



POLICY BRIEF

The Fintech Ecosystem and Financial Inclusion: Evidence from Kenya

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Introduction

The purpose of this policy brief is to explain the role that the fintech (financial technology) ecosystem could play in facilitating financial inclusion in Kenya. The country has witnessed tremendous growth in the fintech subsector in recent years. It had at least 385 registered fintech firms/startups by July 2022 operating in various subspaces such as savings and credit, foreign exchange and cryptocurrency, insurance, and micro/neo-banking. Alongside these developments there has been a steep growth in financial inclusion, with FinAccess surveys documenting growth in formal financial services usage between 2006 and 2021 from 33.2% to 85.9% among men, and from 20.5% to 81.7% among women. Therefore, understanding the linkages between fintech and usage of formal financial services is of interest to policymakers. This study explored linkages using FinAccess data for 2016 and 2021 and documented several interesting findings.

The Context

The fintech ecosystem in Kenya has witnessed remarkable growth since m-pesa was launched in 2007. Data from the Central Bank of Kenya show that mobile money transactions increased by 17.5% from KES 3.26 trillion to KES 3.8 trillion in the first half of 2022. The country had at least 385 registered fintech startups by July 2022 operating in various subspaces such as savings and credit, foreign exchange and cryptocurrency, insurance, and micro/neo-banking. Further, the banking subsector has increasingly incorporated digital technology in its product offerings: for example, about 38% of Kenyan banks use digital only banking according to the Banking Sector [Innovation Survey 2021](#). The country has also made big strides in financial inclusion with credit and savings usage growing, respectively, from 66.4% and 34.2% of the population in 2016 to 74.0% and 60.8% in 2021.

The Problem

The notion that participation by individuals and households in the digital ecosystem could promote financial inclusion has been criticized on the basis that the fintech ecosystem is driven by profit motive and hence fails to address the underlying causes of financial exclusion, such as irregular/low income. Data appear to bear out this criticism: as of 2022, Safaricom's short-term credit service, Fuliza, charged a minimum daily maintenance fee of KES 18 on transactions between KES 1001 and KES 1500, translating to about 36% monthly interest rate. This is too expensive to facilitate lasting welfare improvement, the expected outcome of financial inclusion.

Despite these criticisms, recent evidence shows that the fintech ecosystem stands a good chance as a catalyst for financial inclusion. For example, fintech ecosystems enable participants to specialize in the provisioning of services in which they have comparative advantage, which lowers the aggregate cost of provisioning such services. Thus, conceptually, higher levels of financial inclusion should be realized with the presence of a fintech ecosystem than would be attainable under the traditional system of provisioning financial services. For example, by partnering with telcos to use mobile service platforms, commercial banks could foster access in remote locations at a lower cost (e.g., by eliminating the need to rent space), which could foster usage of such services (e.g., for loan applications, and savings).

Key Findings

Using a battery of scientific procedures, we analyze data, covering over 7000 households, obtained from the 2021 FinAccess Kenya Household Financial Inclusion Survey. The study sought to establish the role of the fintech ecosystem on financial inclusion in Kenya and to explore the specific mechanisms through which the fintech ecosystem may influence financial inclusion.

The study documents several findings of interest to policymakers.

1. The distance barrier is as much a disincentive to the use of the fintech ecosystem as it is to physical branches/agents of financial institutions. This is because the typical usage of fintech is for transactional purposes (e.g., remittances, where recipients must collect money physically from agents located in commercial centers).
2. There is a positive nexus (of at least 0.8%) between the engagement with the fintech ecosystem and use of formal financial services/products, after controlling for socio-demographic factors.
3. Investments do not respond with as high economic importance to the fintech “intervention” as do the other uses of financial products (e.g., savings). This possibly reflects low levels of awareness of opportunities available in the capital market.
4. Engagement with the fintech ecosystem falls by at least 21% if an individual lives in Northern Kenya, where physical infrastructure is relatively underdeveloped.
5. The benefits of the fintech ecosystem are not uniform across user categories. For example, the uptake of securities’ investments improves, interestingly, for women, and older adults during 2021 but falls for men and young adults.

Policy Recommendations

1. One way of addressing the distance barrier is to facilitate fintech adoption by provisioning electricity in remote areas. For example, mobile money agents naturally prefer locations with electricity for them to charge their phones. Another way is through policies that reduce the cost of digital access such as reduction of excise tax on mobile data and mobile money usage.
2. A sustained financial inclusion drive (e.g., initiatives such as Mzansi Account in South Africa), funded and systematically implemented across the country by the government, or its agencies, could help create awareness for capital markets products. Alternatively, since low income may be manifested through low participation in capital markets, interventions include fiscal policy actions that improve disposable incomes, such as greater tax reliefs.
3. Targeted interventions may be required to make financial inclusion attractive to marginalized populations (e.g., low-income earners, women in rural areas) including intensifying financial literacy campaigns and addressing cultural practices that perpetuate marginalization.
4. Given the finding that residents of Northern Kenya have lower chance of utilizing the fintech ecosystem and given the important role that fintech appears to play in promoting financial inclusion, improved provisioning of physical infrastructure (e.g., modern communication infrastructure in the region is important.



Mission

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