

# Chapter 31

## Innovation and Financial Inclusion in Kenya

### Innovation and Financial Inclusion in Kenya: A Case Study of M-PESA

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#### ABSTRACT

*This chapter analyzes the role of financial innovation and mobile phone technologies to financial inclusion in Kenya. In order to do so, a case study on M-PESA is conducted, the leading mobile service of money transfers in Africa, which is offered by Safaricom. M-PESA services are cheap and easy to use in comparison to other formal and informal providers of financial services. It solves two different problems in Kenya: customers do not have to travel anymore long distances to reach financial services and more people can afford them. As result and in line with the literature, this chapter suggests that M-PESA services can be considered a type of disruptive innovation that promotes financial inclusion and wealth growth in Kenya.*

#### INTRODUCTION

There is evidence of a positive link between financial inclusion and a more inclusive economic development (Chibba, 2008, 2009, 2011; Kumar & Mohanty, 2011). Financial inclusion has recently gained prominence as a policy tool by governments and other actors to breach the poverty gap between developing and developed countries and between communities (Alfred & Stefan, 2010; Donovan, 2012; Hughes & Lonie, 2007). However, the high costs associated to offering small bank accounts to low

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income consumers and the unwillingness of banks to lend to small businesses form the major barriers to financial access and inclusion in rural areas of developing countries (Demirguc-Kunt & Klapper, 2012). In order to promote financial inclusion, governments need to develop a consistent financial regulation that allows companies to explore innovative ways and models that can extend financial services to poor people cheaply and conveniently (Alfred & Stefan, 2010; Donovan, 2012).

In this context, technological innovations could play an important role to financial inclusion by reducing the costs of these bank accounts to poor people and by raising the capacity of banks or substituting them on giving credit to small businesses. Additionally, these technological innovations could disrupt existing market structures and move the industry to a new standard using simple applications at the bottom of the market. This is clearly a characteristic of the so-called disruptive innovation technologies<sup>1</sup>. The main objective of this chapter is to study the financial inclusion promoted by innovation in money transfers thorough mobile phones in rural areas of Kenya. How do these new technologies affect financial inclusion and wealth? Can the characteristics of the so-called disruptive technologies be observed in mobile transfers?

There are few articles dealing with these questions (among others: Kikulwe, Fischer, & Qaim, 2014; Mbiti & Weil, 2011; Mbogo, 2010). However, most of the literature studies financial inclusion as consequence of mobile money. In order to complement the literature and further discuss mobile money in light of disruptive technologies, we analyze through a case study how and to which extend does M-PESA, the market leader of mobile transfers in Kenya, promote financial inclusion in rural areas of the country. The results show that, unlike traditional banks and informal providers of financial services, M-PESA promotes financial inclusion by providing alternative financial services to new unbanked customers as well as to existing banked ones cheaply and conveniently. Thus, there is evidence that M-PESA is as a good example of disruptive innovation, where new technologies used in a relatively simple way in the bottom of the market gain scale and disrupt the existing market structures. We are careful to describe M-PESA and its characteristics in a mode that is of easy understanding to the general reader.

The outline of the article is as follows: Section 2 describes the background of our analysis including a short literature review. Section 3 describes how M-PESA works and how it has been growing in Kenya, Section 4 discusses the meaning of M-PESA to financial inclusion, Section 5 discusses the model of disruptive technology and how it can be relevant to our analysis of M-PESA and section 6 analyzes M-PESA according to the concepts of disruptive innovation and financial inclusion. Section 7 comments possible topics for future research and Section 8 concludes the chapter.

## **BACKGROUND**

Innovation in delivery channels of financial services, more particularly mobile transfers of money, is one of the areas that led to rapid expansion and access to financial services in rural areas of developing countries. This is especially the case in the Sub-Saharan Africa (Alfred & Stefan, 2010; Demirguc-Kunt & Klapper, 2012; Demirguc-Kunt, Klapper, Singer, & Oudheusden, 2015; Donovan, 2012; Duncombe & Boateng, 2009). Among others, Alfred and Stefan (2010), Donovan (2012), Demirguc-Kunt and Klapper (2012), and Kikulwe et al. (2014) showed that Kenya is one of the leading countries within mobile money technology with its M-PESA services.

M-PESA is a “SMS” (Short Message Service) money transfer and payment system that allows users to deposit, send, and withdraw money by the use of their ordinary mobile phones. The letter “M” refers

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