Inclusive Finance?

Headline findings from FinAccess 2019

ACCESS | USAGE | QUALITY | IMPACT

JULY 2019

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This survey was made possible through the public-private partnership collaborative effort of the Kenya National Bureau of Statistics (KNBS), Financial Sector Deepening Trust (FSD) Kenya and Central Bank of Kenya (CBK) with funding contributions from Airtel Kenya Limited, Kenya Post Office Savings Bank, NIC Bank and Diamond Trust Bank.

CENTRAL BANK OF KENYA

KENYA NATIONAL BUREAU OF STATISTICS

fsd Kenya

finaccess

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1. INTRODUCTION

Kenya aims to become a middle-income country by 2030 delivering a high quality of life to all. This demands sustained, long-term productivity improvement through building human capital and adopting improved technologies. But it also means ensuring that all Kenyans participate in this process both as a means and also as an end in itself. We don't just need growth, we need growth which is inclusive. When we look at the myriad ways in which finance influences the development of the economy and people's livelihoods, it is clear that if growth is to be inclusive then so must finance. What this means in practical terms is not as obvious as it might first seem.

Finance plays a central role in our economy, facilitating trade and underpinning the efficient pooling and allocation of resources and risk. From the perspective of the individual, financial tools can contribute directly to better managing household resources, cushioning shocks and building livelihoods. Dealing with day-to-day needs effectively requires the ability to make payments for goods and services easily, store funds for tomorrow's requirements and sometimes borrow to cover short-falls. Everyone faces threats to their wellbeing. Finance provides tools to mitigate the impact of risk – offering reliable ways to put money aside for use in time of need, sharing risk through insurance or providing credit to recover from a shock. Crucially finance can unlock opportunity for people in many ways. Long-term finance enables entrepreneurs to invest in the businesses which will generate our future wealth and the channels through which individual investors can participate in this wealth creation.

For much of Kenya's history, people had to create their own solutions. With their relevance, low-cost and flexibility, these informal approaches are often effective. But as the economy modernises we quickly reach the limits of informal finance. The entrepreneur seeking to invest in a new plant cannot look to her *chama* especially if she belongs to a poor community. And nor can the threat from drought be tackled collectively if all those sharing the risk face the same threat. As a result, much emphasis in policy has been on expanding the reach of formal finance.

Unfortunately the impact of this drive for formal financial inclusion has been lower than expected. First, we find that many formal services are not relevant to the needs of many

Survey objectives

- Strengthen financial inclusion measurement using demand–side data.
- Provide indicators that track progress and dynamics of the financial inclusion landscape in Kenya.
- Provide data to stakeholders including policy makers, private sector players and researchers.

– and especially poorer – households. Informal solutions are still simply better. Second, the power imbalance between consumers and financial institutions is accentuated where consumers are poorer and less well educated. Market conduct – starting with the basics of transparency, fair treatment and safety – is an increasing challenge. And third, the greatest gains will not necessarily be achieved by focusing solely on the financial services used by low-income households. There are many instances in which we need to look at how finance enables indirect impacts; can investment be achieved in a new industry generating jobs and services which benefit low-income households?

1.1 FINACCESS SURVEYS

FinAccess 2019 is the fifth in a series of national household surveys on access and usage of financial services in Kenya. FinAccess is delivered by a public private partnership led by the Central Bank of Kenya and the Kenya National Bureau of Statistics, with contributions from non-profit organisations and the private sector. The survey seeks to contribute to market development by providing better information to those who will shape the future of the sector - policymakers and regulators, industry players, analysts and researchers and consumer groups. The goal of FinAccess is not simply to measure finance inclusion in Kenya but to provide insights into how finance needs to change. Reflecting our growing appreciation of the complexities of finance and inclusion this year's survey incorporates new metrics. We look at the role of finance in helping people to meet their livelihood needs. Drawing on the emerging concept of 'financial health', a new index has been created to provide a high-level proxy for the impact of finance on people's wellbeing.

1.2 METHODS

FinAccess targets individuals aged 16 years and above, with households drawn from the fifth National Sample Survey and Evaluation Programme (NASSEP V) household sampling frame. A total of 8, 669 households responded to the questionnaire - a response rate of 89%. Field work commenced on October 1st, 2018 and was concluded on December 15th, 2018. The sample was weighted to cater for non-proportional distribution of households and non-response to provide estimates that are representative of target population at national and sub-regional levels. This report focuses on adults, defined as those aged 18 years and above, the minimum age to access most formal financial services. Adults comprise 92.4% of the total population surveyed, representing approximately 25 million Kenyans. The 16-17 year olds population is estimated at 2 million.

1.3 STRUCTURE OF THE REPORT

The report charts the financial inclusion journey, moving from access through usage and quality to impact. Following this introduction, chapter 2 discusses the top line findings on access and uptake of services, looking at changes in the market landscape caused mainly by digitisation. Chapter 3 dives deeper to look at the effects of digitisation on savings, credit and transactions and how this is influencing the use of finance for consumption and investment. Rapid growth leads to possible new challenges relating to consumer protection and market conduct, discussed in chaper 4. In chapter 5 we look at new data on the relevance and impact of finance for people's wellbeing. The report concludes with a summary of the main findings. Our aim here is not to prescribe but rather to encourage both policymakers and industry providers to dive deeper into the data. The journey towards a more inclusive financial system has certainly started but there is a long way to go and we still have to find the route.

2. EXPANDING ACCESS

To what extent is the financial sector reaching Kenya's diverse population with formal financial services?

Kenya is known across the globe for its impressive achievements on financial inclusion. FinAccess 2019 shows that formal inclusion[1] is continuing to rise, making Kenya a leader on the African continent, and putting it on a par with many developed countries. But what does this mean for the included population? Does it mean having access to a full suite of savings, credit and insurance products; or is it limited to a digital wallet? How 'inclusive' is financial inclusion; is the gulf between 'haves' and 'have nots' beginning to close? And to what extent is formal finance substituting for the informal; is the informal disappearing, or does it persist? Finally, for those who remain excluded or only partially included, what barriers do they face in accessing accounts?

1. **Formal:** banks, SACCOs, MFIs, insurance, mobile money, asset finance, digital credit apps
Informal: *chamas* (groups), moneylenders, shopkeeper goods/cash on credit; finance from social networks; saving at home
Excluded: *Formal exclusion* (17%) use no formal services; *Informal* and *formal exclusion* (11%) use no formal or informal solutions except cash savings at home or friends and family finance; *Extreme exclusion* (8%) use no formal or informal solutions at all

2.1 FINANCIAL ACCESS 2006 - 2019

Fig. 2.1 (a) Usage of formal and informal financial solutions *(% adults 2006 - 2019)*

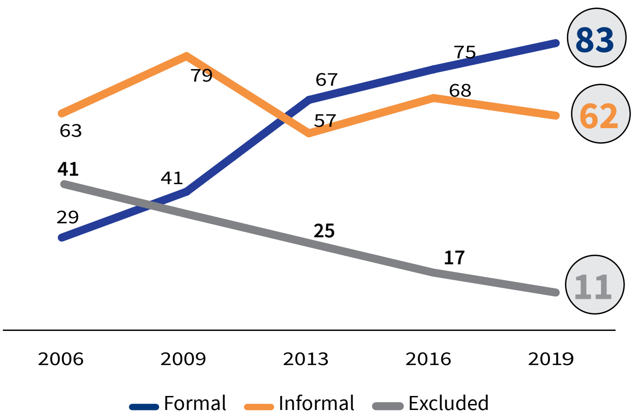
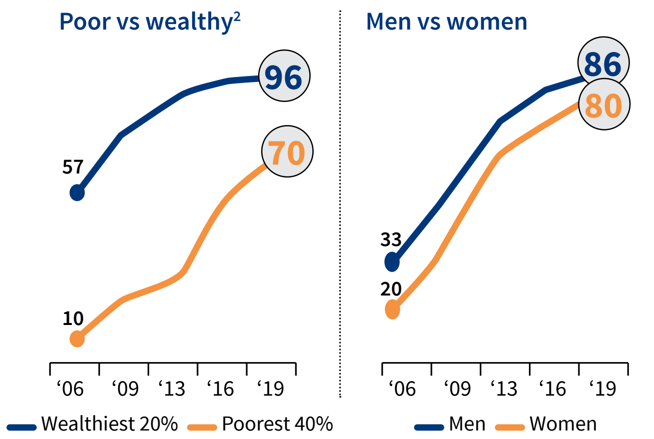


Fig. 2.1 (b) Gaps in inclusion by wealth and gender *(% adults 2006 - 2019)*



Kenya's financial sector has tripled its reach in just 13 years with 83% of the population now formally included. Meanwhile, the informal sector remains strong, with over half the population using informal solutions. Exclusion has gone down to just 11% who use no financial devices at all.

The digital revolution is closing the gap between the haves and have nots. Formal access for the poor has risen steeply from 10% in 2006 to 70% in 2019 closing the inclusion gap between the wealthy and the poor (See below for definition). Women now have similar levels of formal inclusion to men with only a 6% difference between them.

2.2 REGIONAL DISPARITIES IN FINANCIAL INCLUSION

Fig. 2.2 (a) Formal inclusion by region *(% adults 2019)*

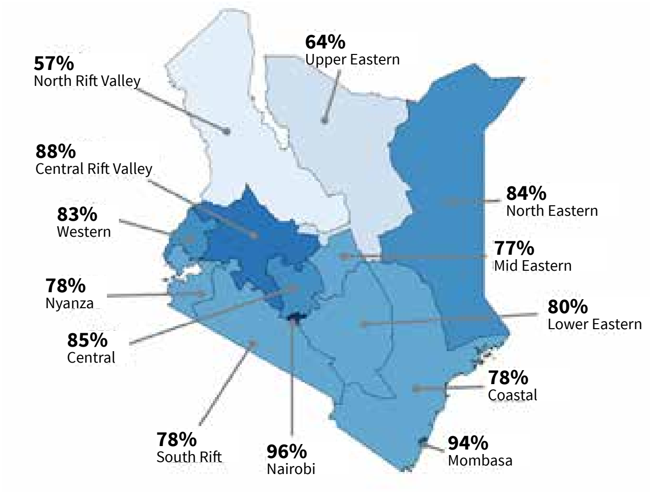
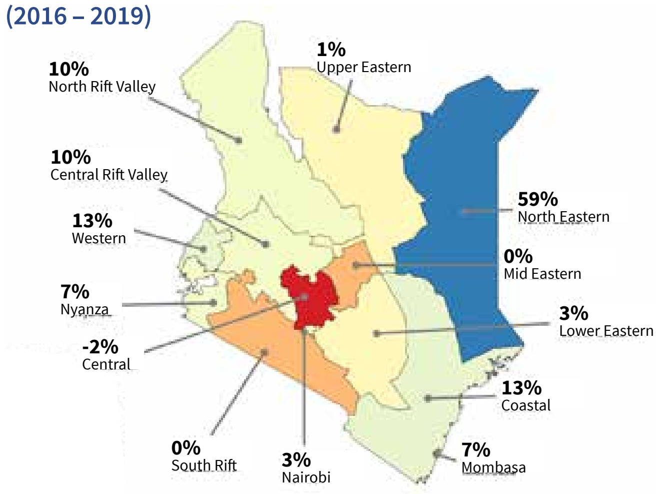


Fig 2.2 (b) Percentage point difference in inclusion (2016 – 2019)



Most regions have seen a low to modest increase in inclusion since 2016, but north eastern has seen a jump of nearly 60%. FinAccess 2019 shows that major cities are now reaching full inclusion, with 96% and 94% of those living in Nairobi and Mombasa now formally included. Since 2016, there has been a substantial increase in inclusion of between 7% - 13% in the west of the country (Nyanza, Western, and lower Rift Valley). This contrasts with southern and eastern counties which have seen a minimal increase, and, in the case of central, even a slight decline. The big surprise is north eastern where inclusion has jumped from 25% to 84% mainly through uptake of mobile money. The magnitude of this shift calls for further research.

2. Using the Poverty Probability Index (PPI) the population was divided into 5 wealth quintiles. In this report, we compare the wealthiest 20% (average monthly household expenditure KES 34,000) and the poorest 40% (average monthly household expenditure KES 13,000).

Numbers at a glance:
% adults using financial services, 2019

79% Mobile money accounts

25% Mobile bank accounts

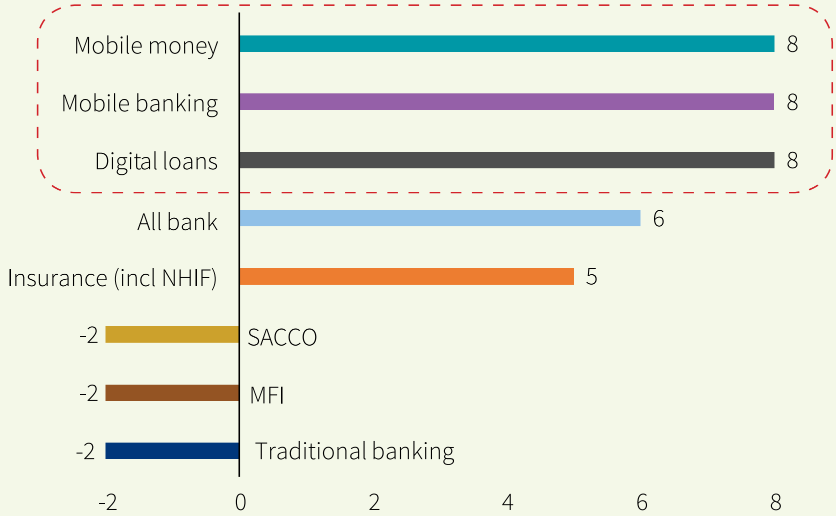
30% Traditional bank accounts

26% National Hospital Insurance Fund

8% Digital app loans

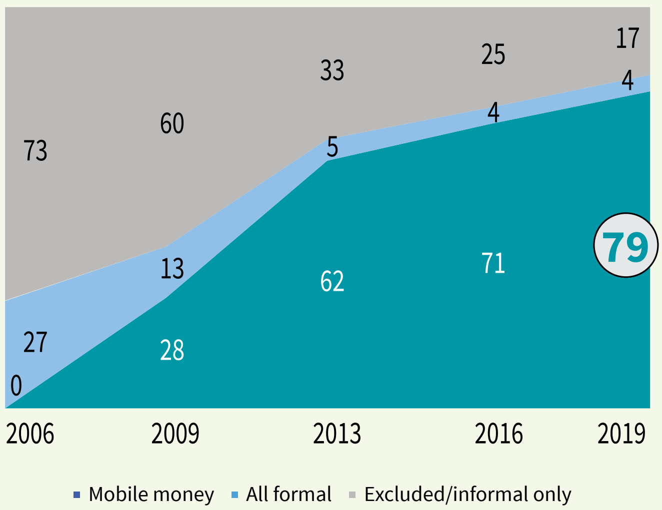
2.3 CHANGES IN THE MARKET LANDSCAPE

Fig. 2.3 (a) Percentage point difference in adult population using formal services (2016 – 2019)



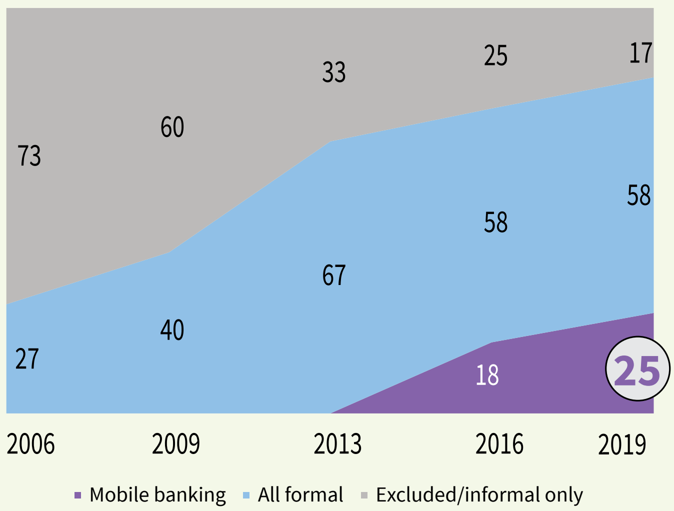
Digital finance is driving market growth. There has been an 8% increase in the share of the population using mobile money, mobile banking and digital apps since 2016 in contrast to a 2% decline in users of traditional services (traditional bank accounts, SACCOs and MFIs).

Fig. 2.3 (b) Usage of mobile money
(% adults 2006 - 2019)



Mobile money has powered Kenya's financial inclusion, with almost all the formally included having a mobile money account. While 79% of the population are registered mobile money account holders, 88% of the population have access to mobile money through their own or other people's accounts.

Fig. 2.3 (c) Usage of mobile banking
(% adults 2006 - 2019)



Mobile banking services that offer interest-bearing savings and formal credit are now used by 1 in 4 Kenyans. Since 2012 when MShwari demonstrated the viability of these types of services, partnerships between MNOs and banks have multiplied with every bank now shifting to a digital strategy.

Fig. 2.3 (d) Usage of bank accounts including mobile banking *(% adults 2006 - 2019)*

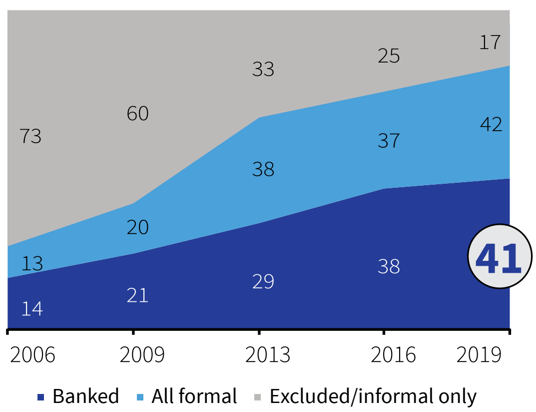
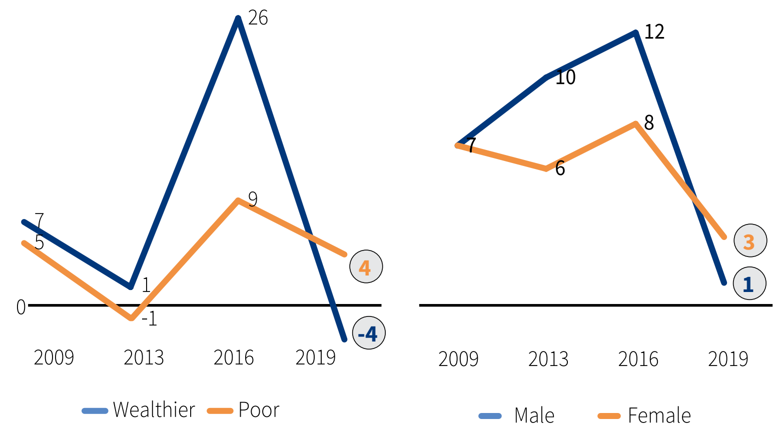
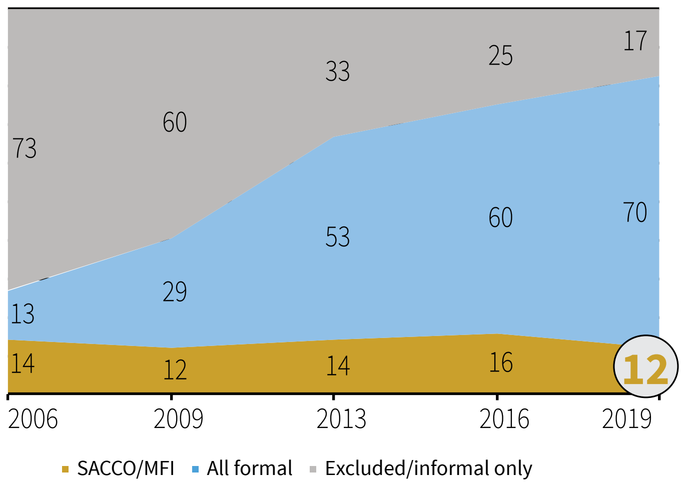


Fig. 2.3 (e) Percentage point change in usage of bank accounts by wealth and gender *(% adults 2006 - 2019)*



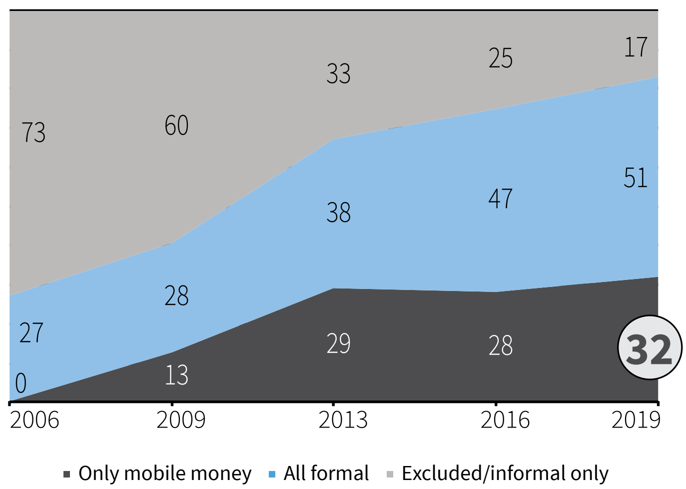
Following Equity Bank's success over a decade ago banks have tripled their user base to 41% of the population, but more recently they have failed to keep pace. Through a savings-led approach that drastically simplified accounts, Equity was at the forefront of the inclusion curve, driving uptake of banking products well beyond the core banking market. Banking received another boost with the launch of MShwari (2012) and agency banking (2009), opening a new era of banking without branches. More recently, however, banks have failed to keep pace possibly due to pricing of services and lack of innovation beyond what is now a fairly standard mobile banking offer. Since 2016, usage of banks by the wealthy has declined by 4%.

Fig. 2.3 (f) Usage of SACCO and MFI accounts
(% adults 2006 - 2019)



SACCOs and MFIs provide just over 1 in 10 Kenyans with financial services, but have not broadened their user base. Historically, SACCOs and MFIs have played an important role, reaching out to more marginalised populations such as women and rural residents. Compared with other providers, they are also more likely to provide finance for investment as opposed to consumer loans. Despite their value in providing a more tailored lending and savings offer, they are now struggling to expand their user base. The question is why?

Fig. 2.3 (g) Share of the formally included whose only formal account is mobile money *(% adults 2006 - 2019)*



For a third of the formally included population, mobile wallets represent their sole formal account. Mobile money services such as M-PESA offer a bare-bones account with a basic store of value and relatively expensive payments and remittance functionalities. Until recently they have not given people access to regulated savings, credit or insurance. The fact that a third of the formally included still lack access to core financial products, begs the question of whether we are over-representing the level of inclusion in Kenya.

2.4 INFORMAL FINANCE

Fig. 2.4 (a) Usage of informal solutions *(% adults 2006 - 2019)*

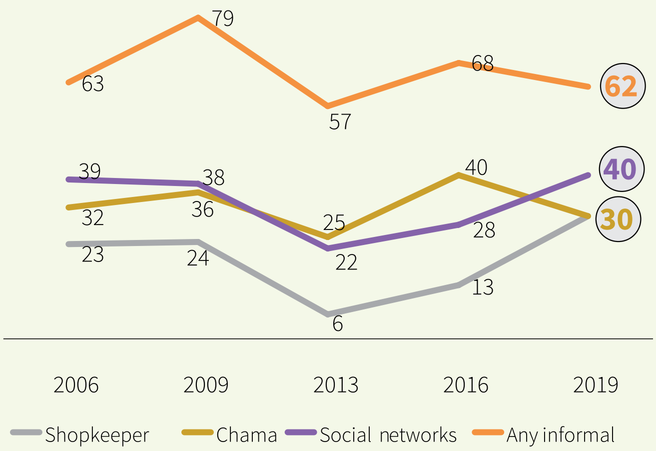
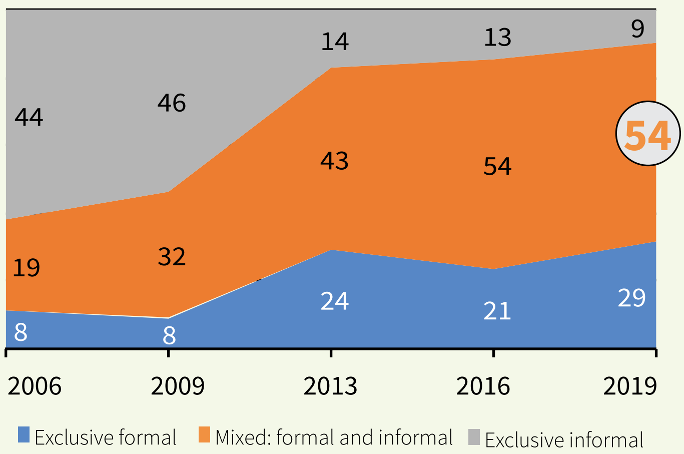


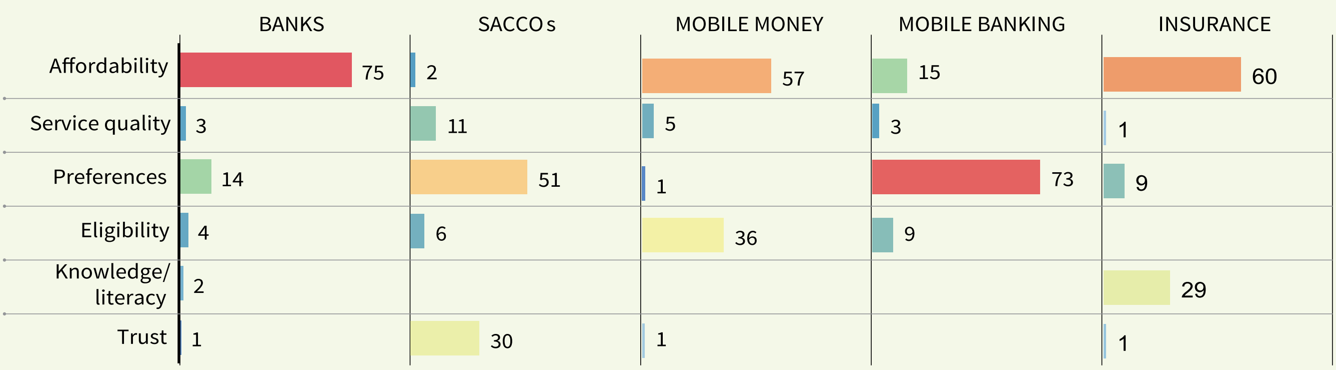
Fig. 2.4 (b) Exclusive usage of formal and informal solutions, vs mixed portfolios *(% adults 2006 - 2019)*



Far from substituting for the informal, the rise of formal inclusion has added to the richness of people's portfolios, with a growing population (over 50%) choosing to use a combination of formal and informal solutions. This makes sense in the context of Kenyans' complex economic lives which straddle formal and informal sectors, requiring a wide range of financial tools that can help manage liquidity, transact and grow. Fluctuations in use of informal finance tend to reflect changing economic conditions. 2019 has seen a growth in usage of shopkeeper credit and borrowing from friends and family,[3] possibly due to an economic squeeze. Interestingly, while generally in decline, use of chamas (informal groups) is actually rising quite steeply among the wealthiest 20% and among business owners, pointing to the usefulness of chamas in building social and financial capital for those who have the resources to participate.

2.5 BARRIERS TO ACCESS

Fig. 2.5 Reasons cited for lack of usage *(% non users 2019)*



Cost is still the main barrier to uptake, especially for banks, mobile money and insurance. In a context where monthly household expenditure for the bottom 40% averages 12,700 shillings, paying an average of 6,400 shillings a year to run a bank account is beyond the reach of many.[4] Financial literacy and trust do not present major barriers, except for insurance (literacy) and SACCOs (trust).

3. *Metrics on borrowing through friends and family disguise the true extent of the social network where the terms of transfers can include anything from repayment with interest to unconditional gifts.*

Take aways

- **83% of Kenyans** have a formal account; exclusion is down to 8%
- **Informal finance remains strong** with over half the population using a mix of formal and informal solutions
- **Digitisation is driving formal inclusion** with a corresponding decline in the use of traditional accounts (SACCOs, MFIs and conventional bank accounts)
- For a third of the included, **mobile money is their only formal account**
- **Cost is the main barrier to access**

SUMMARY

Across the globe, Kenya is seen as the poster child of financial inclusion, tripling its formally included population in just 13 years through the ascent of mobile money. Mobile money has provided an on-ramp for formal inclusion via digital channels. While traditional formal services are stagnating, use of mobile banking has increased with a quarter of the population now having an interest-bearing mobile banking account. However, for over a third of the included population, inclusion simply means having a mobile money account. And formal financial intermediation as a driver of investment and growth is still not a reality for many. At the same time, mobile money has almost certainly turbo-charged the social network, enabling people to more effectively pool risk, manage liquidity and invest through mobilising their social and financial capital, with significant impacts on household resilience.[5] Finally, for formal and informal alike, a key barrier to inclusion continues to be cost. With average household expenditure for the poorest 40% at KSh12,700 a month, inclusive finance for many is still beyond reach.

5. Suri, Tavneet & William Jack (2016) The long-run poverty and gender impacts of mobile money. *Science* 09 Dec 2016: Vol. 354, Issue 6317,pp. 1288-1292
Jack, William & Tavneet Suri (2014) Risk sharing and transactions costs: evidence from Kenya's mobile money revolution. *American Economic Review 2014, 104(1):183-223*

3. DEEPENING USE

How is the digital revolution changing the way we use financial solutions?

Mobile money has been a major driver of formal inclusion, demonstrating the power of digital technology to support a more inclusive economy. Mobile money has also created the rails for further innovation, inspiring a plethora of digital borrowing and savings solutions now emerging on the market. The ubiquity of digital technology raises important questions: Has digital currency replaced the cash economy? Is digitisation changing the way people save and borrow? And to what effect- are digital solutions contributing to building livelihoods; or are they simply fuelling consumption?

3.1 DIGITISATION OF PAYMENTS

Fig. 3.1 (a) Frequency of mobile transactions *(% mobile money users 2006 - 2019)*

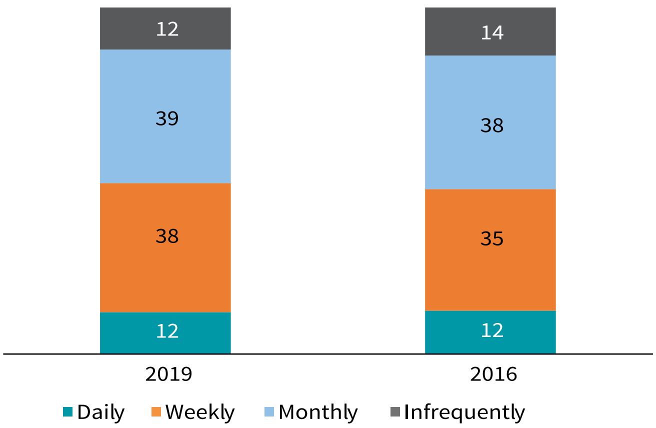
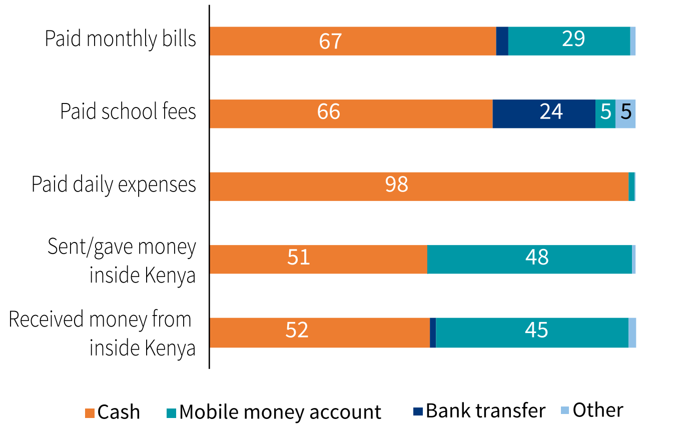


Fig. 3.1 (b) Most frequent payment modes *(% adults making payments by payment type 2019)*



Uptake of mobile money accounts has increased but the reported frequency of mobile money transactions has not. Indeed, transactions associated with daily life (groceries, transport etc.) are still mostly cash based. For less frequent payments on the other hand, digital currency is beginning to compete with cash. Just under half of domestic remittances and 30% of bill payments are now made via mobile money. Mobile money is an optimal solution for remittances over distance, and bill pay solutions are well integrated into business systems for services such as electricity. However, bank transfers are preferred for school fee payments, raising the question of why mobile money has not moved into this space

Fig. 3.1 (c) Payments modes for income received *(% income earners by livelihood 2019)*

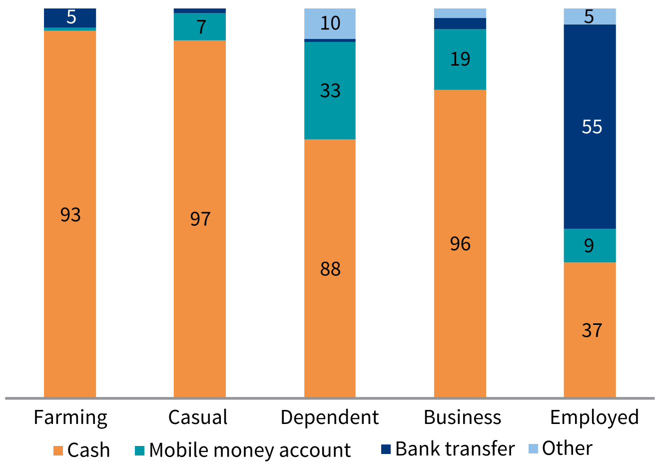
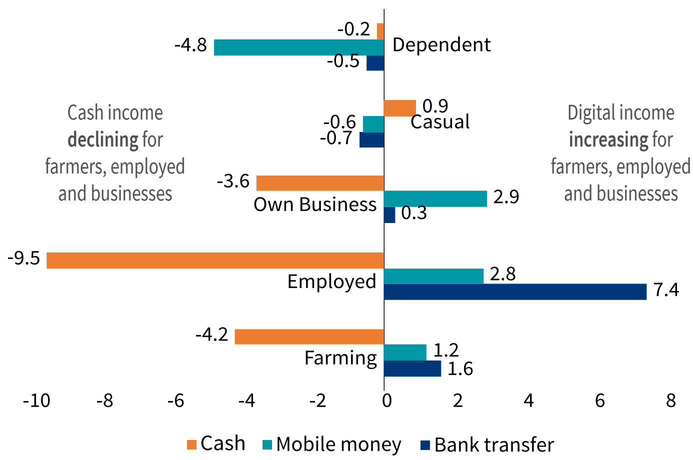


Fig. 3.1(d)Percentage point difference in payment modes for income received (2016-2019)

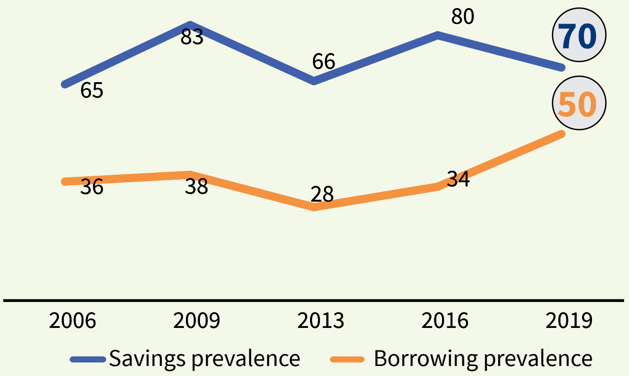


Is the continued dominance of cash masking a trend towards digital? With the exception of the employed, most people receive their incomes in cash. This does appear to be changing however, with farmers, business owners and the employed receiving less money in cash and more via digital in 2019 compared with 2016 (Fig 3.1 (d)). Interestingly, while a relatively high proportion of dependants receive income digitally (likely related to the digitisation of the remittance economy), this is declining, with a corresponding increase in income received in kind.[6]

6. The percentage of dependants receiving income in-kind increased from 0.5% in 2016 to 5.7% in 2019 while those receiving cash and digital income declined. More research is needed to investigate the reasons behind this.

3.1 SAVING AND BORROWING TRENDS

Fig. 3.2 Usage of savings and credit *(% adults 2006 - 2019)* [7]



Kenyans are savers, but borrowing is rising rapidly. Over 70% of the population are saving formally or informally and 50% of the population currently have a loan.[8] Savings rates have remained more or less the same over the years with periodic ebbs and flows. This may be related to fluctuating economic conditions and a tendency to liquidate savings in times of stress. **The steady rise in borrowing since 2013 may partly reflect tightening economic conditions which, together with the increasing availability of low-value credit, could stimulate a cycle of escalating loans.**

Fact box

Economic conditions worsened in 2017

Economic conditions were particularly tough in 2017, with GDP growth the lowest since 2012 (4.7%). Manufacturing output growth dropped (0.2% in 2017, compared to an average growth rate of 3.6% per year between 2013 and 2016) and agricultural output growth fell to 1.6% in 2017 (down from an average of nearly 5% between 2013 and 2016). Set against this lack lustre growth, the country was experiencing severe drought and the price of basic consumables rose significantly – maize flour increased by 28% and petrol increased by 10%.

– Statistics Abstract 2016, 2018 (KNBS); National Drought Bulletin February 2019 (NDMA).

3.3 SAVINGS TRENDS AND DEVICES

Fig. 3.3 (a) Savings trends, formal and informal
(% adults 2006 - 2019)

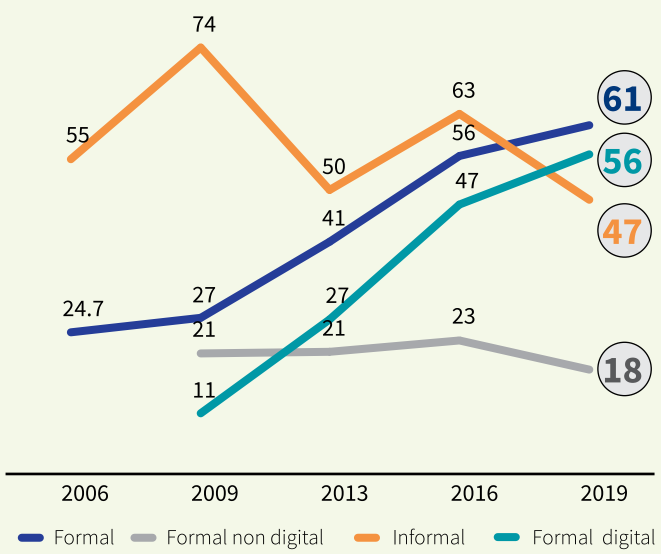
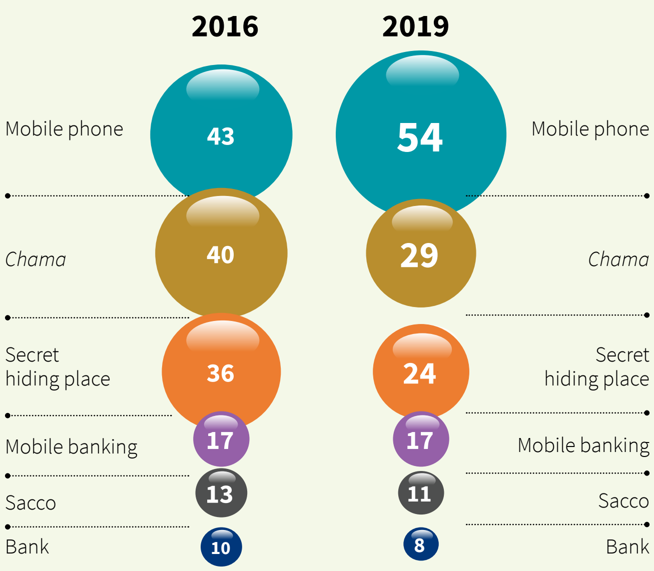


Fig 3.3 (b) Change in use of top 6 savings devices
(% adults 2016 - 2019)



7. Savings here include secret hiding place and friends and family
8. The metrics on 'current use' of loans under-estimate the prevalence of borrowing, as loans are not normally taken on a continuous basis. A more realistic measure would be those who have borrowed in the past 12 months which is 61% for 2019.

Formal savings have now overtaken informal savings, with 54% of Kenyans saving on their mobile money wallets, up from 43% in 2016. Perhaps surprisingly, the share of the population saving in mobile banking accounts (17%) has not changed since 2016, despite the fact that mobile banking accounts offer interest and deposit protection, giving them an advantage over the digital wallet. Research shows that, for most savers, interest is not the primary reason for choosing a savings device. Instead, some degree of liquidity together with flexible withdrawal terms are the most valuable features, enabling people to keep money safe from the temptation to spend while providing access in times of emergency.[9] In this sense, the digital wallet beats its main competitor, the cash wallet, being easy to access but slightly more illiquid than cash. This could be one possible reason why cash savings at home have declined.

3.4 BORROWING TRENDS AND DEVICES

Fig. 3.4 (a) Borrowing trends, formal and informal *(% adults 2006 - 2019)*[10]

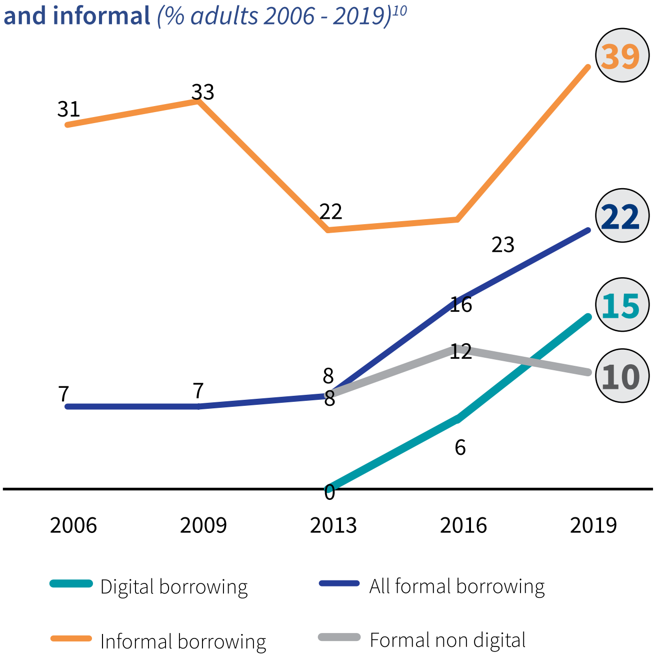
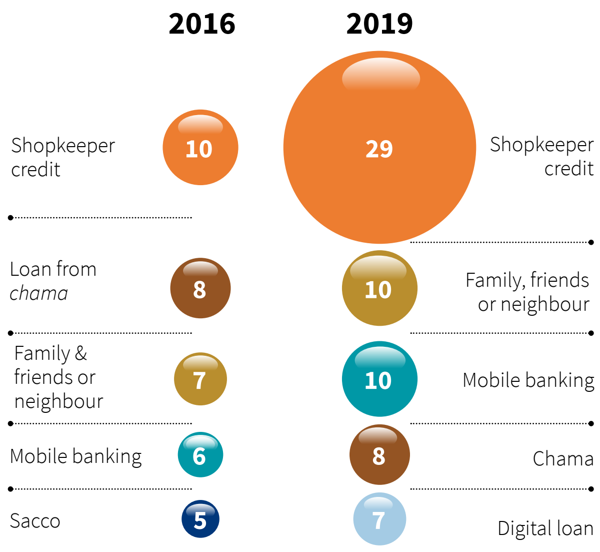


Fig 3.4 (b) Change in use of top 6 borrowing devices *(% adults 2016 - 2019)*



Unlike savings, both formal and informal borrowing has risen substantially since 2016. The population using digital app loans has risen from just over 0.6% to 7%, with those using mobile banking loans increasing from 6% to 9%. However, the biggest change has been a threefold increase in those taking goods on credit from shopkeepers (from 10% to 30%), a possible signal of either economic stress or over-indebtedness or both. Meanwhile, loans from other sources including SACCO and *chama* loans have remained more or less stagnant. This suggests that digital loans are not substituting for traditional sources of credit, but instead are reaching a new audience of borrowers- perhaps people who were not satisfied with existing options or previously unable to obtain credit at the size and terms they needed.

Loans are mainly used for consumption while savings have a broader range of use cases and are more likely to support productive investments and investment in assets. Compared to other types of borrowing, SACCO and MFI loans are most likely to support larger investments. This contrasts with digital loans which are almost all for consumption or emergencies (**Fig 3.5**).

9. https://fsdkenya.org/publication/a-promise-fulfilled-financial-market-development-in-kenya-2011-2015/
10. The overall formal borrowing figure of 22% is lower than formal digital and formal traditional combined because of overlapping usage (a borrower may have both a formal digital and formal traditional loan simultaneously)

Fig 3.5 Uses of loans and savings by provider type *(% product users 2019)*

Borrowing (%)	Basic personal consumption	For an emergency	Large infrequent expenses*	Investing in agricultural production or businesss
All providers	72	9	13	6
Conventional bank	58	13	20	10
Mobile banking	62	15	15	8
SACCO/MFI	45	10	28	16
Digital app	67	20	9	5
Any informal	77	9	9	5
Chama	66	10	15	8
Shopkeeper	90	4	4	
Social network	81	8	7	4

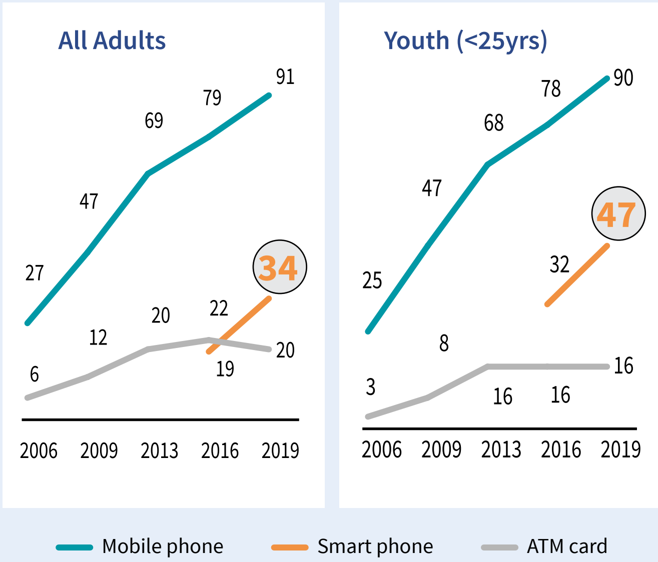
Saving (%)	Basic personal consumption	For an emergency	Large infrequent expenses*	Investing in agricultural production or businesss
All providers	37	12	39	13
Conventional bank	24	12	49	16
Mobile banking	24	12	46	18
SACCO/MFI	16	11	53	19
Any informal	38	12	37	13
Chama	32	10	44	14
Social network	38	12	38	12
Secret hiding place	42	12	34	13

* Education, land, housing, livestock, vehicles, old age

Fact box

Smartphones: financing the future

91% of the population now have access to mobile phones, (their own or through others) up from 78% in 2016. But smartphones and data are poised to shape the future of financial inclusion. Between 2009 and 2019, smartphone ownership increased from less than 4% to 34% of the adult population. There are now more smartphones in Kenya than ATM cards. Smartphones open up exciting opportunities for innovation, but they also come with risks- exposing personal information and channelling unregulated activity. Nearly 1 in 2 Kenyan youth own a smartphone that can connect to the internet to download and install applications. Not only are they more likely to own a smartphone, they are also more likely to use advanced digital financial services, such as mobile banking and digital credit. These *digital natives* provide a glimpse at what might be to come.



SUMMARY

Digitisation has changed the way people save, borrow and transact. While transactions are still dominated by cash- possibly because of cost – there is evidence of increasing levels of digitisation. Savings are now formalising through mobile banking and the digital wallet, which provides a safe store of value easily accessible in times of need. Despite the improved value proposition of mobile banking accounts, the share of the population migrating from the digital wallet to interest-bearing mobile banking savings has not changed since 2016. Meanwhile informal savings devices such as chamas and cash savings at home, have dropped significantly, suggesting that formal savings are now substituting for informal. On the borrowing side, the story is different. The rapid expansion of digital lending is creating a steady rise in formal borrowing across the population. Together with the drop in informal savings, the rise in borrowing could also reflect an economic squeeze, impelling liquidation of savings and propensity to borrow. Given that formal and informal borrowing are predominantly used for consumption, an economic downturn coupled with fast-rising uptake of loans, may be cause for concern.

Take aways

Cash is still king, but use of digital payments is growing

Savings are formalising, with 54% of Kenyans using their digital wallets as a short-term savings solution

Borrowing is rising fast, with increased use of digital loans and shopkeeper credit mostly for consumption and emergencies

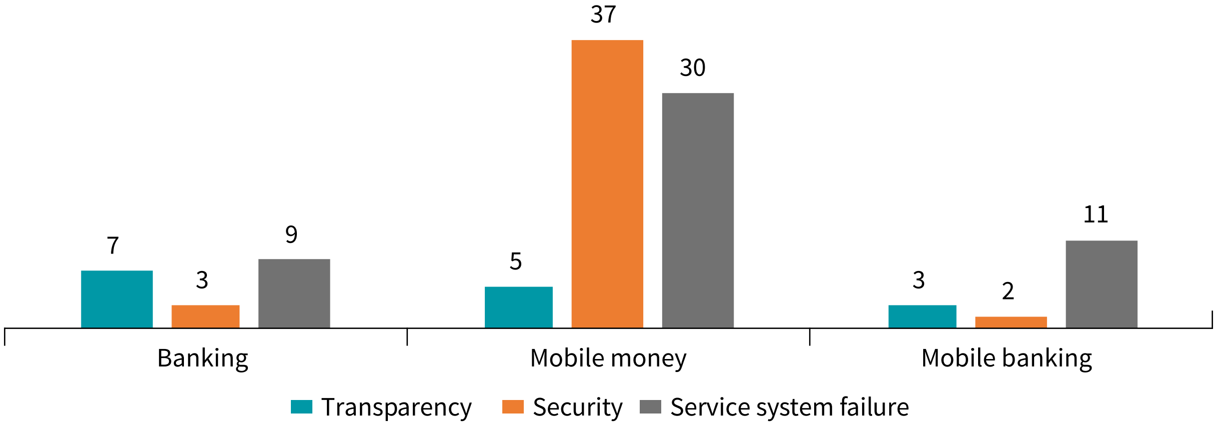
4. PROTECTING CONSUMERS

Is Kenya's financial sector providing sufficient protection for consumers?

Inclusive finance is not simply about expanding access to accounts; it is also about ensuring that the services people use are safe, secure and transparent and that they add value to people's lives. FinAccess is designed primarily to measure access and use, and further research is needed to create an evidence base on consumer protection. However, the survey gives us clues as to how effectively the financial sector is increasing transparency, protecting consumers from harmful practices and improving the safety of finance for all.

4.1 CONSUMER PROTECTION CHALLENGES

Fig 4.1 Percentage of users experiencing consumer protection challenges (2019)



Consumers highlighted challenges in three key areas:
security (loss of money/fraud), **transparency** and **system downtime**

Mobile money users had substantially more challenges than users of regulated financial services like banks and mobile banks, with nearly 30% (over 5 million users) experiencing loss of money or fraud, mostly through hoax SMSs or phonecalls. Over 80% of these managed to resolve their challenges, but the rest did not. Meanwhile, 3% of bank users (roughly 220,000 consumers) also reported losing money from their accounts. The fact that three quarters were able to recover their funds suggests that loss of money within the banking system is not just a self-reporting inaccuracy, but a well-recognised issue for the banks concerned.

Service system downtime was a major challenge for users of mobile channels and banks, fuelling uncertainty and undermining trust (e.g. network downtime or ATM not working). While these incidences may not necessarily occur on a regular basis, the inability to get hold of funds when needed creates high levels of anxiety and inconvenience for users. This may also result in a direct monetary cost, for example when one misses an important payment. These figures suggest an urgent need to address the reliability of technology-based channels to avoid undermining trust in the financial system.

Lack of transparency is the second most mentioned challenge for bank users (e.g unexpected charges, unclear terms). Without full information, it is hard for people to make good decisions about the management of their funds. Unclear terms and conditions result in unexpected costs, which can have a serious impact on people's financial portfolios. Relative to other challenges, users of mobile money and mobile banking did not present this as a major issue. One factor here could be the effectiveness of disclosure mechanisms on mobile handsets enforced by the Competition Authority of Kenya (CAK) since 2016.[11]

11. From 2016, all mobile-based financial services providers were mandated to disclose costs on the mobile handset: https://www.cgap.org/blog/kenyas-rules-mobile-money-price-transparency-are-paying

4.2 LOAN DEFAULTS

Fig. 4.2 (a) Percentage of borrowers claiming to have defaulted or been late repaying loans (2019)

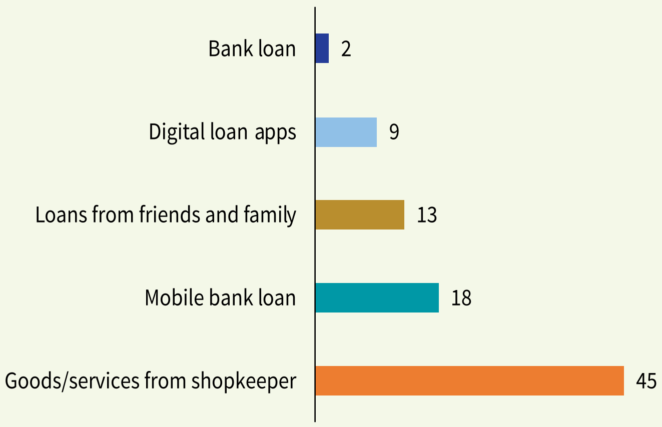
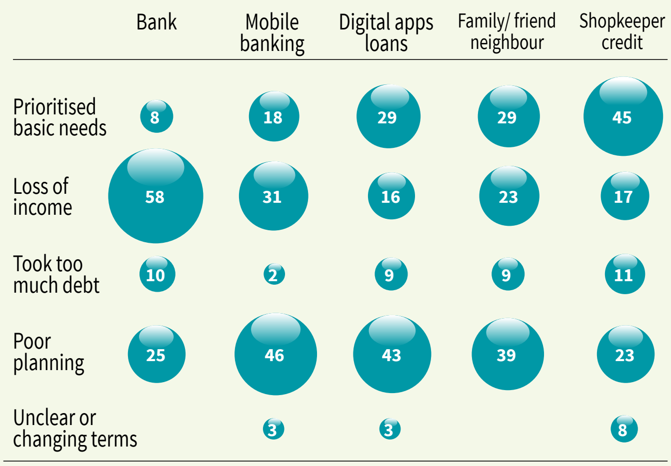


Fig. 4.2 (b) Main reason given for default by institution *(% defaulters 2006 - 2019)*



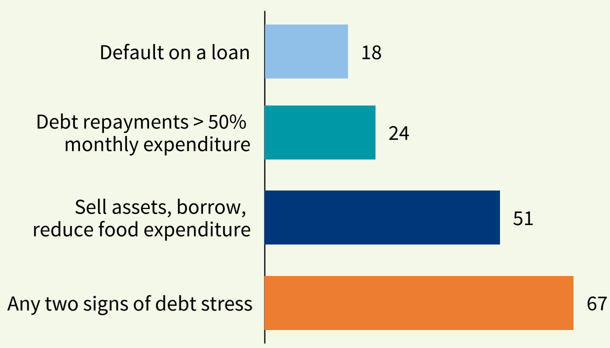
The highest levels of default were for shopkeeper goods on credit (45% of borrowers), followed by mobile banking loans (18% of borrowers). Taking goods on credit from shops is more prevalent among the poor with the main reason being 'prioritising basic needs' suggesting that these households are more prone to economic stress. Borrowers of digital loans (mobile banking and apps) as well as those borrowing from friends and family also mentioned 'poor planning' as a major reason for default. This could point to a transition in Kenya's credit landscape where consumer credit is encroaching on a previously informal borrowing space in which flexibility is the norm, and the clear-cut terms of formal contracts have yet to be internalised . Lastly, reasons for bank defaults were overwhelmingly related to loss of income. This is not surprising given that many bank loans are based on pay-day lending models pinned to salaried employment.

Fact box

The CBK Annual Report and Financial Statements 2017/18 indicates that credit markets have grown between June 2017 and June 2018, with an **increase in gross loans of 4.7 %** (from KSh 3,002 billion to 3,203 billion as of June 2018). In the same period, **gross non-performing loans (NPLs) increased by KSh 63.8 billion** (27.2 %) from KSh 235 billion in June 2017 to KSh 298 billion in June 2018.

4.3 DEBT STRESS

Fig. 4.3 (a) Percentage of borrowers experiencing symptoms of debt stress (2019)



Two thirds of borrowers experienced at least two symptoms of debt stress including: default; being overleveraged; and selling assets/ borrowing/cutting expenditure to repay loans. Nearly 1 in 5 borrowers defaulted on a loan in the past year; over half had to sell assets, borrow or reduce expenditure to repay their loans; while a quarter had debt repayment burdens of over 50% of monthly expenditure.

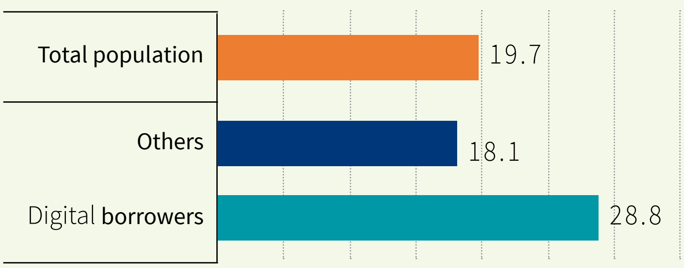
Levels of debt stress are high across the board but particularly for farmers, the elderly and the poor. For these groups, difficulties in repaying loans resulted in asset sales, cutting back on expenditure, or borrowing to repay existing loans. Compared to the poor, **wealthier groups may be over-leveraged,** with a third of wealthy borrowers having debt service payments of over half their monthly expenditure. For the employed this is as high as 40%.

Fig. 4.3 (b) Percentage of borrowers experiencing symptoms of debt stress by population segment (2019)

	All adults	Men	Women	Richest (20%)	Poorest (40%)	Youth <25yrs)	Working age (25-60ys)	Retired (65+)	Farmers	Business owners	Employed	Casual	Dependent
Had to sell asset or reduce food expenditures to repay	51	48	55	40	60	44	52	58	58	47	32	32	58
Defaulted in past year	18	17	19	11	23	18	18	16	20	17	9	20	21
Debt service payments >50% of total monthly expenditure	24	27	21	32	18	15	26	22	26	28	40	24	13
Debt stress overall (any two)	67	67	67	62	72	56	69	73	74	66	62	58	67

4.4 SPORTS BETTING

Fig. 4.4 Percentage of adults who think that sports betting is a good way to earn income (2019)



Nearly a fifth of the population think that sports betting is a good way to earn income, with digital borrowers being particularly prone. There are increasing concerns over the relationship between digital credit and sports betting, and these data suggest that this is worth further investigation.

SUMMARY

Transparency, lack of security and uncertainty all affect one of the most important pillars of the financial sector- namely, trust. These challenges were mentioned a number of times, including incidences of unexpected charges, fraud, loss of money and system downtime. Even more worrying was the high level of debt stress across the borrowing population, with over two thirds of borrowers exhibiting symptoms of debt stress. This suggests that we need to look carefully at issues of responsibility and market conduct in Kenya's burgeoning credit markets. Those especially threatened are the poor, but the wealthiest 20%- particularly the employed- are highly over-leveraged, exposing them to long-term risk. These high-level indications underline the urgency of conducting further research to better understand the extent and nature of consumer protection challenges, so that concrete action can be taken to avert a potential crisis. Market conduct is crucial to the health of any financial system and the value of financial services in people's lives. As Kenya's financial system matures, the spotlight will increasingly turn on the effectiveness of regulators, service providers and policy makers in enforcing measures and behaviours that ensure consumers of financial services are shielded from harm.

Take aways

2 out of 3 borrowers suffer from debt stress, with the highest levels among the poor

Nearly a fifth of mobile banking borrowers have defaulted in the past year

40% of the employed are over-leveraged

5.6 million mobile money users experienced loss of money or fraud

Lack of transparency was the second biggest challenge experienced by bank users

5. RELEVANCE

How relevant is Kenya's financial sector in people's daily lives?

Kenyans need a financial system that works for them. Simply measuring the uptake and use of accounts doesn't tell us much about the relevance of Kenya's financial sector in meeting people's needs. How effectively are financial solutions helping people to manage their day to day lives when they face a shortfall between income cycles? Is the financial sector giving people the tools to deal with large shocks- the biggest contributor to a slide into poverty? And to what extent is the financial sector supporting people to grow and aspire? This chapter reverses a supply-side perspective which measures uptake and use of accounts, to ask: what financial strategies did people use to cope with their needs and what impact did this have on their financial wellbeing, or *financial health.*

5.1 TOP PRIORITIES IN LIFE

Fig 5.1 (a) Kenyans' top priorities *(% adults 2019)*

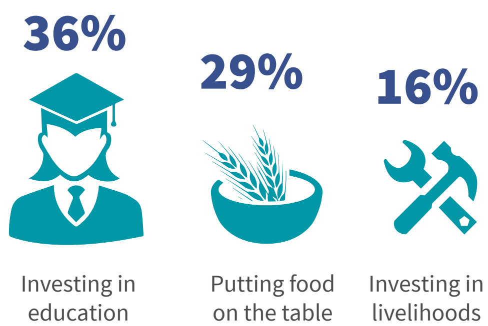
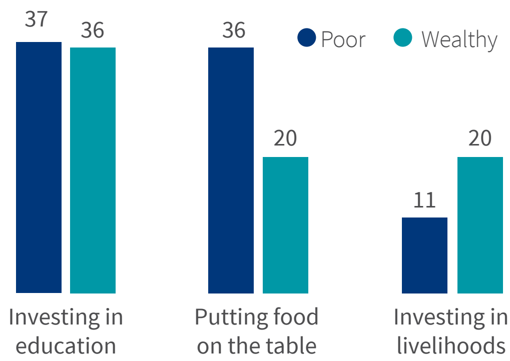


Fig. 5.1 (b) Top priorities by wealth category *(% adults 2019)*



Education is the top priority for Kenyans especially marginalised populations, for whom education represents a pathway out of poverty and a means of acquiring dignity and respect. For poorer Kenyans, putting food on the table is a high priority, while wealthier groups emphasise investing in livelihoods such as business, farming or their careers.

5.2 FINANCIAL NEEDS

Fig 5.2 (a) Percentage of adults experiencing liquidity distress and/or shocks and/or investing in goals (2019)

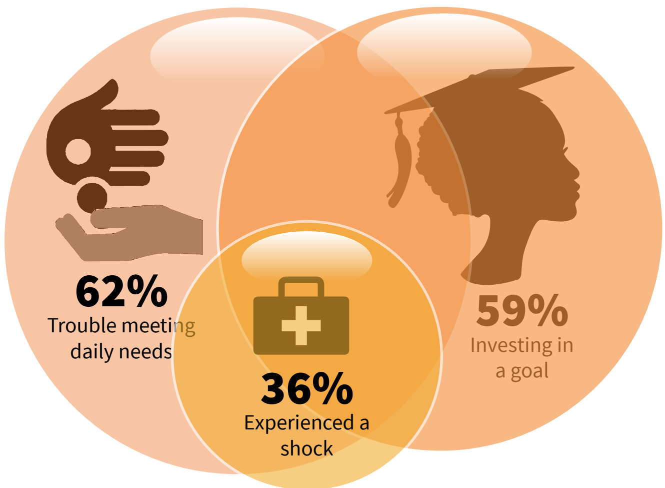
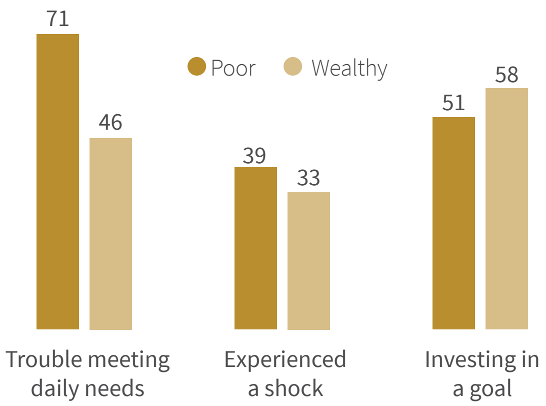


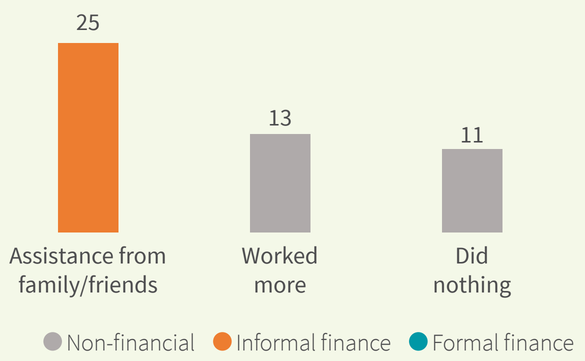
Fig 5.2 (b) Percentage adults experiencing liquidity distress and/or shocks and/or investing in goals by wealth category (2019)



Education, putting food on the table and investing in livelihoods are central to people's lives and aspirations. How can finance help? There are three fundamental ways in which finance can contribute to these and other priorities and needs. Finance can help people to bridge day to day shortfalls - 'putting food on the table' - for example, through being able to tap into savings or borrow small amounts when income is low. Finance can also help people to build their futures- investing in livelihoods, paying for education, saving for old age- for example, through agricultural loans, education investments, pensions or asset investments. Finally, in times of trouble, finance can help people to deal with shocks such as health emergencies, for example, through formal or informal insurance. While shocks affect rich and poor alike, wealthier populations are more likely to be investing in goals and the poor are more focused on finding solutions to meet their basic expenses.

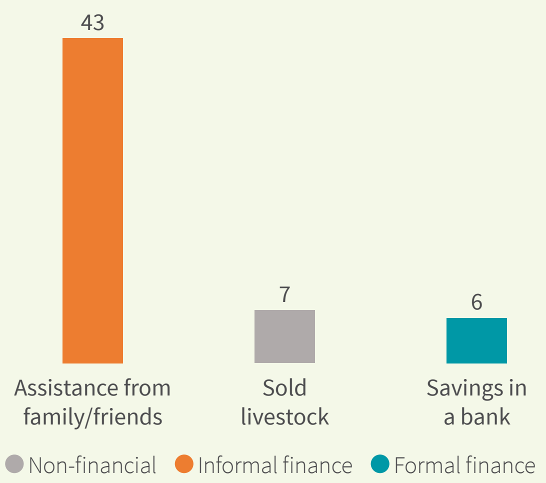
5.3 SOLUTIONS USED TO ADDRESS NEEDS

Fig 5.3 (a) Top three solutions used to address shortfalls in day to day needs
(% adults experiencing liquidity distress 2019)



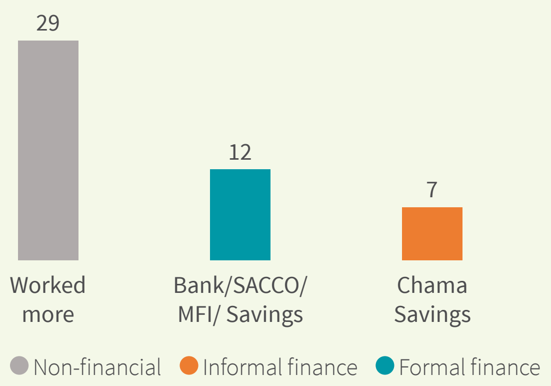
Assistance from family & friends is Kenya's most important financial solution for day to day needs and shocks. This points to the importance of a formal financial service which wasn't specifically mentioned as a solution to address needs – mobile money. Mobile money owes much of its success to its value in enabling social network payments, helping people to quickly get hold of funds in times of need. In the context of social networks, mobile money may also be a lifeline for Kenyans, demonstrating the potential for formal finance to strengthen rather than substitute for informal solutions. In relation to day to day shortfalls, working more was also significant. For many, this entails *ad hoc* casual labour for minimal returns, compromising their capacity to invest in long-term strategies for growth. A number of people simply did nothing, which effectively means cutting back on expenses.

Fig. 5.3 (b) Top three solutions used to address shocks *(% adults experiencing shocks 2019)*



Health is the main shock experienced across the population. Again, calling on assistance from friends and family was overwhelmingly the go-to solution for dealing with shocks. A small proportion of those with health shocks sold livestock (7%) emphasising the continuing importance of livestock as a financial asset for Kenyans. A similar number (6%) liquidated bank savings underlining the importance of saving in the absence of safety nets and comprehensive insurance. **Despite the fact that 28% of the population have access to NHIF however, only 3% of the population used insurance as their main solution to cope with shocks.**

Fig. 5.3 (c) Top three solutions used to invest in future goals *(% adults investing in future goals 2019)*

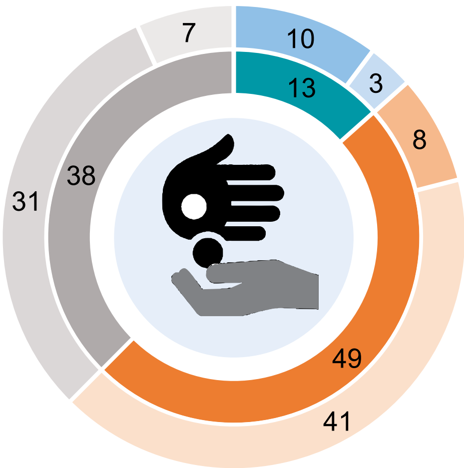


Formal savings are a key for investing in goals- but what about formal credit? Starting or expanding a business was the most frequently mentioned goal followed by education and investments in property/land. Here the formal sector comes into its own, with bank/SACCO/MFI savings being the second most mentioned investment solutions. Again, it is noteworthy that savings is preferred over credit for investment needs, indicating that credit solutions are not offering value for Kenyans' growth strategies. But the most important device for meeting goals was to find more work. This underlines the wider importance of finance as a catalyst for inclusive growth and job creation.

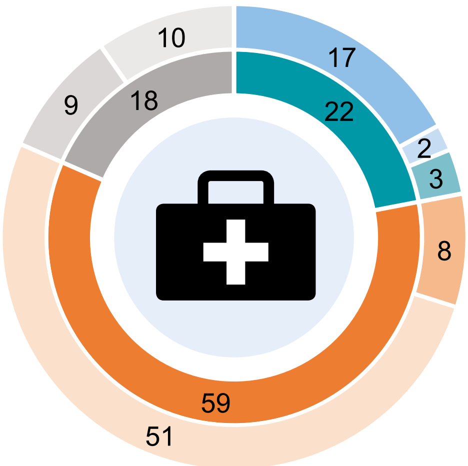
5.4 FINANCING NEEDS

Fig 5.4 Use of formal, informal or non-financial solutions to meet needs
(% adults experiencing liquidity distress, shocks or investing in goals 2019)

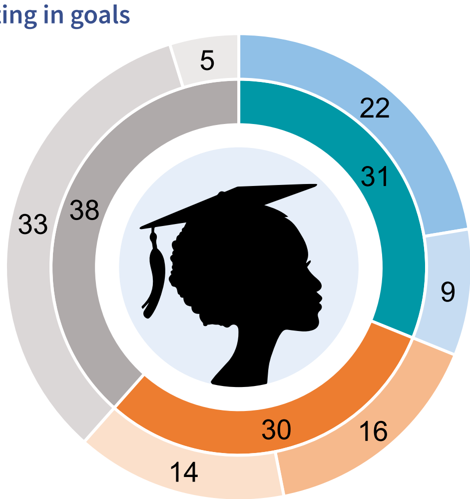
Trouble meeting daily needs



Managing shocks



Investing in goals



Take aways

- **Overall, formal solutions play a limited role** in helping people to meet their needs
- **But formal savings** (Bank, SACCO, MFI) are **significant** for investment
- **Informal devices are key**, especially assistance from the social network
- Finding ways to get **more income is also crucial**

Formal finance plays a limited role in addressing people's needs. Especially for liquidity management and shocks, the informal sector is key. Kenya's vision for inclusive growth will not be realised if the social network continues to carry the burden of being its main safety-net. Formal safety nets are critical for household resilience; and resilient households underpin inclusive growth. Kenyans still rely heavily on non-financial mechanisms to support their needs-cutting back on expenses or trying to find additional income through working more or selling assets such as livestock. Again, this speaks to the wider role of finance in supporting economic growth and creating jobs. Lastly, formal savings play an important role, especially in relation to investment. This underlines the importance of innovations in savings markets, and also suggests that there is a void in formal borrowing with current business models not well suited to supporting investment and growth.

Legend:

- **Non-financial**
  - Worked more/cut expenditure
  - Sold assets
- **Informal**
  - Informal saving
  - Informal borrowing
- **Formal**
  - Formal saving
  - Formal borrowing
  - Insurance

5.5 FINANCIAL HEALTH

Fig. 5.5 (a) Percentage of adults classified as financial healthy (2016-2019)

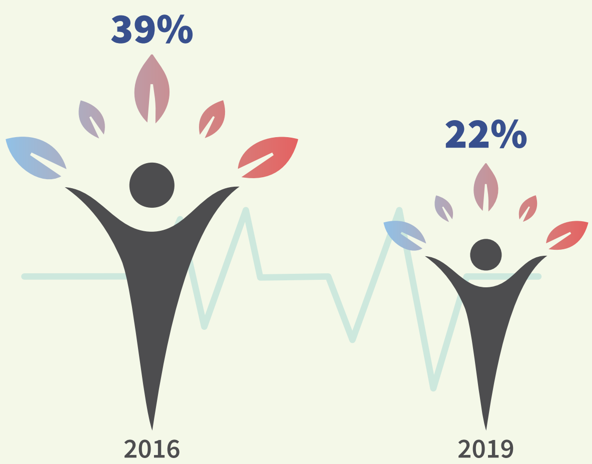
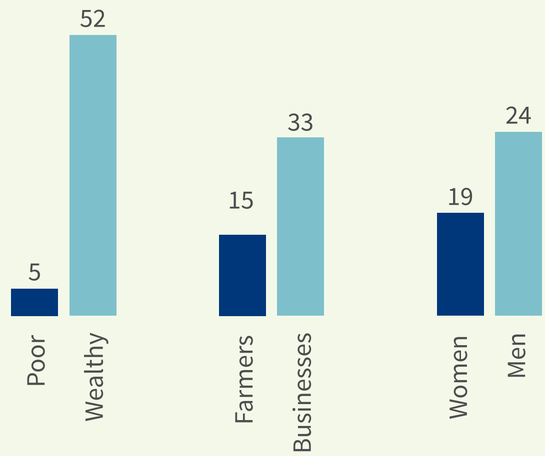


Fig. 5.5 (b) Percentage of adults classified as financial healthy by wealth category (2019)



In 2019, 83% Kenyans are financially included but only 22% are financially healthy, indicating that uptake of accounts alone will not deliver the dividends we seek for improved wellbeing. This is particularly acute for the poor where only 5% are financially healthy compared to over 50% of the wealthy. The financial health index gives us a shorthand tool to measure the outcome of financial inclusion in terms of the resilience of the population and its potential for growth. It is important to recognise that financial health is not just dependent on the financial sector. People's resilience and growth hinges on broader economic conditions as well as access to services such as social protection, health and education. Nonetheless, finance has a key role to play not just directly through financial inclusion, but also in relation to its core role of catalysing the economy to enable inclusive growth. That access to formal finance has improved while measures of financial health have worsened underlines the weakness of the relationship between welfare and a simple conception of financial inclusion.

The financial health index

Ability to manage day to day:

- never went without food during the last year
- doesn't have trouble making ends meet between income cycles
- has a plan/budget for allocating income and expenses

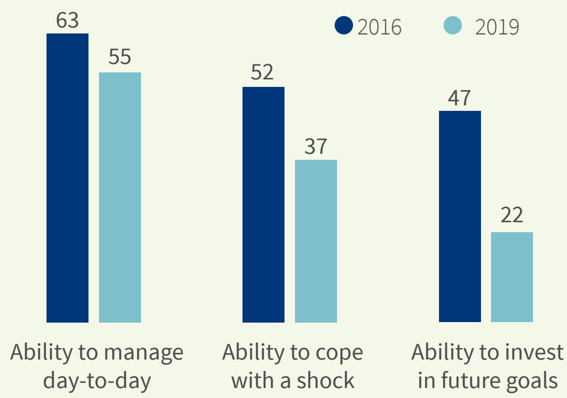
Ability to cope with risk:

- never went without medicine in the last year
- regularly kept money aside for emergencies
- can get hold of a lump sum within 3 days

Ability to invest in the future:

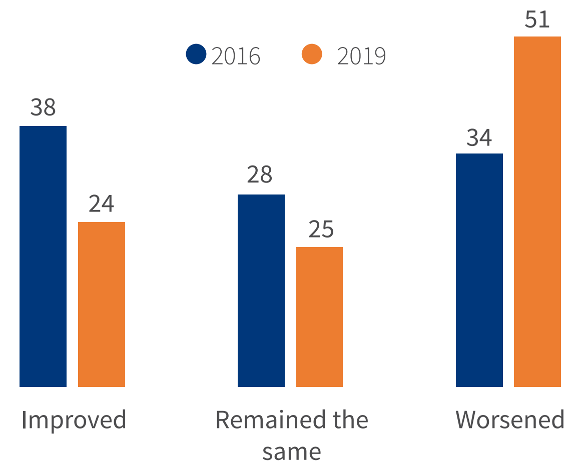
- using savings or credit to invest in productive assets
- education or old age; is using/plans to use savings
- pension or investment income to make ends meet in old age; has been regularly putting aside money for the future.

Fig. 5.5 (c) Percentage of adults with ability to manage day to day, manage shocks and/or invest in the future (2016-2019)



Financial health shows a marked decline since 2016, when nearly 40% of Kenyans were found to be financially healthy. Declining levels of financial health in 2019 were most acute in relation to people's ability to invest in their futures- fewer people were mobilising finance for productive investment or saving for old age. People's ability to cope with shocks also declined, with fewer people setting money aside for a rainy day or able to access a lump sum in case of an emergency. Ability to manage day to day, including being able to put food on the table and having budget for expenses was more buoyant, although many more people claimed to have trouble making ends meet at the end of the month than was the case in 2016.

Fig. 5.6 Over half the population claim that their financial situation has worsened (% adults 2016 - 2019)



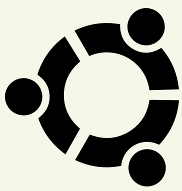
Lastly, the drop in financial health is corroborated by people's perception that their life status has worsened. Compared to 2016 when 34% said their lives had worsened, in 2019, 51% reported that this was the case.

SUMMARY

We care about financial inclusion because we care about the health of our economy and society. Financial inclusion can strengthen economic inclusion- the ability of people to participate in growth and ensure that growth results in quality of life for all. It can help to make households more resilient and support individuals to build their capabilities through access to health and education. The data shows that finance is not yet there in enabling people to meet their core financial needs and improve their financial health. However, with the building blocks in place, Kenya's financial sector is now poised to take on the challenge of building a financial sector that is relevant for the needs of its society.

Take aways

Despite strong progress on inclusion, the formal sector has limited relevance in helping Kenyans to address their needs



Assistance from family and friends and finding more work were main solutions for meeting daily needs, dealing with shocks & investing

83% have formal accounts but **only 22%** are financially healthy; uptake of accounts alone is not sufficient for financial wellbeing

Over half of the wealthiest are financially healthy but 95% the poor are not, suggesting high levels of economic inequality

6. CONCLUSION

FinAccess 2019 shows impressive achievements in financial access, with 83% of the population having a registered formal account. An increasingly diverse array of formal products and a long-established informal sector has given Kenyans a rich portfolio of financial instruments from which to choose.

As the sector matures, Kenyans' portfolios are formalising such that formal savings have now overtaken informal and many more people (22%) have a formal credit product than was the case in 2006 (7%). But there are still substantial levels of inequality in access to formal services – especially banking.

Digitisation has been responsible for driving much of Kenya's progress towards financial inclusion, creating a channel that can reach into the most remote communities and provide access to a secure and diverse range of financial solutions. As we look to the future, smart phones and data are poised to become key ingredients that will shape the direction of innovation in financial services for the mass market. Among Kenya's youth (between 18 and 25 years of age), nearly half own a smartphone and a significant proportion of these are already using advanced digital financial services, such as mobile banking or digital credit.

In spite of the increase in financial inclusion, indicators of overall financial health have worsened over the last three years. Looking at how people are using formal finance it is clear that there has, as yet, only been a modest impact on addressing people's needs. With the rapid growth of finance and digital technology, Kenyans are also exposed to increasing risk, which have a particular impact on the poor (levels of debt stress among the poorest are higher than for wealthier groups). Unless there is greater emphasis on creating real value for consumers, with appropriate regulation to ensure transparency and fair treatment, Kenya's financial sector could do more harm than good. **If we are to set our sights beyond simply providing Kenyans with accounts and aim to provide solutions to real world problems, we need to raise the bar.**

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