

## Financial Inclusion and Cream Skimming in Kenya's Financial Sector

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### Abstract

Tremendous efforts have been put in place by the relevant government bodies and partners in enhancing financial inclusion in Kenya. An analysis of the data from the FinAccess National Survey of the year 2013 shows that mobile financial services has been the main driver of these positive trends in financial inclusion. However, there is a marginal decline in usage of banks, savings and credit organizations (SCOs) and informal groups for financial services with the Micro-Finance institutions (MFIs) showing the highest decline in usage of its services. We found Cream skimming practices are evident in the market based on income levels and access to certain type of financial services. The verdict, financial inclusion has increased in Kenya due to the penetration of mobile phone financial services and concerted government efforts and minimal cases of Cream skimming are observed.

**Keywords:** Financial inclusion, Cream skimming, financial services, Livelihood, Income

### Introduction

Financial inclusion is the ability of individuals to access appropriate financial products and services. This includes financial awareness, knowledge about banks and banking channels, facilities and advantages of the banking channels usage (Islam and Mamun, 2011). When financial institutions tend to be more inclined towards serving the more profitable segment of a population, this practice is referred to as Cream skimming. The practices of Cream skimming have been noted in world countries and continue to be practiced in different forms as it is not legally forbidden in some countries (Mancero and Eduardo, 2001; Beschomer, 2003).

In Kenya, concerted efforts through various avenues to widen the financial inclusion landscape have gained momentum but with challenges and opportunities for the financial service providers. In making the financial inclusion a reality, the government of Kenya and its development partners has continued to innovate and deploy more affordable and a variety of financial products. To appreciate this progress, it is important to highlight some of the government driven initiatives. In 2006, the Kenyan government passed The Micro Finance Act allowing MFIs to take deposits. This act was crucial for depositors' protection under the supervision of the Central Bank of Kenya (CBK). The Financial Sector Deepening (FSD) and CBK started FinAccess National Survey in the year 2006, followed by another survey in 2009 and 2013. The key objective of the survey was to explore and understand the financial inclusion landscape, identify constraints and design appropriate policy strategies and reforms (FSD, 2013). The latest survey (of 2013) reveals that Kenya's financial inclusion landscape has undergone considerable change with the overall verdict being that it has expanded. The survey found that a broad spectrum of financial services is yielding distinct benefits to the different consumer groups.

The FSD (2013) observes that transaction costs and development of financial services and products hinder financial inclusion efforts. A recent development in the Kenyan Financial services landscape is the innovative M-pesa service, which allows anyone with a cellphone to perform financial transactions without necessarily visiting a bank. This product, M-pesa has received accolades world over, it being replicated in other parts of the world. M-pesa, and its

'baby', M-Shwari, a micro-credit facility, have led to increase in diffusion of more financial innovations. This has increased competition, reduced cost, improved inclusion of the low market segment with low income and faster ways to transact (Ntwiga, 2016; Messy and Monticone, 2012). Even with all these financial inclusion developments, certain market segments, around 25 percent of adult population are still not accessing financial services as highlighted in FSD 2013 report. No reason for this exclusion is given.

In this paper, we enhance and contribute to the FSD 2013 report by analyzing possibility of cream skimming in the Kenyan financial services market. The report noted that 25 percent of the adult population is not using any form of financial services and products. Cream skimming is not mentioned as an obstacle in financial inclusion in Kenya (FSD, 2013). We hypothesize that cream skimming, livelihood, income and type of financial service hinders financial inclusion in Kenya.

Section two reviews the Cream skimming theory, livelihood, income and form of access to financial services. Section three is on the methodology, data analysis methods, results and discussions. Section four has the concluding remarks.

### **Cream Skimming Theory**

Most financial institutions have not focused on providing savings products or services to the poor, as it is considered neither profitable nor sustainable (Sherraden and Boshara, 2007). Cream skimming consists of assessing the cost of serving a customer and it aims at attracting those customers from a competitor and served at a lower cost (Beschomer, 2003). Therefore, financial service providers are unwilling to venture in certain population segments. For example, the unbanked and poor people's income is volatile often fluctuating daily, and without reliable ways of pushing and pulling money between good and bad days. Few banks are willing to build the costly infrastructure needed to collect the low value cash deposits (Ntwiga, 2016).

Financial service providers know that certain market segments are more profitable than others are and thus practice Cream skimming. One way to discourage this is through government incentives to offer services to segments that are not 'creamy'. This practice of skimming negatively modifies the outcome of the post entry competitive process in the financial services sector (Mancero and Eduardo, 2001). Foreign banks presence in developing countries promotes financial development and efficiency due to the inefficiency of the domestic banks (Lee, 2012). They however face information asymmetry in these markets and have negative effect on developing countries as they reduce access to credit and increase costs due to Cream Skimming.

In the year 2002, around 8 percent of Kenyans owned a mobile phone, but that figure stands at 80 percent today, a tenfold increase (Poushter and Oates, 2015). The year 2007 saw the birth of a mobile phone based money transfer system in Kenya which has grown at a fast pace since its inception. A shift has occurred where there are more mobile money accounts than deposit accounts with commercial banks. M-Pesa has enhanced the poor segment of the population in accumulating their savings to pay for life-cycle events and manage day to day cash flows. The service is popular as it is based on already existing infrastructure, thus low expansion and handling costs (Ntwiga, 2016). This system of banking is likely to be evenly distributed among the 'creamy' and 'non-creamy' segments of the population due to the shared infrastructure.

We expect financial inclusion through mobile phone financial services to be equal in the rural and urban areas, thus very low levels of Cream Skimming.

## Livelihood and Income

In Bangladesh, large sections of household with low income levels, particularly in the rural areas are un-served by any financial institution (Islam and Mamun, 2011). A study by FSD (2010) shows that families with low incomes in Kenya have cash flow that is erratic and unpredictable. Mostly, the financial decisions are based on discipline rather than analytical skills. Hard choices are needed on everyday living expenditure and saving choices. To this end, further changes in social policies and how they are delivered are needed as new challenges and opportunities of how poor households can build their assets and wealth are emerging (Sherraden and Boshara, 2007). Studies done in developed world have documented a correlation between financial literacy and usage of formal financial services. The FSD (2010) report shows that in the developing world, the poor talk about financial capability when they refer to generating income, not allocating funds into financial investments. One way to enhance inclusion is through low cost products with shared access for the poor (NCR Corporation, 2009).

We expect the rural areas of Kenya to have a lower financial inclusion compared to the urban areas but with almost equal access of financial services where access is shared like the mobile phones, the M-pesa services. Further, the wealthy consume financial services more compared to the poor.

## Form of Access

Literacy campaigns, shared access, government incentives and favorable policies to start community centers can increase the form of access to financial services in the rural areas (NCR Corporation, 2009). Under developed infrastructure in parts of the country has hindered the penetration of the different forms of access to these services. Messy and Monticone (2012) observes that high fees, physical barriers and terms and conditions of the service provider limits access to a product. Other factors are low income, low financial literacy, psychological and cultural barriers.

Formal financial services decrease among individuals whose main income sources are farming and business ownership. The individuals are likely to use informal products or to be excluded and the author noted that based on income, SCOs are more frequented by individuals with low income. (Messy and Monticone, 2012). They argue that introducing financial literacy in schools is crucial as the large share of young population is able to gain these skills.

On the gender front, women are more likely to shun new forms of financial services and thus have a higher degree of being excluded (Messy and Monticone, 2012). A need exists to enable the poor have access to savings, structured savings products and incentives for saving. This can enable them to make deposits and build assets that lead to positive outcomes and greater stability on how they manage their money (sherraden and Boshara, 2007). The form of financial access is affected by different factors like level of income, financial literacy level, gender and if the individual lives in rural or urban. We analyze if cream skimming, livelihood, income levels and form of financial services hinders financial inclusion of the 25 percent of the adult population in Kenya without any form of financial services.

## Hypothesis

The hypotheses that capture the objectives of the study are:

*H<sub>1a</sub> Livelihood and income affects the increase in financial inclusion*

*H<sub>1b</sub> There is a change in the form of access to financial services*

*H<sub>1c</sub> There is evidence of Cream Skimming in offering financial services*

## Methodology

The profiling of the Kenyan population in terms of basic demographics, livelihoods and income, wealth and vulnerability is available in the FSD (2013) report, a collaborative research between the CBK and the financial access partnership members. This report has secondary data for the studies done in the year 2006, 2009 and 2013. We extract the data to test the three hypotheses for this study. The original study by FSD (2013) has a target sample size of 8,520 households but 6,449 completed the survey interviews. We are convinced that the data from this study qualifies for further analysis having looked at the methodology used to collect it and the team that was involved in this survey (FSD, 2013). The test for normality on the data failed. Descriptive statistics summarized the data to ascertain the general trend of the data for the three years 2006, 2009 and 2013. The Wilcoxon rank test compared the samples of the three years to test if differences exist between them. The Friedman test tested for significant differences in the row and column treatments of the data.

## Results and Discussion

The mean usage of financial services (in table 1) between the year 2006, 2009 and 2013 increased from 13.6 to 17.6 then to 26.2 respectively. The financial inclusion for the three periods shows a Friedman test mean rank of 3.0, 1.57 and 1.43 for the year 2013, 2009 and 2006 respectively. This is an increase in financial inclusion in Kenya in this period.

Table 1: Financial service Classification in FSD (2013) study

Financial Service	Transactions	Savings	Credit	Investment	Insurance	Pension
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In table 2, the type of the financial service was statistically significant ( $p=0.001$ ) based on wealth quintile (see table 4) with more people doing financial transactions, followed by savings, and lowest is pensions.

Table 2: Type of service and wealth quintile

Financial Services	Mean Rank
Transactions	5.60
Savings	5.40
Credit	3.80
Investment	2.00
Insurance	2.80
Pensions	1.40
Asymp. Sig.	0.001

The usage of financial service providers is dependent on livelihood (in table 3) as those employed had the highest usage, followed by those with own business, agriculture, dependent and finally others.

Table 3: Livelihood classification in FSD (2013) study

Livelihood	Agriculture	Employed	Own Business	Dependent	Other
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The wealthiest had a mean of 41 and standard deviation of 34 in usage of financial services while the poorest had a mean of 10.5 and a standard deviation of 11.3. Thus, the wealthy are four times more likely to use a financial service than the poor. A Friedman test shows that the type of livelihood (in table 3) and usage of financial services (in table 1) are statistically significant ( $p=0.000$ ).

Table 4: Wealth classification in FSD (2013) study

Wealth Quintile	Wealthiest	2 <sup>nd</sup> Wealthiest	Middle	2 <sup>nd</sup> Poorest	Poorest
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Usage of banks per region shows an increase in the average number of bank users in the country with year 2006, 2009 and 2013 having an average of 13.1, 18.3 and 30.0 percent respectively. In Table 5, between the year 2006 and 2013, mobile services users increased by 34.8 percent, with a marginal increase in usage of SCOs, a decline in banks, informal groups and MFI usage. Increase in mobile phones and decline in banks usage is possibly due to presence of cream skimming in Kenya's financial sector.

Table 5: Usage of financial providers in the years 2006 and 2013

Service Provider	2006 to 2009 (%)	2009 to 2013 (%)
MFSPs	-	34.8
Bank	23.9	21.4
SCO	13.8	15.7
Informal Group	22.2	12.1
MFI	40.1	16.0
Total	100%	100%

A mean rank for Friedman test in table 6 shows that a Kenyan is more likely to use a Mobile phone, then an informal group followed by a bank to access financial services. The mobile phone ownership in the rural and urban areas had no significant difference based on the Wilcoxon rank sum test. However, there was a 56 percent chance that an individual in urban can access financial services compared to 44 percent in the rural area. This is true due to the ease of accessibility of any of these financial services providers and income level disparity in rural and urban areas.

Table 6: Service provider and wealth quintile

Financial Service Provider	Mean Rank
Bank	3.40
SCO	2.00
MFI	1.00
Mobile Phone Services	5.00
Informal	3.60
Asymp. Sig.	0.001

In table 7, formal prudential (that includes banks), in the period 2006-2009 and 2009-2013, in rural areas had a 5 percent decline while urban areas declined by 7 percent. The excluded from financial services declined by 4 percent in urban and 6 percent in rural areas in the same period, evidence of increase in financial inclusion.

Table 7: Access strand and percentage change in the three years

Access strand	Urban		Rural	
	2006 – 2009 (%)	2009-2013(%)	2006-2009(%)	2009-2013 (%)
Formal Prudential	27	20	21	26
Formal non-prudential	47	50	28	52
Formal registered	3	7	32	2
Informal	6	11	5	12
Excluded	17	12	14	8
Total (%)	100	100	100	100

Between the two periods in table 7, 18 percent of female and 29 percent of male's accessed services through formal prudential institutions while 28 percent of female and 17 percent of male accessed services through the informal strand (see table 8). The population excluded

decreased both in urban and rural areas, indicating that financial inclusion is on the increase in Kenya. Individual access to financial services increased in urban and rural areas for those using the formal non-prudential access strand (see table 8).

Table 8: Classification of the access strand in the FSD (2013) study

Formal prudential	Individuals whose highest level of reported usage of financial services is through service providers which are prudentially regulated and supervised by independent statutory regulatory agencies
Formal Non-prudential	Individuals whose highest level of reported usage of financial services is through service providers which are subject to non-prudential oversight by regulatory agencies or government departments with focused legislation
Formal registered	Individuals whose highest level of reported usage of financial services is through providers that are registered under a law or government direct interventions
Informal	Individuals whose highest level of reported usage of financial services is through unregulated forms of structured provision

### Conclusions

The livelihood and income levels affect access to financial services with a wide gap between the wealthy and the poor. An individual is more likely to use a mobile phone, followed by an informal group, a bank, SCO and then a MFI. Banks usage is inclined toward the wealthy regions and mobile phones are evenly distributed in rural and urban areas. The excluded population from financial services has continued to decrease. We therefore conclude that low levels of cream skimming are evident but the increase in financial inclusion has continued to grow in Kenya.

Further research would be crucial to ascertain if mobile phone financial services has led to slowdown in usage of the MFI and SCOs in Kenya.

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