negative shocks.¹⁹ Mobile money appears to increase the number of active participants and effective size of risk-sharing networks, without increasing information, monitoring, and commitment costs. Another study has correlated improved access to mobile phones with living standards, which in turn is one of the dimensions of poverty.²⁰

Another study established that access to mobile-phone financial services had increased daily per capita consumption levels of 194,000 Kenyan households (2 percent), since 2008, thereby lifting them out of extreme poverty. This impact was largely accrued by female-headed households, which were able to diversify their income generating activities from farming to business occupations. The study, further extrapolates the impact of mobile-money agents' density and its impact on per capita consumption. In households where agents density increased by five agents, there was a 6 percent increase in per capita consumption – enough to push 64% of the sampled households above the poverty level. The impact was even more pronounced among female-headed households which saw a daily per capita consumption increase of about 18.5 percent. Not only did the per capita consumption increase among female-headed households, but their savings level was found to increase by around 22 percent²¹.

h) Employment Creation

Financial inclusion provides low-income households, vulnerable groups and informal enterprises with an opportunity to undertake financial transactions, generate income, accumulate assets and manage risks, thereby enabling their participation towards inclusive and sustainable development. The roll-out of the innovative delivery channels and initiatives since 2006 have greatly contributed to employment creation, particularly within the financial services industry. The initiatives and supporting frameworks highlighted have not only led to a reduction in the cost of doing business, but they have also sustained

¹⁸ Gender gap refers to how much less likely a female is to own or use a mobile phone as compared to a male: Groupe Speciale Mobile Association (GSMA), "Bridging the Gender Gap: Mobile Access and Usage in Low- and Middle-income Countries", 2015.

¹⁹ Suri, T. "The Mobile Money Revolution in Kenya: Can the Promise Be Fulfilled?" 2015, FSD Kenya.

²⁰ Oxford Poverty and Human Development Initiative "Global Multidimensional Poverty Index Databank" 2016, University of Oxford. The MPI is a measure of acute poverty, complementing income-based measures by reflecting the multiple deprivations that people may face. It uses ten indicators across three dimensions (education, health, and living standard), with access to a mobile phone an indicator of "asset ownership" which impacts "living standard". It reveals that multidimensional poverty in Kenya has fallen, with an MPI of 0.244 in 2009 and 0.187 in 2014.

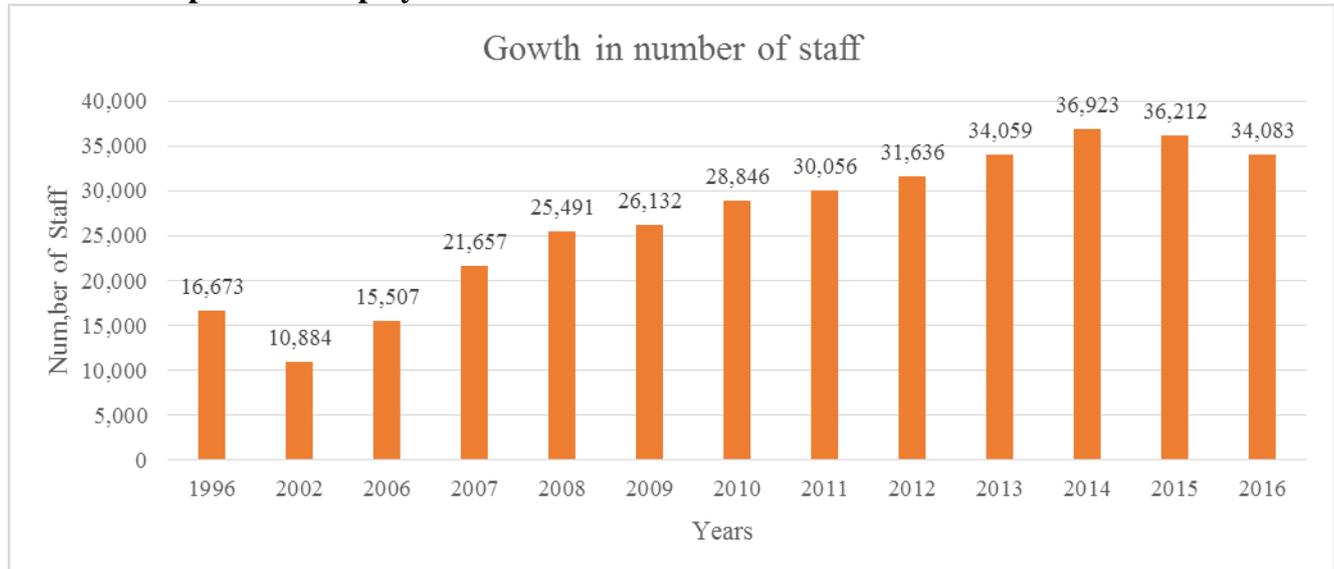
²¹ . Tavneet Suri and William Jack, 9 December 2016, "The long-run poverty and gender impacts of mobile money",

<http://science.sciencemag.org/content/sci/354/6317/1288.full.pdf>

an effective distribution of capital and risk across the economy. Leveraging on these opportunities, financial institutions and business enterprises across the nation have been able to create job opportunities within the financial services industry by contributing 75.7 thousand jobs of the 2,687 thousand jobs in the formal wage-employment sector²².

The chart 11 below illustrates growth of employment in the banking sector between 2006 and 2014. A decline is noted from 2014-2016 due to digitalisation, review of business models, as well as other market factors, which made some staff redundant.

Chart 11: Impacts on Employment



The GSMA study report mentioned above, also indicated that mobile money had helped about 185,000 women in Kenya move from farming to business. It stated that households located in areas with a high density of agent outlets saw 3% of women in both female- and male-headed households take up business or retail occupations over farming.²³

Key impending risks

These developments have not been without risks. Key in this regard are:

- i). *Vulnerability of the poor consumers to the financial system:* As innovative finance takes the day, poor consumers may not be aware of the complexities of the new financial systems or their consumer rights. Financial service providers may not accord them fair treatment and quality service to meet their needs. It is important that they get financial education to abate these challenges.
- ii). *Resilience of technology* - Financial sector innovations must increasingly meet the highest standards of resilience, reliability, privacy and scalability. They must remain robust and secure to mitigate the risks of cyber-attacks, fraud and breach of privacy, among other new risks.
- iii). *Financial stability concerns:* Regulators are awake to the risks that financial innovations especially in the area of FinTech could pose to stability. As we embrace more innovative and

²² http://www.knbs.or.ke/index.php?option=com_content&view=article&id=369:economic-survey-2016&catid=82:news&Itemid=593

²³ <http://www.gsma.com/mobilefordevelopment/wp-content/uploads/2017/04/Mapping-the-mobile-money-gender-gap-Insights-from-C3%B4te-d%E2%80%99Ivoire-and-Mali.pdf>

inclusive platforms, we increasingly invite more technology-based, unregulated or less-regulated non-bank players into the formal financial sector. This increases the threat of regulatory arbitrage by non-banks operating within the formal financial sector. The impact on the safety and soundness of existing regulated institutions as well as likely disruptions to systemically important markets must also be taken into consideration.

Lessons Learnt

Innovative and inclusive finance has played a critical role in expanding financial inclusion across Kenya. There are clear lessons to be learnt through this journey. We learnt that:

- i). It is critical to have a clear vision and strategic policy from a country perspective on social and economic growth and development. For Kenya, this was provided through Kenya's economic blueprints, Economic Recovery Strategy for Wealth and Employment Creation (ERSWEC) of 2003 to 2007 and Kenya Vision 2030 of 2008 to 2030. Within these broad roadmaps, the role of the financial sector was clear and undisputed, which is paramount to successfully implementing the strategic plan.
- ii). Regulators must proactively seek to understand emerging innovations, potential risks and how to regulate them. This way they are able to carefully consider new approaches to regulating technology and ensure the necessary safeguards are applied to mitigate the potential risks of innovative financial models and solutions without stifling them. Through this, they are able to appreciate the innovations targeting the poor and work towards facilitating rather than stifling them.
- iii). Some of Kenya's innovations were successfully implemented on the basis of the lessons learnt from other countries. We have learnt the importance of learning from others rather than reinventing the wheel. We have also learnt that there were times we needed to be brave enough to blaze the trail and be the one that tried first, made mistakes and shared these lessons with others.
- iv). Realizing the full potential of inclusive finance requires innovative and proactive leadership, coordination and sustained effort from governments, the private sector, development partners and even consumers. Working together achieves much.
- v). Private sector players must have "skin in the game" - they must bring something to the table. For instance, they can experiment with various technologies and partnerships to provide consumers with new and exciting products and services.
- vi). All players within the financial inclusion space need to have a deep understanding of the financial lives of the poor and low income people, including how they acquire, manage and use their money. This way they will be able to design appropriate frameworks and products that fit their unique needs and empower them to better manage their finances.
- vii). Poverty, in and of itself, is a multifaceted challenge that needs a multiplicity of solutions to combat it. Innovative and inclusive finance, is not a "silver bullet" to get people out of poverty, but by creating employment, additional income and savings buffers, it can play a role in reducing poverty and the impact thereof, as well as boosting wellbeing²⁴.
- viii). The ultimate challenge for regulators is to maximise opportunities for innovative and inclusive finance and minimise risks for society, particularly the poorest.

6. Next Steps

Innovative finance is increasingly becoming about bringing choice and knowledge on the palm of consumers. Not only are financial services being unbundled into their core elements and functions, but they are also democratizing choice and socialising challenges. Every service that was traditionally offered by a bank is now being, or will soon be, delivered by a non-bank or a FinTech start-up. The

²⁴ <http://www.worldbank.org/en/topic/financialinclusion>

diversity of these newcomers and their processes and systems are indeed changing the way business is done by lowering costs and reducing barriers to access.

Advances in technology and communication, combined with the explosive growth in data and information, are giving rise to a more empowered global consumer. Greater transparency is not only providing consumers with superior choices but also greater freedom and better value. As the face and shape of finance responds to innovation and our changing preferences and needs, as consumers, the ultimate result becomes the ‘democratization of finance’. This phenomenon, to an industry that has been averse to change, is something that all of us should embrace and aspire for. It is a fact that with this democratisation, we will have better calibrated and more informed and empowered citizenry who will have more choices and customised services; product pricing will be competitive and transparent, financial institutions will dispense services at lower transaction costs, utilise capital more efficiently and have stronger operational resilience. Ultimately we will build inclusive financial services that serve MSMEs as well as the poorest. The light is on and poverty reduction will continue to be a key focus within such a system.
