

BREAKING DOWN BARRIERS: HOW FINTECH POWERS FINANCIAL INCLUSION IN KENYA



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Overview

This article shares the inspiring story of how 'fintech', or financial technology, is revolutionizing Kenya. It centers around M-PESA, a service that turns mobile phones into wallets. Since its inception in 2007, M-PESA has grown exponentially, now serving over 50 million individuals across seven African nations. It's emerged as one of the most impactful fintech services on the continent.

The success story of M-PESA has set the stage for other fintech companies to flourish in Kenya. In 2022 alone, these innovators attracted more than \$850 million from investors. The Kenyan government deserves credit too, as they've made helpful rules and set up 'sandboxes' for trying out new ideas, creating a favorable environment for fintech businesses to grow.

These combined efforts have brought about significant improvements in Kenya's economy and increased the accessibility of financial services, particularly in rural communities. Back in 2006, only 26% of Kenyans had access to these services. By 2021, this number had leaped to 84%. M-PESA has played a major part in driving this change, lifting an estimated 194,000 households out of hardship and promoting gender equality.

The tale of fintech in Kenya shows us how this technology can make a real difference. With many Africans still without access to financial services, fintech holds great promise. It has the potential to energize economies and significantly enhance the lives of countless Africans.

INTRODUCTION

The daily lives of many Africans have been profoundly transformed by the advent of fintech “financial technology” which refers to a variety of innovations including mobile banking and payment, digital currencies, open banking, insurtech, P2P lending, etc. Today, mobile money, which constitutes the beginning of the amazing fintech journey in Africa, has reach nearly \$840 billion in total transaction value in 2022 with more than 780 million registered accounts across the continent.

By doing so, fintech has clearly contributed to reduce gender and financial gaps between rural and urban populations, or between the formal and informal sectors, and drive economic growth. The Kenyan fintech industry is experiencing a veritable boom, and the country is positioning itself at the forefront of fintech innovation across Africa with the emergence of many fintech companies after the huge success of M-PESA, the largest fintech platform in Africa, launched in 2007 by Safaricom.

This article explores the evolution of the fintech ecosystem in Kenya, highlighting key players, regulatory frameworks, and the impact on financial inclusion and the reduction of poverty.

M-PESA AND THE BIRTH OF KENYAN FINTECH

M-Pesa, which means “mobile money” in Swahili, the main language in Kenya, was launched in 2007 by Safaricom as a money transfer service for the “unbanked”, mainly rural population in Kenya without access to traditional banking services. It consists of an e-wallet and allows users to send and receive money, top up airtime, pay bills, and purchase goods and services.

The service was initially designed as a microfinance instrument to help rural populations borrow money at a lower cost using mobile phones. To test the idea, Safaricom launched a pilot, and the outcome was completely different from what they expected. They realized that people were using it to send money to their relatives who live far away without access to a bank account, so they focused on P2P transfers to send money instead. M-Pesa’s success can be attributed to many factors, including the ease of use and the capillarity of the network distribution.

M-Pesa has a wide network of agents in Kenya: +250, 000 agents as of the end of 2022, or around 1 agent for every 200 people, making the service available to everyone at every corner. This capillarity was not possible for banks or any other financial services, and this is one of the keys to their success.

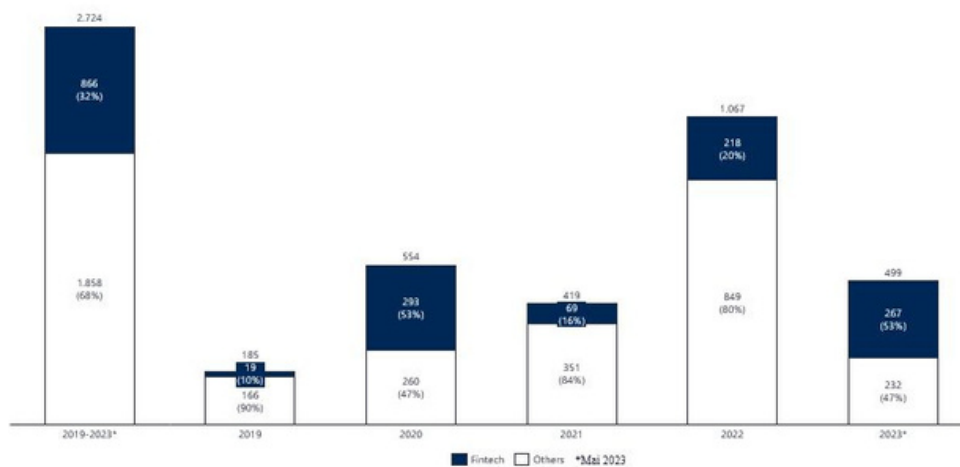
M-Pesa is also very simple to use, doesn’t need an internet connection, and consists of a short code to send money to someone or just to see your balance. Now you have a super app that has gathered all the financial services available (payment, savings, loan, insurance, etc.) plus many other daily use services (transport solution, food delivery, shopping, etc.) and positions itself as a lifestyle application.

As of March 2023, M-Pesa generated around \$1 billion for 30 million monthly active customers and over \$300 billion in transaction value in Kenya. At a global scale, M-PESA is willing to conquer Africa and the world; they had more than 51 million customers in 7 countries across Africa (Kenya, Tanzania, Mozambique, Lesotho, Egypt, Ghana, and the Democratic Republic of Congo) with 26 billion transactions.

M-Pesa is the leading fintech actor in Kenya and Africa, and they continue to evolve their business and their goal to reduce financial inclusion across the continent. As part of this journey, they set up a new partnership with Visa to enable their customers to hold a virtual card linked to their M-Pesa account and make international payments. They also paved the way for many other fintech companies in Kenya trying to empower small businesses and the rural population, making the country one of the locomotives of financial technologies in Africa.

THE FINTECH ECOSYSTEM IN KENYA

Kenya's startup ecosystem is one of the biggest in Africa, along with Nigeria, South Africa, and Egypt. According to Africathebigdeal, Kenyan startups have recorded around \$2.8 billion in VC investment since 2019, with around 32% (including M-Kopa and M-Tiba) going to financial technology-based startups (+\$860 million) and 47 deals in 2022 worth +\$218 million, or around \$5 million per deal.



Evolution of disclosed deals in Kenya, 2019–2023 in \$m

According to Disrupt Africa, there are more than 90 start-ups registered in the Kenyan Fintech ecosystem, with around 70 that have received investment between 2019 and May 2023. Most of them have been created between 2015 and 2022, with +30 created in 2019 and 2020, in a period where light has been put on African startups and the value of VC investment has increased.

Fintech startups in Kenya cover all the value chains, and they provide many solutions for individuals and small businesses. According to Disrupt Africa, around 70% of fintech start-ups in Kenya operate in payment, lending, insurance, crypto, and trading.

- **Payment:** include mobile money, remittances, and all solutions and wallets that enable individual customers to make a payment or a business to receive payment from their customers.
- **Lending and financing:** all solutions, including microcredit institutions and buy now pay later, that enable unserved populations to apply for a loan at a lower cost
- **Insurtech:** all platforms or solutions using technology to give insurance protection to urban and rural populations and or use AI to address insurance challenges (claims, underwriting)
- **Cryptocurrency and trading:** Using crypto and AI to make investments and buy or sell products on market

Kenya's fintech landscape

One of the biggest actors in the fintech landscape in Kenya apart from M-PESA is DPO, a Kenyan-based fintech that has been acquired by Network International in 2020 in a \$288 million deal. The platform enables businesses and individuals to make payments online and offline with all currencies and payment methods (credit and debit cards like Visa, American Express, mobile money, and more) and operates in 20+ countries in Africa with 100,000+ merchants in its portfolio.

M-Kopa, which allows the unbanked access to loans to finance energy, health, or smartphones, is one of the oldest startups in Kenya. As of today, they have deployed \$1 billion in credit, reached 3 million customers, and made smartphones available to 400,000+ users.

Some actors are smaller but have a great impact on Kenyan daily lives, like grassroots Economics, which empowers communities to create their own financial systems based on local goods and services. One of its greatest achievements is Sarafu Networks, a community currency convertible in Kenyan shilling (the local currency in Kenya), available in some rural areas using USSD technology that you can subscribe to on your smartphone and pay only at local shops.

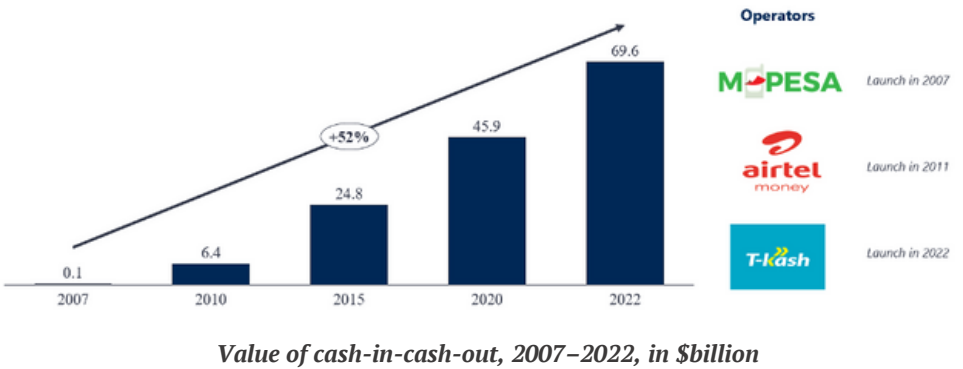


Kenya's fintech ecosystem

Focus Mobile money

Mobile money transaction value has grown steadily at a pace of 52% per year between 2007 and 2022, from \$130+ million in December 2007, in the first year of launch, to \$70+ billion 15 years later in December 2022, for 2 million transactions in 2007 vs. 2 billion in 2022 (+57% p.a.).

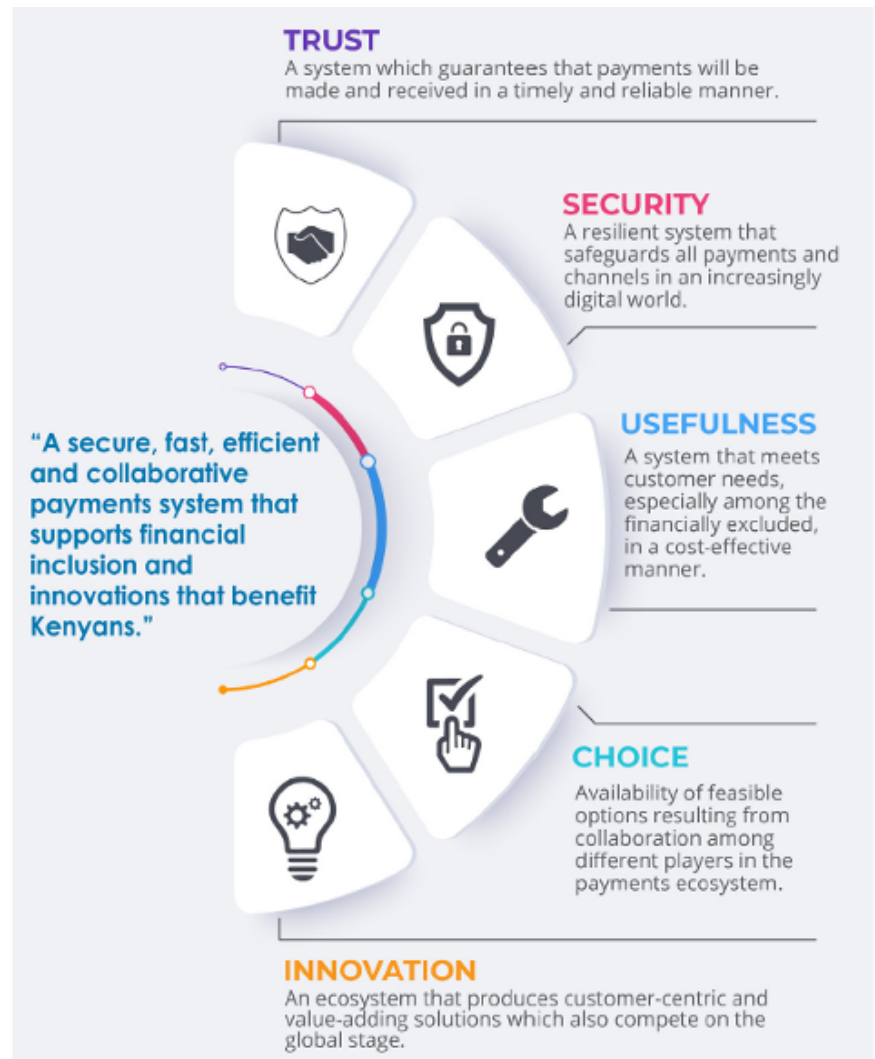
This outstanding evolution of mobile money transactions over time is in line with the adoption of the internet in the country, with 42% of the population using the internet and 114% of mobile penetration in the country.



THE ROLE OF GOVERNMENT INITIATIVES AND REGULATORY SANDBOXES

The success of Kenyan fintech is not only due to the genius of the founders but also to the willingness of the government and its entities, mainly the Central Bank of Kenya (CBK) and the Communications Authority of Kenya (CA), that ambition to have a digital, inclusive, 24/7 economy and to create an environment conducive to innovation.

The Government has set up the national strategy Payment 2022-2025 with the vision statement "A secure, fast, efficient, and collaborative payments system that supports financial inclusion and innovations that benefit Kenyans". This vision is all about the Kenyan population and is supported by five core pillars: Trust, security, usefulness, choice, and innovation.



National Strategy Payment 2022-2025

The national Payment strategy will need to fulfill these four strategic objectives.

- 1 To support a payments system that meets the diverse needs of customers, especially with respect to **financial inclusion and shared prosperity**
- 2 To **enhance the safety and security** of the payments system through the adoption of relevant industry and global standards
- 3 To support an ecosystem that is anchored on collaboration that produces **customer-centric and world-leading innovations**.
- 4 To create a **supportive policy, legal and regulatory framework** that is robustly enforced across existing and emerging players in the payments ecosystem

Over the years, the Kenyan government has supported M-PESA growth while banks were fighting them and launched several initiatives and frameworks, showing their commitment to financial inclusion and encouraging innovation. Here are some existing frameworks:

Actions	Objective	Date
National Payment systems Act	Make provision for the regulation and supervision of payment systems and payment service providers, and for connected purposes	2011
National Payments Systems regulation	Provide a formal framework for the regulation of payments systems and payment service providers.	2014
Digital Economy blueprint	A conceptual framework adopted by Kenya in its quest towards the realization of a successful and sustainable digital economy.	2019
Insurance regulatory sandbox guidance note	Support the development of InsurTech and provide an environment for the testing of innovative insurance solutions with real consumers	2019
National ICT policy guidelines	Facilitate the creation of dignified jobs that provide financial security and independence to allow for greater innovation and futuristic thinking.	2020
National Payments strategy 2022-2025	A secure, fast, efficient and collaborative payments system that supports financial inclusion and innovations that benefit Kenyans	2022

Government programmes

Apart from these frameworks, some actions are taken directly by public institutions to increase mobile phone adoption. As an example, in 2017, Kenya was the first country to sell government bonds to its citizens via mobile phones.

This government bond is called M-Akiba and is set to foster financial inclusion and enhance saving and investment culture among Kenyan citizens, who can buy it for \$30 on their mobile phone for around 10% interest.

Kenya has made significant steps in setting up a regulatory environment and sandboxes to adapt existing frameworks and laws to digital technologies and encourage innovation by reducing entry barriers.

The system is not perfect, and some improvements can still be made to reduce the digital divide completely and achieve total financial inclusion while protecting customers.

THE TRANSFORMATIVE POWER OF M-PESA

These actions and innovations have a substantial impact on Kenyans daily lives and help the country make significant progress in reducing inequalities, bringing the unbanked population into the formal financial system, and empowering communities.

Inclusive Growth

Financial exclusion of the underprivileged poses a challenge to sustainable economic growth (Klapper et al., 2016). In Kenya, the digitization of financial systems and the advent of virtual savings platforms have allowed low-income populations with sporadic income flows to maintain savings accounts.

The introduction of digital credit supply platforms, leveraging transaction and savings data for credit risk assessment, has expedited asset accumulation and investment possibilities for the economically disadvantaged, providing a pathway out of poverty cycles.

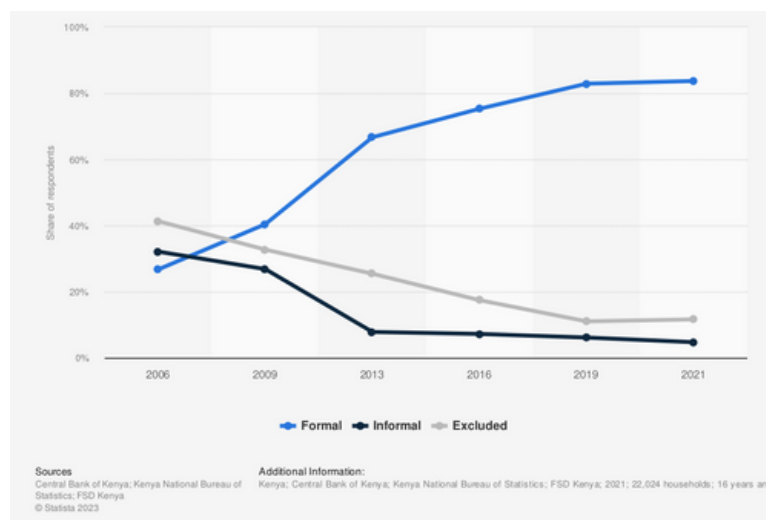
Digitization has thus helped level the economic playing field by easing credit constraints for individuals who typically lack collateral, credit history, and financial connections (Cull et al., 2014).

There is also substantial evidence showing a correlation between digitization and GDP per capita growth (El-Darwiche et al., 2013).

Financial Inclusion

M-PESA has revolutionized financial inclusion in Kenya. By March 2023, M-PESA had reached a milestone with 30 million active monthly users. This democratization of financial services has not only streamlined transaction processes but also extended essential services such as credit and savings to a larger population.

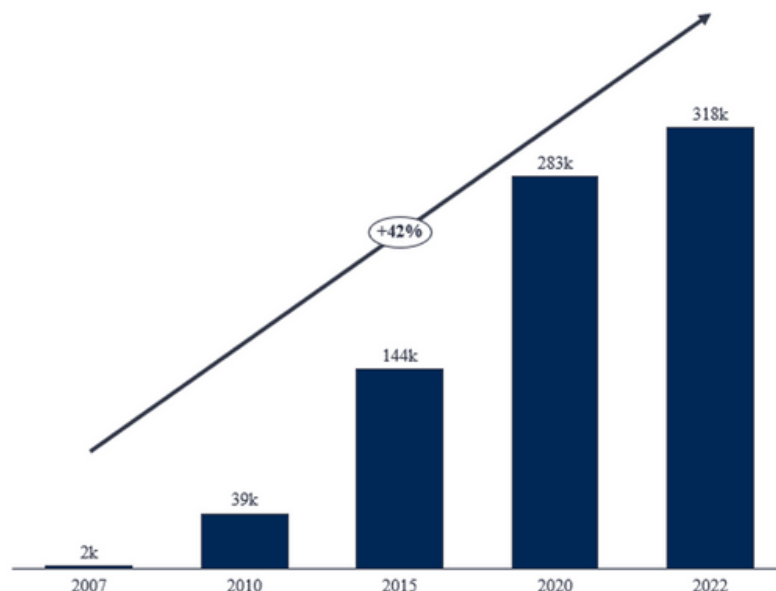
By providing financial access to millions of unbanked Kenyans, particularly in rural regions, M-PESA has spurred savings and investment activities. The ripple effects on the national economy have been significant, contributing to an increase in financial inclusion from a meager 26% in 2006 to an impressive 84% in 2021.



Access to financial services and products in Kenya from 2006 to 2021

Employment and Digitization in the Kenyan Context

Since the introduction of M-Pesa in 2007, the number of mobile financial service agents in Kenya has grown from 307 to 318,000 by December 2022. This steady growth of 42% per year reflects the massive transformation in financial services and job creation fuelled by digitization.



Evolution of active mobile service agents in Kenya, 2007-2022

Integration with commercial banks, which resulted in a surge in employment opportunities due to the expansion of bank branches and the need for IT experts to manage the expansion.

The use of transactions and savings data for pricing microcredit and assessing credit risk alleviated the requirement for collateral, fostering better savings habits and improving access to credit for informal traders and poor households. As a result, there was a significant growth in SMEs, which continue to provide employment opportunities across the country.

Agency banking, launched in 2010, further added to the commercial banks' branch network in Kenya. In this model, an entity approved by the Central Bank and contracted by a commercial bank provides limited-scale banking and financial services to underserved populations.

This model has facilitated the location of non-traditional outlets in remote areas where brick-and-mortar branches aren't financially feasible. Since inception, the agency network for banks has increased to over 35,000 entities. This growth has created opportunities for small entrepreneurs—like retail shop owners and service station operators—to offer agency banking services, thereby creating additional jobs and enhancing SME operations.

However, since 2010, most commercial banks have reduced the opening of brick-and-mortar branches in favor of digital branches and internet banking, which offer lower operational costs for banks and transaction costs for customers. This shift has stirred fears of job losses in the banking industry, but the introduction of agency banking has opened new avenues for self-employment in the sector.

Empowering Small and Medium Enterprises (SMEs) through M-PESA

M-PESA's influence on the development and expansion of Small and Medium Enterprises (SMEs) in Kenya is remarkable. It offers an efficient, secure, and user-friendly transaction platform, reducing the risks associated with cash transactions and fostering SME growth.

This impact is particularly pronounced among small traders and entrepreneurs, including those in remote regions, who now enjoy access to a broader customer base. M-PESA's facilitation of financial transactions has encouraged more Kenyans to establish small businesses and transition into the formal economy.

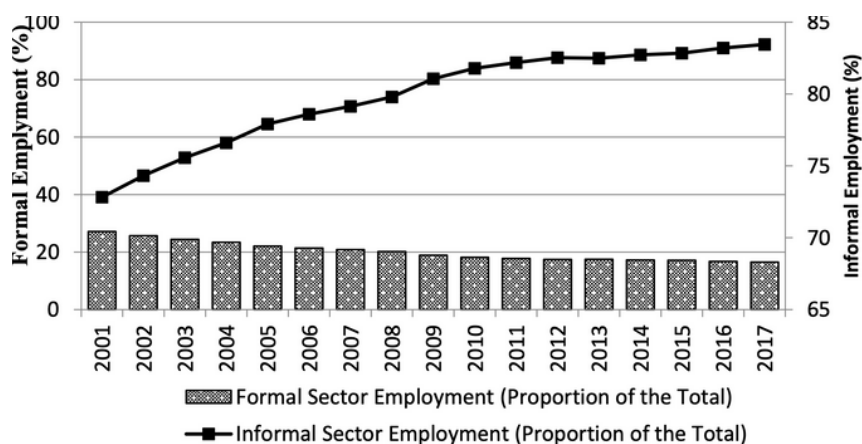
Studies suggest that M-PESA has enabled Kenyan enterprises to scale their operations and capitalize on economies of scale (Beck et al., 2015). Their findings reveal that improved access to trade credit potentially contributed up to 0.5% of annual total factor productivity (TFP) growth, a significant achievement given that TFP growth in Kenya stood at 3.3% between 2006 and 2013.

Impact on Informal Employment

African economies, including Kenya, are characterized by market segmentation, with a significant role played by the informal sector. The journey from informal to formal market segments is complex.

The proportion of formal employment decreased from 27% in 2001 to nearly 17% in 2017, while informal sector employment grew from 73% in 2001 to 83% in 2017. A notable acceleration in informal employment was observed from 2008 to 2012, coinciding with the take-off of digitalization in Kenya's financial sector. This implies that digitalization has potentially contributed to a rise in informal employment.

In an economy grappling with high unemployment levels, particularly among the youth, digitalization can foster self-employment opportunities, improve informal market operations, and increase labor absorption. This shift can pave the way for a more formal, organized economy, creating a new employment landscape in Kenya.



Proportion of Formal and Informal Employment in Kenya, 2001-2017

Social Impact

M-PESA led to significant effects on consumption, investment, remittances, and notably, poverty reduction.

Studies indicate that users of such platforms who were subjected to a negative income shock maintained their consumption levels, compared to non-users, who experienced a 7% decrease. These platforms have also been instrumental in fostering self-employment and bolstering investment in fixed assets

Remittances, a crucial income source for many households, increased annual income by 3–4% following a negative shock when received through mobile money platforms. The impact of M-PESA on poverty reduction is especially striking. According to Suri and Jack's study, M-PESA increased per capita consumption levels and lifted approximately 194,000 households, or 2% of Kenyan households, out of poverty.

These platforms have not only increased efficiency in consumption and labor allocation but have also contributed to a significant reduction in poverty in Kenya. A noteworthy finding from this study is that the impacts were more pronounced for female-headed households. Changes in their financial behavior, asset accumulation, and labor market outcomes led to greater increases in consumption for female-headed households compared to male-headed ones. Moreover, mobile money services have enabled an estimated 185,000 women to transition from farming to business occupations. Female-headed households in areas with numerous mobile money agents saw their long-run consumption grow by 8.5%.

Globally, by facilitating remittances, savings, entrepreneurship, and financial inclusion, platforms like M-PESA have played a vital role in poverty alleviation in Kenya, contributing to the decrease in the national poverty rate from 43% in 2006 to 36% in 2015.

M-PESA in Agriculture: A Transformative Case

Agriculture serves as the foundation of Kenya's economy, and smallholder farming plays a crucial role in this sector. However, these farmers often face challenges, such as low yields, substandard quality, inadequate market connections, and limited access to finance, leading many of them to live below the poverty line. Swiftly adopting digital financial services for input supply and output payment becomes imperative in this context.

Digital finance platforms, exemplified by M-PESA, offer invaluable support by financing input supplies, ensuring prompt output payments, fostering market linkages, and ultimately improving the livelihoods of smallholder farmers.

Research shows that financially inclusive farmers tend to make more significant investments during planting seasons, resulting in better yields and contributing to key United Nations Sustainable Development Goals, including improved food security (Klapper et al., 2016; Goldman et al., 2016).

The One Acre Fund (OAF), founded in Kenya in 2006, exemplifies the transformational potential of digital finance in agriculture. OAF recognizes and addresses the unique challenges faced by farmers and provides a comprehensive range of services, encompassing finance, accounting, marketing, and administration.

Since 2014, OAF has enabled Kenyan farmers to repay loans digitally through M-PESA, expanding economic opportunities and fostering financial inclusion in some of the world's most impoverished farming communities. By aligning loan repayments with cash flow, this approach reduces the pressure on household finances and facilitates the development of sustainable business models.

Results from the OAF program demonstrate that the combination of farm inputs, timely input delivery, and M-PESA-facilitated payments has led to a remarkable 50% increase in income per acre and generated an approximate impact of \$135 per farmer. This approach has not only enhanced food security but also created self-employment opportunities for impoverished households.

The story of Mama Lenna

“This is a lady who took one of our lending products. At the beginning, she had a \$10 credit, and she wanted to start a restaurant. And with that \$10, she woke up at four in the morning, went to the market, bought some vegetables and some flour, and started cooking breakfast for workers at a construction site. Fast-forward about six or seven months later, her credit was at \$50, and she had recruited four other women. Today their combined credit is slightly above \$1,000, and the five women now support another 23 dependents.”

Conclusion

The emergence of fintech, notably as demonstrated by M-PESA in Kenya, has brought about a profound transformation in the daily lives of many Africans. Fintech has drastically reduced the gender and financial divides between rural and urban people, as well as between the formal and informal sectors, by offering cutting-edge financial services like mobile banking, digital currencies, and peer-to-peer lending. As a result, there has been a significant impact on financial inclusion and economic growth in Kenya.

M-PESA, the pioneering mobile money service, has played a pivotal role in this fintech revolution. Launched in 2007 by Safaricom, M-PESA was initially designed to provide microloans to the unbanked and rural population. However, its remarkable success in facilitating P2P money transfers led to its widespread adoption and exponential growth. With over 30 million active monthly users and generating over \$300 billion in transactions by March 2023, M-PESA has become a leading fintech platform not only in Kenya but also across Africa.

In addition, the Kenyan fintech ecosystem has seen a huge increase as many new businesses enter the market. The National Payment Systems Act and the Digital Economy Blueprint, two government-sponsored programs and regulatory frameworks, have helped to foster a climate that is favorable to fintech innovation and financial inclusion.

M-PESA and other fintech services have had a broad range of effects on Kenya's financial inclusion and economic growth by expanding access to financial inclusion, creating new employment opportunities, and improving the livelihoods of farmers and other rural populations. They also positively affected consumption patterns, investment opportunities, and improved poverty reduction and gender equality in Kenya.

With continued government support and ongoing innovation, fintech will continue to be a driving force in shaping the future of finance and uplifting communities in Kenya and beyond. In our next article, we will try to showcase the challenges faced by African fintech in their journey as well as the plethora of opportunities offered to them.



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