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Towards financial inclusion?

A study of the co-operative and digital lending models in Kenya

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A thesis submitted in fulfilment of the requirements for the degree of

Doctor of Philosophy in Development Studies

in the

Department of Anthropology, Archaeology and Development studies

Faculty of Humanities

University of Pretoria

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January 2024

DECLARATION

I, **Eric Gwandega Magale**, declare that:

i. **Towards financial inclusion? A study of the co-operative and digital lending models in Kenya** is my original work.
ii. This thesis has not been submitted for any degree or examination at any other university.
iii. This thesis does not contain other persons' data or other information unless specifically acknowledged as being sourced from other persons.
iv. Where secondary material is used, this has been specifically acknowledged and carefully referenced.
v. I understand what plagiarism is and I am aware of the University's policy and its implications in this regard.

Eric Gwandega Magale

Date: 22nd January 2024

ACKNOWLEDGEMENTS

One incurs very many debts of gratitude when embarking on a challenging course in life, such as completing a PhD. I am no exception. Obviously, I cannot possibly thank everyone who has been generous to me with their time, ideas, resources and prayers over the last four years, complete strangers in some cases. In a special way, I want to acknowledge my dear wife for her unwavering support and daily cheering. You have been the very cornerstone of our young family and the wind beneath my wings through this grueling journey. I thank God for you. I thank my parents-in-law for always being supportive to our young family and my siblings and siblings-in-law for their thoughtful words of encouragement every now and again, and for their fervent support. I also wish to thank my friends for their support, given by each one in their own special way.

To my parents, Andrew and Phanice Magale, I thank you for your never-ending support, for your silent prayers and encouragement. Being a first-generation PhD student fills me with a great sense of achievement but also an overwhelming sense of gratitude. Looking back, I owe this achievement to the seeds of hard work, honesty, and perseverance you laid many years ago. I am filled with gladness that you were both able to witness this fruit that has been 35 years in the making. Thank you for pushing me to achieve what you could only dream of.

I owe a debt of gratitude to my supervisor, Professor John Sharp. Most of all, I am grateful for your patience to listen and read unrefined ideas and for holding my hand on this steep learning path. It was a true privilege to learn and grow under your wing and I thank you for laying the foundation stone of my career. I am equally grateful to my colleagues at the Human Economy Programme for our countless brainstorming sessions and charged debates and for making my PhD journey all the more interesting and bearable.

I thank God, my strength and my source during this challenging period, for bringing my journey to its expected end.

DEDICATION

For

Tugi and Maya

You can do anything you put your mind to and work toward. Be all you can be!

ABSTRACT

Financial inclusion emerged around the mid-2000s as a developmental strategy that proposed the tailoring of financial services of different kinds to the poor as a means of tackling poverty and inequality. This thesis examines how financial inclusion plays out through the extension of credit to people in Kenya. Besides the traditional banking institutions, there are two important credit providers in Kenya, namely co-operatives and digital lenders. On the one hand, the co-operative sector has a long history in Kenya and has witnessed significant developments over the last two decades. On the other hand, digital lenders have a more recent history but have quickly grown to become significant players in the credit industry.

Co-operatives in Kenya began in the colonial period with white settler farmers who brought along the model from Britain where it began. A few decades later, disenfranchised smallholder farmers under the yoke of colonialism were allowed to form co-operatives for their mutual benefit. After independence, the government fashioned co-operatives as a conservative form of African socialism which proved largely successful compared to other aggressive forms of African socialism practiced elsewhere in Africa. Co-operatives have become an enduring feature in Kenya's credit industry, offering inexpensive loans. The genius of the co-operative model is that it dispensed with the need for collateral in favour of guarantees by co-members.

Co-operatives have transformed significantly since deregulation of the sector from government control in 1997. The most significant of these changes was the emergence of financial co-operatives which are more formally known as Savings and Credit Co-operative Organizations (SACCOs) and the opening of the common bond and offering of quasi-banking services, all of which took place from the late 2000s. Notably, these changes inspired the innovation of new products and services, including digital loans, making co-operatives assume a more commercial outlook, a significant departure from their solidarity roots. Although opening of the common bond in SACCOs has led to an uptick in the number of new members, this change has attracted only members with moderate to high incomes who are able to pay the minimum share capital and make periodic savings. Fundamentally, the changes in the sector have not made SACCOs more accessible to the people at the bottom of the pyramid.

Around the same time that the co-operative sector was experiencing the changes highlighted above, mobile money, M-Pesa, was invented in Kenya. M-Pesa disrupted the financial services sector dramatically, forcing commercial banks to devise ways to cater to the lower end of the market whom

the banks had ignored for a long time due to their lack of productive assets and savings and unstable wages. From 2012, commercial banks and other non-bank digital lenders have stepped in to offer unsecured digital loans, leveraging on the mature mobile money market and the fledgling credit rating industry. Over the last decade, digital lending has taken different forms and has transcended industries to include non-financial corporations that previously had no role in the provision of credit.

This thesis shows that there are nuances in the use of and the benefit that users derive from digital loans. For high-income borrowers and to a lesser extent moderate-income borrowers, the loans are used as a convenience tool while low-income borrowers use digital loans for their day-to-day consumption needs and emergencies. While the loans can be useful when used for convenience purposes, they become predatory when they are used by low-income borrowers.

That the changes in the co-operative sector and the promotion of mobile money and its spin-offs, including digital credit, happened around the same time that financial inclusion was gaining popularity is no coincidence. Notably, the financial inclusion discourse also took shape within the context of a global shift in financialization which also affected Kenya. This shift refers to a change from organizations making money from the production of goods to the current form of capitalism where they make 'money from money' by simply positioning themselves in the financial industry. The change in financialization has been facilitated by financial innovations which have made financial services, in this case digital credit, more accessible to users in the pursuit of profit.

Proponents of the financial inclusion discourse proposed that financial service providers of all kinds should tailor and make their services more readily available to the poor, arguing that this will help the poor to forge their own paths out of poverty through entrepreneurship and to build their resilience through savings. This thesis argues that financial inclusion has little to do with borrowing for convenience and SACCOs gaining additional members with moderate to high incomes. This thesis argues that a deeper understanding of financial inclusion requires a departure from generalizations of financial inclusion in favour of a keen unpacking of financial inclusion strategies. Given that the targets of financial inclusion are typically the poor in the developing world, financial inclusion strategies must be sound and must not propagate or exacerbate the problems of poverty and inequality.

Keywords: Financial inclusion, digital credit, co-operatives, SACCOs, financial services, Kenya

ACRONYMS AND ABBREVIATIONS

CBK	Central Bank of Kenya
CBDC	Central Bank Digital Currency
CGAP	Consultative Group to Assist the Poor
DLAK	Digital Lenders Association of Kenya
CoopAfrica	Co-operative Facility for Africa
CRB	Credit Reference Bureau
FinAccess	Financial Access
FOSA	Front Office Service Activity
FSD	Financial Sector Deepening
KCB	Kenya Commercial Bank
KCC	Kenya Co-operative Creameries
MFI	Micro Finance Institution
MNO	Mobile Network Operator
MSMEs	Micro, Small and Medium Enterprises
NBFI	Non-Bank Financial Institution
NGO	Non-Governmental Organization
ODPC	Office of the Data Protection Commissioner
SACCO	Savings and Credit Co-operative Organization
SASRA	SACCO Societies Regulatory Authority
USSD	Unstructured Supplementary Service Data
WOCCU	World Council of Credit Unions

LIST OF FIGURES

Figure 1: A VISA-branded ATM card issued by a SACCO

Figure 2: Screenshot showing information accessed by a digital lender

Figure 3: Screenshot showing information accessible by a digital lender

Figure 4: Mobile phone screenshot showing penalties charged on a digital loan

Figure 5: Mobile phone screenshot showing promotional SMS blast from a digital lender

Figure 6: Mobile phone screenshot showing promotional SMS from a digital lender

Figure 7: Mobile phone screenshot of an SMS sent to a phone contact of the borrower by a digital lender demanding repayment for a digital loan

Figure 8: Mobile phone screenshot showing an SMS sent to a borrower by a debt collector demanding repayment for a digital loan

TABLE OF CONTENTS

DECLARATION i
ACKNOWLEDGEMENTS ii
DEDICATION iii
ABSTRACT iv
LIST OF FIGURES vii
TABLE OF CONTENTS viii
CHAPTER ONE: BACKGROUND, PROBLEM STATEMENT AND THE FINANCIAL INCLUSION DISCOURSE 1
1.1 Introduction 1
1.2 Background 1
1.3 Problem statement 5
1.4 Research question and objectives 6
1.5 The financial inclusion discourse 6
1.6 Theoretical debates on financial inclusion 10
1.7 Financialization 16
1.8 The common bond and the 'degeneration' debate 21
1.9 Contribution of the thesis 28
1.10 Organization of the thesis 28
CHAPTER TWO: METHODS 31
2.1 Introduction 31
2.2 Research design 31
2.3 Study setting 32
2.4 Data collection: Sources and tools 33
2.4.1 Secondary data 33
2.4.2 Primary data 33
2.4.2.1 Sampling 34
2.4.2.2 Categories of informants 38
2.4.2.3 Interview style 40
2.5 Data analysis 43

2.6 Researcher positionality and reflexivity 44
2.7 Ethics and permissions 45
2.8 Conclusion 46
CHAPTER THREE: HISTORY OF THE CO-OPERATIVE MOVEMENT AND BANKING SECTOR IN KENYA 48
3.1 Introduction 48
3.2 Pre-liberalization era of co-operatives in Kenya 49
3.2.1 The co-operative movement in the colonial era 50
3.2.2 Wave of African socialism 51
3.2.3 Co-operatives as a nuanced path to African socialism 53
3.2.3.1 Coffee co-operatives as a socialist initiative 56
3.2.3.2 The death of African socialism 57
3.3 Post-liberalization era of co-operatives in Kenya 59
3.3.1 Near collapse of the co-operative sector 60
3.3.2 Revival of the co-operative sector 62
3.3.3 The emergence of SACCOs 63
3.4 History of banking in Kenya 67
3.4.1 The emergence of banking in Kenya 67
3.4.2 Africanization of the banking sector 68
3.4.3 Mobile money as a disruptor 70
3.5 Conclusion 71
CHAPTER FOUR: CASE STUDIES 73
4.1 Introduction 73
4.2 Case studies 74
Case 1: Makosa the security guard 74
Case 2: Odongo the boda-boda rider 75
Case 3: Brian the contract worker 77
Case 4: Aisha the young lawyer 78
Case 5: Vivienne the corporate banker 81
Case 6: Jeanne of Pioneer Nanoloans 83
Case 7: John the serial tech entrepreneur 85

Case 8: Lydia of Biashara credit 89
Case 9: Siaya of Cop SACCO 90
Case 10: Sarah of Uni SACCO 93
Case 11: Leah of Auditor SACCO 95
Case 12: Patrick of Fertilizer SACCO 98
Case 13: Meyo the personal financial guru 100
CHAPTER FIVE: A CRITICAL ANALYSIS OF THE PROPOSED IDEAL SACCO MODEL AND THE QUESTION OF FINANCIAL INCLUSION 104
5.1 Introduction 104
5.2 Proposals about the ideal SACCO model 105
5.3 Financially secure SACCOs 108
5.4 Financially vulnerable SACCOs 122
5.5 The question of financial inclusion 126
5.6 Conclusion 130
CHAPTER SIX: SCATTERING SEEDS: THE EMERGENCE AND GROWTH OF DIGITAL LENDING 131
6.1 Introduction 131
6.2 Digital lending and financial inclusion – a fallacy 132
6.3 Kenya's dualistic credit market and the unmet demand for formal short-term credit 133
6.4 The emergence and growth of digital lending in Kenya 136
6.4.1 Scattering seeds: the digital lending model 139
6.4.2 Credit information sharing and credit scoring 144
6.4.3 The landscape of the digital lending industry in Kenya 149
6.5 Borrowers' experiences with digital credit 154
6.5.1 Use of digital loans 154
6.5.2 Pricing of digital loans 156
6.5.3 Over-indebtedness and adverse inclusion 160
6.5.4 Expanded choice and marketing of digital credit 162
6.6 The question of regulation 165
6.7 Conclusion 173
CHAPTER SEVEN: RESPONSES, PERSPECTIVES, AND COUNTER-NARRATIVES FROM INDUSTRY INSIDERS 175

7.1 Introduction 175
7.2 Who are the industry insiders? 176
7.3 Dissemination of the financial inclusion discourse 177
7.4 Shifting views on financial inclusion 180
7.5 Perspectives of insiders in the digital lending industry 182
7.5.1 Good versus bad debt 186
7.5.2 The entrepreneurship myth 192
7.6 Perspectives of insiders in the SACCO sector 195
7.7 Conclusion 198
CHAPTER EIGHT: WHICH WAY? 200
8.1 Introduction 200
8.2 Money as an object of contest 200
8.3 Beyond fiat: new stories of money 203
8.4 Summary of thesis 206
BIBLIOGRAPHY 209
APPENDICES 226
Appendix I: Summary of pseudonyms 226

CHAPTER ONE: BACKGROUND, PROBLEM STATEMENT AND THE FINANCIAL INCLUSION DISCOURSE

1.1 Introduction

Financial inclusion simply refers to the extension of financial services of different kinds to those who do not have access to these services, otherwise referred to as the financially excluded. Many scholars and development practitioners view financial inclusion as a development strategy that will solve the challenges of poverty and inequality. It is with this idea that international institutions, such as the World Bank and others, in the past two decades have made spirited efforts in marshalling financial institutions, especially in the developing world where poverty is rampant, to implement financial inclusion strategies that would see more poor people access formal financial services. These institutions include co-operative societies that have a rich history in Kenya and are particularly popular among low- to middle-income earners. It also includes different types of institutions engaged in digital lending which have developed since the late 2000s when financial innovations – M-Pesa and its spin-offs – put Kenya on the map. At issue is looking at how these co-operative societies and digital lending institutions attempt to include people financially and identifying the possible socio-economic consequences of their financial inclusion strategies.

This chapter gives a background of the study and presents the research problem and the research question. The sections that follow set out the theoretical framework of the study which is informed by the financial inclusion discourse. The chapter critically examines the propositions made by proponents of financial inclusion, criticisms advanced about its perceived benefits, and the social implications of key financial inclusion strategies. Thereafter, the chapter highlights the concepts of financialization and co-operative degeneration which are closely linked to the push for financial inclusion. The last two sections provide a description of the rationale and contribution of this study as well as the overall structure of the thesis.

1.2 Background

Co-operative societies in Kenya have a long history. This history dates back to the colonial period and predates the 'microfinance years' and the subsequent popularization of financial inclusion. The first

co-operative societies formed by Africans were based in the agricultural sector, formed by farmers on communal land clubbing together to sell their produce and purchase farm inputs. Principally, members organized co-operatives around their economic activities and their geographical setting. This shared characteristic is referred to as a 'common bond' which has been an integral feature of the co-operative model and is seen as part of the reason co-operatives have been relatively successful in Kenya.

By the early 1970s, co-operatives were encouraging members to save with the society to which they belonged. Co-operatives intermediated these savings into affordable loans co-guaranteed by other members and mainly used to buy farm inputs. This form of lending was quite straightforward and dispensed with the need for physical assets, which allowed co-operatives to flourish where banks had limited capacity to make credit widely accessible. Later in the twentieth century, the scope of co-operatives extended beyond agriculture with the emergence of two broad new common bonds. These were common bond by occupation, for example a group of teachers, and common bond by the fact of a common employer, for example employees of a government department or a private corporation. Co-operatives would also develop new loan types, such as the school fees loan, emergency loan, and home development loan.

The co-operative model is distinct in several ways from other institutional forms. To begin with, co-operatives are dual-purpose organizations, given that they seek to satisfy some social goals while offering some economic benefits to their members. Secondly, being member-owned organizations, co-operatives are democratically controlled organizations that keep their services affordable and have attractive connotations of collectiveness. This collective sense of purpose is important in building relationships among members and between members, which provides co-operatives with a natural competitive advantage (Rowe & Barnes, 1998). Likewise, Byrne, McCarthy, Ward, and McMurtry (2012) suggest that the key strength of co-operatives is not the core product but rather the ability to build a close and long-term relationship with their members.

The ideologies of co-operation and solidarity are crystallized into seven co-operative principles namely open and voluntary membership, democratic member control, member economic participation, autonomy and independence, education and training, co-operation among co-operatives and concern for the community. These principles are widely perceived as the invisible force behind the growth of co-operatives worldwide. However, the co-operative movement in Kenya has faced several monumental challenges over the years. To begin with, the co-operative movement was under tight

state control from independence to the end of the twentieth century. The strict oversight of co-operatives by government in the pre-liberalization era undermined their autonomy and democratic running and diverted their focus from the members who formed them. Another challenge came at the turn of the twentieth century when a large number of co-operative societies collapsed, due to a multiplicity of reasons, after the sector was liberalized. A series of legislations and sector reforms, however, succeeded in stemming the tide of mismanagement and collapse.

Even with their unique model highlighted above, co-operatives until the late 2000s had limited capacity to serve a significant segment of borrowers due to the common bond restrictions. The common bond rule required that new members share some strictly prescribed attributes with the existing membership as earlier highlighted. For many, this rule varied greatly from the goal of financial inclusion which, at the time, was gaining traction globally. This led to co-operatives tweaking the common bond rule over time. This tweaking of the co-operative model, however, led co-operatives to abandon their socialist roots and mutate into more capitalist organizations, adopting much of the practices of other financial institutions. Global trends, especially from mature co-operative movements, greatly influenced the transformation in the co-operative model.

Financial inclusion discourse has promoted the use of digital access channels as the ultimate means of achieving financial inclusion. The discourse has celebrated financial innovations, such as mobile money and digital lending, as vehicles for financial inclusion and these innovations have put Kenya on the map in this regard, earning it the title 'Silicon Savanna'. This title draws inspiration from 'Silicon Valley' in San Francisco which is home to global tech giants. The leading mobile money operator in Kenya, Safaricom, launched its mobile money service, M-Pesa ('M' is short for 'mobile' and 'Pesa' means 'money' in Swahili), in 2007 as a convenient and cheap means of transferring money. Kenyans adopted mobile money quickly and in large numbers, abandoning some of the services offered by commercial banks.

In 2008, the World Bank Group, the International Financial Corporation, and other sectoral players organized the inaugural Mobile Money Summit in Cairo. The summit brought together central bankers, financial services institutions, mobile network operators (MNOs), development organizations, and solution vendors, among others, with the overall aim of fostering collaboration in scaling up mobile money deployments. The timing of the Cairo summit was far from accidental. Industry players were flushed with the instant success of M-Pesa and were enthusiastic about the

prospects that mobile money held for the market. The main outcome of the Cairo summit was that 'digital financial services can help poor people forge their own paths out of poverty' (Jenkins, 2008). This, it was argued, could be achieved through mobile technology providing savings and credit facilities that increase poor people's incomes, build investments, and reduce their vulnerability to financial shocks (ibid). The deployment of digital lending platforms was seen as a market opportunity and as a poverty alleviation tool and was therefore in keeping with the prescriptions of the international financial inclusion lobby.

The mobile money industry has significantly influenced developments in the financial services industry. The rapid adoption of mobile money presented strong incentives for banks to partner with M-Pesa and set up mobile banking (M-Banking) platforms which link customers' mobile money accounts and their bank accounts to initially facilitate round-the-clock deposits and withdrawals. It was not long before banks fashioned their mobile banking platforms as a new channel on which to offer unsecured loans to their customers and in some cases to the mass market. The Commercial Bank of Africa (now NCBA Bank) led the charge by partnering with M-Pesa to provide the inaugural mobile-based loan service, M-Shwari, in 2012. In the last decade, digital lending has moved from novelty to mainstream; other banks, local and international private financial technology (fintech) outfits, as well as other financial and non-financial institutions quickly followed suit, offering unsecured digital loans of various kinds. The sheer pervasiveness of digital lending in Kenya has seemingly unlocked credit for the country's financially excluded, to great acclaim.

The last decade also saw the commencement of credit information sharing through Credit Reference Bureaus (CRBs) in Kenya. CRBs collect historical data on an individual's borrowings and repayments and use the information to compute credit scores. Digital lenders make use of these scores alongside a wealth of alternative data obtained from third-party sources or mined from the borrower's mobile devices. The lender feeds this wealth of data and credit scores into its proprietary algorithms which then assign the borrower a credit limit. The credit limit reflects a borrower's capacity to borrow and their likelihood to repay their loan. A borrower's credit limit improves or deteriorates over time, depending on their borrowing and repayment behaviour. Carlson (2017) describes this 'carrot-and-stick' strategy as the dynamic incentive model where lenders increase the opportunity cost of default by excluding defaulting borrowers from access to additional credit. Conversely, the good borrowers, or the 'cream' as Di Maggio and Yao (2018) describe them, are rewarded with future access to progressively larger loans conditional on repayment. This development points to a fast-moving trend

in Kenya and one can see a shift over the past two decades in personal loan making from a situation in which traditional lenders – banks, co-operatives, and microfinance institutions – had knowledge of the circumstances of the relatively small circle of borrowers, to the present situation where lending decisions are made impersonally and remotely using inscrutable algorithms which use information collected on a borrower.

1.3 Problem statement

The overall logic of financial inclusion is to have poor people access affordable financial services that are useful to them with the belief that longstanding socio-economic challenges, such as poverty and inequality, will be alleviated in the process. Kenya is an interesting case study of the extension of personal credit for two reasons. First, co-operatives have long been important institutions in Kenya, and they have played a salient role in extending credit to Kenyans who could not access credit from banks, well before the discourse on financial inclusion came into vogue. Second, Kenya has been at the forefront of the global development of mobile money since the mid-2000s, after which all of Kenya's banks and other financial and non-financial institutions have partnered with mobile money operators to deliver easy and convenient access to formal financial services, including personal credit. While both the co-operative and digital lending models have been somewhat successful in reaching out to disenfranchised, low-income populations, the net benefit of co-operative and digital lender strategies to the consumers is unclear. The effectiveness of these two financial inclusion strategies is neither self-evident nor historically obvious. The question of which lending model works better for financial inclusion is one that this study grapples with.

The means used to achieve financial inclusion are undeniably important. I take it that the manner in which co-operatives and digital lenders go about financial inclusion is just as important, if not more important, as the result (financial inclusion). However, various strategies used to ostensibly promote financial inclusion have been lauded and criticized in equal measure in the literature. While many accounts praise the ideology of co-operation as a way of shoring up the poor, others criticize the recent commercial outlook of SACCOs in the name of financial inclusion. Similarly, digital lenders seem to have solved a clear gap in the credit market, while accounts of growing over-indebtedness and financialization of the poor, among other adverse consumer outcomes, are worrying trends that accompany the pursuit of digital financial inclusion. The puzzle deepens when we observe the spirited manner influential financial institutions are popularizing the financial inclusion discourse. Given that

these financial inclusion strategies are mostly targeted at the vulnerable in society, and more particularly in the developing world, there is a need to study whether deployed financial inclusion strategies are sound or whether they propagate or exacerbate the problems of poverty and inequality.

1.4 Research question and objectives

This research aimed to study the personal credit industry in Kenya, particularly how co-operative societies extend credit to their members and whether the co-operative model works better than the digital lending model in advancing financial inclusion. This study explored the emergence of the two lending models, successive developments, and how these developments have contributed to the current state of financial inclusion in Kenya.

My main research question was 'is the co-operative lending model perceived to work better than the digital lending model in promoting financial inclusion in Kenya?'

To this end, this study has attempted to address the following three objectives:

(i) To explore the rise of digital credit in Kenya and its consequences.

(ii) To describe how co-operatives work in Kenya, in particular how they extend credit.

(iii) To determine how the co-operative lending model and the digital lending model seek to advance financial inclusion.

1.5 The financial inclusion discourse

The financial inclusion discourse was preceded by the upsurge of microfinance in the 1990s. Microfinance was pioneered by Nobel laureate Mohammed Yunus who founded the Grameen Bank in Bangladesh in the early 1980s. Microfinance set out on the ambitious goal of making the world's poor self-sufficient and eliminating poverty through the extension of microfinance services, such as microcredit, micro-savings, and micro-insurance, to the poor. The fundamental idea of microfinance was that the poor and ultra-poor can come together to satisfy their financial needs through microfinance institutions (MFIs), given that larger financial institutions did not consider poor people as viable customers. At the time, the Grameen Bank microfinance model was heralded as ground-breaking and went on to win many accolades including the Nobel peace prize; the United Nations also declared 2005 to be the International Year of Microcredit.

As the microfinance years wore on, a lively debate emerged about the potential of microfinance to alleviate poverty and about the claimed positive impacts of microfinance programmes. Duvendack, et al (2011), for example, note that most of the evidence in support of the effect of microfinance is anecdotal and inconclusive. Along similar lines, Armendariz de Aghion and Morduch (2005) point out methodological weaknesses and the lack of quantitative robustness in the studies that acclaim the positive outcomes of microfinance. Bateman and Chang (2012) equally reject claims that microfinance has been positive for sustainable poverty reduction and declare claims of local economic and social development as overblown and false.

The financial inclusion discourse emerged in the early 2000s and is mostly seen as an extension of microfinance (Mader, 2018). Soederberg (2013) posits that financial inclusion helped re-frame the earlier emphasis on microfinance as the market-based solution to poverty. Beck (2016), however, argues that financial inclusion is a broader concept than microfinance. Beck (2016) claims that unlike microfinance, which refers to the provision of microfinance services to specific groups at the lower end of the market using specific delivery methods and institutions, financial inclusion entails expanding access to financial services to previously unbanked individuals who are typically poorer and live in more remote areas. Financial inclusion also encompasses a much broader range of financial services and providers (Soederberg, 2013).

At the forefront of the push for financial inclusion were influential international institutions, such as the World Bank and G20's (Group of Twenty's) Global Partnership for Financial Inclusion (GPFI)[1]. They were backed by boutique consultancies, such as the Consultative Group to Assist the Poor (CGAP)[2] and influential private foundations such as the Bill and Melinda Gates Foundation, the Omidyar Network, and others. The grand proposition was that extending a variety of financial services to those who could not access them, the so-called unbanked, would solve pressing global issues of poverty and inequality. Since the mid-2000s, financial inclusion has been at the top of the development agenda of many countries and institutions, particularly in the Global South which is home to a majority of the 31% of the world's adults (1.7 billion people) who lack access to financial services (Demirguc-Kunt, Klapper, Singer, Ansar & Hess, 2018).

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[1] Global Partnership for Financial Inclusion is the financial inclusion lobby for the G20 and was founded in 2010.

[2] CGAP, Consultative Group to Assist the Poor in full, is a think tank supported by over 30 leading development organizations, such as the Bill and Melinda Gates Foundation, the World Bank, International Financial Corporation, MasterCard Foundation and many others. The CGAP was founded in 1995 at the height of microfinance and is housed at the World Bank Headquarters in Washington D.C.

In recent years, there has been a growing appreciation of the multi-faceted nature of financial inclusion. This was in the realization that even though a growing population obtained bank accounts, they were not using these accounts for one reason or another. This proves or indicates that the financial services in question are poorly designed, expensive, or generally not useful to these bank account owners' needs. This new category of financially excluded persons is commonly referred to as the underbanked or underserved. There was therefore an imperative to broaden the definition of financial inclusion to encompass aspects of affordability, convenience, and quality of financial services. The Financial Inclusion Data Working Group of the Alliance for Financial Inclusion (AFI)[3] defines financial inclusion along three dimensions: (i) access to financial services, (ii) usage of financial services, and (iii) quality of products and services delivery (Alliance for Financial Inclusion, 2019).

Implicit in this discussion are the metrics used to measure financial inclusion. When financial inclusion came into the limelight in the early 2000s, account ownership with a formal (regulated) or semi-formal institution was the metric used to measure financial inclusion. Account ownership was and is still seen as a gateway to other financial services, particularly formal credit. The advent of mobile money in 2007 expanded financial inclusion metrics to include ownership of a mobile money account. For this reason, the World Bank, through its triennial Global Financial Index reports, credits the global increase in financial inclusion to the rapid adoption of mobile financial services (Demirguc-Kunt et al., 2018). Similarly, the biennial Kenya Financial Access (FinAccess) Household Survey by the Central Bank of Kenya (CBK), which monitors financial inclusion in Kenya, points out that mobile money and its related services have effected growth in financial inclusion from 23.7% in 2006, just before the advent of M-Pesa, to 83.7% in 2021 (CBK, 2021).

The measures of financial inclusion have also been evolving in tandem with the growing recognition that financial inclusion is a multifaceted phenomenon, as highlighted earlier, and is not only about access to financial services. Beck (2016) makes the case that focusing exclusively on account ownership as a headline indicator of financial inclusion is inappropriate; this is because the positive impact of financial inclusion on individuals and the economy as a whole does not come solely through the ownership of accounts but rather through their active use.

[3] The Alliance for Financial Inclusion, founded in 2008, is an organization whose membership comprises central banks and other financial regulatory institutions from 75 developing countries.

The above arguments have recently led to the revisiting of financial inclusion metrics and have encouraged a move away from binary measures, that is whether one has an account or not (and is therefore included or excluded), to metrics that take account of the three facets of financial inclusion. The Kenya FinAccess survey and Global Financial Index reports highlighted above include usage as a proxy measure of quality and, to a lesser extent, affordability of financial services alongside account ownership as a measure of access. In this sense, there has been a move away from using demand-side measures (account ownership) to using more supply-side measures, such as usage.

Leveraging technology to promote financial inclusion, commonly known as digital financial inclusion, is pivotal to the financial inclusion project. This is because financial technology provides a range of financial services at scale to a much broader set of users, transcending social-economic and geographical settings. Beck (2016) points out that this is made possible through the innovation of new delivery channels, new products, and new intermediaries. Specifically, technology solves two key issues affecting the provision of financial services. First, technology solves the issue of easy and convenient access, given that the majority of the population has access to mobile phones. With technology, financial services can reach rural populations whom the mainstream financial institutions are unable to reach. Secondly, Bharadwaj and Suri (2020), Kendall and Voorhies (2014) and Ouma, Odongo, and Were (2017), among others, argue that technology reduces the back-end costs of extending financial services to the poor thereby freeing up more disposable income for low-income households. Likewise, Ozili (2018) suggests that fintech leads to greater financial intermediation and greater economic stability, and could boost economic development through improved aggregate expenditure.

Many accounts in the literature posit that mobile-based financial technology is central to the push for financial inclusion. Ouma et al. (2017), Kpodar and Andrianaivo (2011), and Ouma, Misati, and Njoroge (2012) note that the growing and deepening scope of mobile phone financial services significantly promotes financial inclusion, especially in low-income countries. After the incipient mobile money service was launched in Kenya, numerous mobile money platforms were deployed across different markets and were widely adopted. Carlson (2017) notes that by 2015, 271 mobile money platforms had been deployed in 93 different countries, with an additional 110 in the works and that 411 million people operated mobile money accounts at the time. Further, CBK (2019) credits mobile financial services with narrowing the disparities in access and use of financial services between rich and poor, men and women, and rural and urban areas in Kenya. Indeed, it is often surmised that technology is an ‘equalizer’ and therefore critical to financial inclusion efforts. However, Kofman and

Payne (2020) observe that despite this improved access to digital financial services, inequality and inequity across societies in both developed and emerging economies persist. This brings me to a theoretical debate about the perceived benefits and mounting criticisms of financial inclusion strategies.

1.6 Theoretical debates on financial inclusion

The discourse on financial inclusion informs the theoretical framework of this study. Ringing endorsements from the international lobby for financial inclusion were instrumental in formalizing and shaping the discourse on financial inclusion. The notion of financial inclusion draws significantly from earlier work by Coimbatore Prahalad, who made the case that there was a 'fortune at the bottom of the pyramid' for business enterprises of various kinds. Prahalad (2005) argues that the real source of market promise is not the wealthy few in the developing world, or even the emerging middle-income consumers, but the world's poor. He makes a reasonable argument for this, saying that because they constitute the majority of the population, the poor should be able to participate in the global market economy, even with the extreme inequity of wealth distribution. Prahalad (2005) argues that this form of 'inclusive capitalism' will lead to a 'win-win' scenario for both the poor consumers and the corporations. However, he offers a qualification to his proposition and stresses that this win-win situation will only come about if the goods and services are firstly 'tailored' and secondly 'accessible' to the poor. Finally, Prahalad (2005) suggests that designing goods and services for the poor will require radical innovations in technology and business models.

In agreement with the foundational work by Prahalad, Duncombe (2012) posits that digital financial services can be appropriate to the needs of the poor if these services are carefully designed to map onto pre-existing and socio-culturally entrenched financial practices and norms. By the same token, Maurer (2012) suggests that indeed profitability and financial inclusion go hand in hand; the poor constitute a relatively untapped market for enterprises looking to increase revenue and, in the process, to provide services that enhance financial access.

Literature abounds with claims about the positive socio-economic outcomes of financial inclusion. The most significant and controversial of these propositions is that extending financial services to the financially excluded, who are mostly poor, will reduce poverty and inequality. This proposition was most prominently canvassed in the World Bank's (2014) *Global Financial Development Report 2014* and a

handbook titled *Access for All* (Helms, 2006) by a World Bank acolyte, the CGAP. In agreement, Suri and Jack (2016), while doing a study on the impact of M-Pesa, argue that the service has lifted 2% of Kenyan households out of poverty. In a later study, Bharadwaj, Jack, and Suri (2019), while studying the first and largest digital lending platform in Kenya, M-Shwari, back the notion that unsecured lending to the poor is a sound development strategy. Likewise, Imboden (2005) emphasizes that access to financial services which are adapted to the poor is critical to poverty reduction. Chibba (2009) suggests a nexus between financial inclusion, poverty reduction, and the Millennium Development Goals, which, if strengthened, could foster economic and social progress in developing countries that are the prime targets of the three interventions.

Beyond the larger claim that financial inclusion reduces poverty, numerous studies associate financial inclusion with several positive consumer outcomes. For example, financial inclusion has also been associated with increased entrepreneurship. In their study highlighted above, Suri and Jack (2016) find that the use of mobile money has spurred entrepreneurship among women. This mirrors results from an earlier study by Dupas and Robinson (2013) which finds that access to bank accounts has enabled women in Kenya to expand their businesses, among other benefits. Ouma et al. (2017), Björkegren and Grissen (2018), and Bharadwaj and Suri (2020) argue that extending credit and savings services improves the financial resilience of poor households. Further, Hariharan and Marktanner (2012) and Sarma and Pais (2011) suggest that access to financial services could help increase household income while Jack and Suri (2011) suggest that it could help poor households make investments.

Over and above the highlighted benefits to households, several studies argue that financial inclusion has had benefits for the wider economy. Hannig and Jansen (2010) and Ahamed and Mallick (2019) suggest that financial inclusion could lead to diversification of service channels and providers and could lead to a more stable financial sector over time. Bold claims of the positive impact of financial inclusion are widespread and have been instrumental in popularizing the financial inclusion message over the last decade and perhaps in shaping the behaviour of different actors in the financial services industry, particularly innovators, regulators, and financial institutions.

The wisdom and effectiveness of financial inclusion strategies have, however, been the subject of fierce debate in recent times, with the extension of credit in the form of personal loans to poor people being the most controversial of these strategies. The critics can be broadly divided into two categories

– those who make arguments about adverse socio-economic implications of financial inclusion and those who reject evidence about positive outcomes of financial inclusion.

The first group of critics focuses on the social consequences of extending credit to the poor – microcredit – which is the most prominent form of financial inclusion. For example, James (2014) explores over-indebtedness in post-apartheid South Africa. James (2014) gives a moving account of the plight of poor borrowers who take up more expensive loans from local moneylenders, 'mashonisas', to repay cheaper ones from financial institutions, which inevitably entraps them in debt. She further documents the abuse of garnishee orders which are used to safeguard repayment from borrowers' salaries or wages when they fail to meet their loan obligations.

Milford Bateman, through several publications, is the most notable critic of digital lending, particularly in Kenya. Bateman (2018) describes how the promise of small digital loans to the unemployed youth in Kenya has brought about growing over-indebtedness, something often overlooked by proponents of digital financial inclusion. Bateman, Duvendack, and Loubere (2019) further argue that the poor and poor countries are 'dispossessed' through profiteering by global corporations. Similarly, Wamalwa, Rugiri, and Lauler (2019) and Di Maggio and Yao (2018) note that the delivery speed of digital loans is particularly appealing to borrowers who tend to use these funds, in conjunction with other forms of credit, to sustain their consumption, which ultimately makes them more financially vulnerable. Bateman et al. (2019) suggest that predatory lending, as evidenced by a surge in uptake of unsecured loans and growing over-indebtedness, bears reflection on whether financial technology is shaping the future of the credit market and essentially propagating the status quo of poverty and inequality.

Another growing body of research focuses on the commodification of information and digital footprints in the practice of using technology-based tools to assess a borrower's creditworthiness. In her book, *The Age of Surveillance Capitalism*, Shoshana Zuboff (2019) describes this perturbing trend as 'surveillance capitalism'. She describes surveillance capitalism as a new expression of power by mega tech companies and financial institutions who collect oceans of personal data which they render as behavioural data, claim ownership of it (commodify it), and then utilize it as a mechanism of profiteering and even control. Gabor and Brooks (2017) point out that the digital lending model depends on predictions from algorithms to extend as many expensive loans to as many people as possible in the hope that these loans will realize high repayment rates and make a neat return. Using credit reference bureau data on United States (US) consumers, Di Maggio and Yao (2018) point out

that fintech lenders acquire market share by first lending to higher-risk borrowers and then to safer borrowers while relying on information to make lending decisions. This practice of assessing a borrower's creditworthiness makes digital lenders more prone to adverse selection and this is evidenced by the high default of digital loans compared to loan defaults in traditional financial institutions (ibid).

In her book, *Weapons of Math Destruction*, O'neil (2016) takes a dim view of the blind use of 'big data' and algorithms to gauge the creditworthiness of borrowers. She notes that human biases are programmed into algorithms and that algorithms may discriminate when calculating who gets a higher or lower credit score, or as she puts it 'selecting winners and losers' in the credit market. Conversely, algorithms could also lead to adverse inclusion where individuals access loans but do not actually have the financial wherewithal to pay back the loans, leading to so-called 'predatory lending' (ibid). She points out the opaque nature of algorithms and argues that the lack of a 'feedback-loop' to correct any biases entrenches inequality in the credit market.

A related issue pertains to the lack of consumer protection for digital loans, as compared to formal sources of credit. Until recently, the digital lending industry in Kenya had been unregulated. While this seemed to have led to the rapid growth of the sector, it is equally seen as a key reason why some irresponsible lending practices have cropped up in the industry over the past ten years. McKee, Kaffenberger, and Zimmerman (2015) observe that users of digital loans do not fully understand the terms of the loans and that consumer protections for these digital loans are still in their infancy. Francis, Blumenstock, and Robinson (2017b) note that digital loans are predatory in nature and tend to look like payday loans in the developed world. This is on account of their short repayment periods and high borrowing costs. From the above accounts, it appears that despite the initial triumphs of mobile money and its derivatives, mounting concerns about the socio-economic cost of digital lending make this model altogether more sinister.

Above all, the most criticized aspect of financial inclusion is the adverse gains of this drive to extend financial services. While, on the face of it, financial inclusion appears as a reasonable endeavour, debate is rife about who exactly it benefits. Some critics see financial inclusion as a veiled message that lays the foundations for financial inclusion to profit at the expense of the poor, mostly in the developing world – the so-called financialization of the poor. Soederberg (2013) pays attention to the balance of power inherent in global finance and how this plays out in the push for financial inclusion. She argues

that the financial inclusion narrative, as advanced by the G20, is not a neutral project but rather is emblematic of the trend towards finance-led capitalism. This trend, she argues, only serves to benefit capital interests through financial inclusion strategies obscuring and concealing exploitative relations and speculative tendencies.

Gibson (2016) offers an illustration of Soederberg's rebuke of the financialization of the poor when pointing out that while indeed millions of people have gained access to formal financial services since the push for financial inclusion started in Kenya, the banks, and not the poor, have been the biggest beneficiaries of this drive. He notes that the 'inclusion years' have seen banks increase their turnover by 2.5 times and profits by 3.5 times, with profit margins equally increasing. Ultimately, Bateman and Teixeira (2021) and Soederberg (2013) stress that these investor-driven financial inclusion strategies co-opt the poor, in a rather opaque manner, into global strategies of capital accumulation. They suggest that Prahalad's assertion of a win-win scenario between the corporations and poor consumers is far from assured.

Bateman, Blankenburg, and Kozul-Wright (2018) compare the international development community's excitement about and rapid popularization of fintech to their response to microcredit in the 1990s. Bateman et al. (2019) argues that behind the financial inclusion message are self-interested corporations, many of which have a chequered past, hoping to cash in on the wave. Bateman et al. (2019) view the digital lending industry as an extractive sector where private international corporations give small loans to the poor in the pursuit of returns with no regard for the effect of their strategies on the poor. They describe this as 'digital extractivism', comparing it to the colonial period where natural resources were appropriated from African countries. They also point out that technological infrastructure and the rapid diffusion of mobile technologies, such as mobile money and digital lending platforms, particularly in developing countries, are facilitated by global finance networks and re-order the poor as subjects of profit-making.

Natile (2020) offers another contribution to the notion of digital extractivism and, using the case of M-Pesa, argues that digital financial inclusion proliferates financialized fee-based opportunities as opposed to equipping the unbanked poor with the means to take advantage of financial services the platform offers; the poor contribute greatly to the profit of digital financial service providers such as M-Pesa and some form of profit-redistribution could augur well for financial inclusion. Similarly, Bateman et al. (2019) stress that the investor-driven fintech model makes profit-making (to the benefit

of the elites) the focus and is the biggest threat to fintech realizing its potential. Philippon (2016) resounds this view and stresses that financial innovations have neither delivered significant benefits to consumers nor improved the overall efficiency of the financial system. He points out that rent-seeking (the charging of transaction fees) is the main motivation for fintech innovations. Soederberg (2013) finds Prahalad's (2002) view of the poor as the new frontier for profit-making, as discussed earlier, highly problematic.

The second group of critics focuses on the evidence underlying the claims about the ostensible benefits of financial inclusion. They argue that these claims are exaggerated and that the evidence to support them is weak. Much in the same way that Armendariz de Aghion and Morduch (2005) and Duvendack et al. (2011) call for more robust evidence to support claims about the positive effects of microfinance, Bateman et al. (2019) term Jack and Suri's (2011) claims about the potential of fintech, M-Pesa in particular, in reducing poverty in Kenya as egregious. One of the most telling observations that Bateman et al. (2019) point out is the messy reality of lending to the poor – particularly unemployed young men – who use the digital loans to gamble, leaving them disillusioned and over-indebted.

In the same way, Mader (2016) examines studies and source texts used to support the main claims about the positive outcomes of financial inclusion and argues that evidence to support these claims is weak. He critiques three common assumptions made about financial inclusion; the first two assumptions surround the notion that financial inclusion would bring developmental benefits to the economies of 'developing' countries as well as direct benefits to poor individuals in these countries. The third assumption is one that Prahalad (2002) and others advanced earlier about there being an untapped business opportunity in offering financial services to the indigent.

By my reading, Mader (2016) does not precisely dispute the overall rationale of financial inclusion, but rather stresses the improvement of the evidence base to support claims made about the outcomes of financial inclusion. Mader (2016) suggests that unrealistic assumptions could lead to false expectations of impact, misallocated political and economic resources, misconceived interventions, and potentially even harmful effects on the intended beneficiaries. His view mirrors Johnson and Rogaly (1997) who had earlier cautioned that the impact of microfinance on poverty reduction should be continually assessed rather than taken for granted.

The problem as presented thus far has been summed up as a debate between antinomies at the ends of the financial inclusion discourse. There is little common ground in the financial inclusion debate. This conflicting body of theory regarding the best strategy to go about financial inclusion presents a problem for policymakers and financial institutions who seek to realize the momentous goal of reducing poverty and inequality. I take it that a binary situation, such as the one presented, renders it difficult to discern the nuances and subtleties of financial inclusion strategies and to visualize a more sustainable pathway to financial inclusion.

My consideration of the discourse on financial inclusion is not to argue for or against financial inclusion but rather to focus on how the co-operative and digital lending models in Kenya attempt to achieve it. I avoid taking the line of simply deconstructing the financial inclusion discourse, as has been done by critics, and rather take a more cautionary but constructive approach, like the one taken by Mader (2016). I propose that financial inclusion is not in itself objectionable, but that the means of achieving it matter a great deal. In other words, financial inclusion is only as good as the means used to achieve it.

1.7 Financialization

In the last few decades, just as the financial inclusion discourse was emerging, there has been a change in the way capitalism is practised all over the world. This change has been described in the academic world as financialization and is useful in contextualizing the push for financial inclusion outlined above. There are varied conceptualizations of financialization in the literature. The most prominent conception is by Epstein (2005) who describes financialization as 'the increasing role of financial motives, financial markets, financial actors and financial institutions in the operation of the domestic and international economies' (page 3). Lapavitsas (2011) theorizes financialization as a systemic transformation of capitalism, especially in advanced capitalist economies, that takes place at three levels, namely non-financial institutions, financial institutions, and households. Davis and Kim (2015) describe it as the increasing importance of finance, financial markets, and financial institutions to the workings of the economy. Their conception mirrors Lapavitsas (2011) who observes that financialization manifests in the growing size and presence of financial institutions, financial transactions, and activities in the economy as a whole and in the everyday lives of people.

In my conceptualization of financialization, I draw on different aspects of the descriptions set out above. Financial institutions have always had a great imperative to provide their customers with financial products and services that suit their different needs. This involves constant innovation and differentiation strategies and novel consumer targeting approaches. Finance has penetrated everyday life and ordinary people have also been drawn into the financial system like never before. I perceive financialization as the blurring of traditional definitions of financial actors, which primarily takes place through the innovation and differentiation of financial products and the use of these products in the everyday lives of ordinary people.

The process of financialization traces its origins to the transformations in Anglo-American capitalism in the 1970s and the 1980s. It is widely believed that this process started when mortgage-backed securities were devised in the US in the 1970s (Sherman, 2009; Soederberg, 2013). This involved the packaging of individual mortgage loans into security or securities which were required to conform to prescribed underwriting standards and sold off to institutional investors, such as pension and mutual funds. The innovation of asset-backed securities was soon followed by the deregulation of the banking sector in the US and the United Kingdom in the early 1980s and the deregulation of the London Stock Exchange in 1986. The significance of deregulation was that banks could issue more loans and invest in speculative securities while the stock market had renewed focus on the packaging of risky debt instruments. This trend in financial deregulation and the resultant transformation of capitalism replicated itself in other advanced economies soon after and eventually found its way to pockets of the Global South over the last three decades.

The notion of financialization is grounded on the idea that there is a shift in the way that profit-making has evolved in recent decades. Krippner (2005) suggests that this shift is depicted by a change in making a profit through the trading of financial assets rather than the production and trade of commodities which Mazzucato (2013) and others describe as the 'real economy'. Lapavitsas (2013) describes this shift as 'profiting without producing'. He adds that in most if not all advanced economies, this finance-led growth manifests clearly in the weak growth in productivity despite significant advancements in technology. Instead, the production of commodities has been taken to China, which is home to arguably the biggest manufacturing conglomeration, India, and other destinations (ibid).

Production is the thread that runs through successive periods in history – the agrarian period, the industrial revolution, and the post-industrial period before the onset of financialization. In the old order, financiers would put money in the hands of the industrialists who would invest in the production of commodities while engaging labour. Under this arrangement, financiers had the role of initiating the process of creating value, while interest was paid to the financier as compensation for the producer using borrowed capital. Through the process of financialization described above, the order has shifted to a situation where finance plays a speculative role. Put differently, investors make 'bets' on what other investors in the market are doing rather than creating jobs and catalyzing the development of new businesses. This shift in the notion of profit, therefore, is one from 'productive profit' to 'speculative profit'.

Financialization is apparent in different layers of society and the economy. Lapavitsas (2011) suggests three sites of financialization, namely financial institutions, non-financial institutions, and households and individuals. His view is backed up by numerous accounts, mostly by fellow economists, including Mazzucato (2013), Krippner (2005) and others. The first site of financialization, financial institutions, is unsurprising given that banks and other financial institutions are the traditional custodians of capital. Financialization among banks is most evident in the way that they are growing in sophistication and size, especially in advanced economies. Banks have become investment establishments that utilize their big pools of capital to fund massive deals in the financial markets and are essentially stuck in a loop of buying and selling financial assets in the strangle for profit.

Another way that financialization is apparent in financial institutions is through their efforts in packaging sophisticated, highly speculative debt instruments for the financial markets. As earlier mentioned, asset-backed securities surfaced in the US as early as the 1970s when the process of financialization is believed to have commenced. Over time, other sophisticated financial instruments have emerged and include different types of bonds, options, futures, swaps, and other types of derivatives. The devising of these financial instruments and dedicated marketplaces to trade in them, and close monitoring of financial markets to identify profit opportunities, evidence this shift in financialization.

Financialization in financial institutions also manifests in the corporate culture of these institutions which emphasizes maximizing returns and increasing shareholder value. While these institutions have always been fashioned as profit-making entities, the intensified push for returns has given rise to

'activist investors', both institutional and retail, who are exceedingly keen on returns and capital gains on their investment. This puts financial institutions under great pressure to improve yields for these financial instruments and boost the asset prices for their investors. Further, the corporate culture is evident in the level of executive pay in financial institutions which are typically tied to the institution's performance.

The second site of financialization is non-financial enterprises, otherwise called 'big businesses'. Financialization has brought about institutional flexibility in that non-financial enterprises have acquired some characteristics of financial institutions. The first way that this is apparent is in the shift from productive profit to speculative profit, as I touched on earlier in this chapter. Krippner (2005) records one of the earliest accounts of this trend in the literature. She observes an interesting trend where non-financial enterprises derive revenues and make a profit from financial investments as opposed to the production of commodities. Put differently, non-financial enterprises are becoming more bank-like as they substitute productive activity for financial activity in their day-to-day operations. Lapavitsas (2013) echoes this and points out that quintessential industrial and commercial enterprises have amassed large pools of capital from retained profits and have moved away from saving in banks to earn interest on a modest but guaranteed return to investing in speculative financial assets on the open market in the hope that they will make large profits.

The second way that financialization is apparent in non-financial enterprises is their involvement in financial activities beyond investing in financial instruments. This is evident through mostly technology and commercial companies providing different types of financial services. Prominent among these services are digital payment services through platforms such as Apple Pay by Apple, Google Pay by Google, and Alipay by Chinese e-commerce giant Alibaba, and many others. Financial services provided by non-financial enterprises has grown in scope since this trend emerged roughly two decades ago. For example, in the US, Amazon now offers financial services, ranging from cash deposits, payments, and lending to insurance. Similarly, Google has a venture capital investing arm, Google Ventures, which boasts a large portfolio of technology-related investments.

This trend in non-financial enterprises venturing into the provision of financial services is also apparent in Kenya with Safaricom's M-Pesa being by far the clearest example. While M-Pesa is well known for its mobile money transfer service, it has ventured into the digital payments industry with 'M-Pesa Paybill' and 'Lipa na M-Pesa' services, as well as savings and digital lending services in

partnership with two large commercial banks, Kenya Commercial Bank (KCB) and NCBA. Notably, M-Pesa, which is the legacy part of Safaricom's business, now accounts for 36% of all Safaricom's total revenues, making it the largest revenue stream for the company, surpassing revenue from voice calls, messaging, data, and other services (Safaricom, 2022). Safaricom has also grown to become a lending behemoth after partnering with leading local banks. This demonstrates non-financial enterprises relying on the provision of financial services as their source of income and profit.

Of particular interest to this study is the growing role of non-financial enterprises in performing financial disintermediation. In Kenya, as anywhere else in the world, the provision of credit was for a long time the domain of banks and similar financial institutions. However, lending through digital channels has transcended institutional boundaries. With financialization taking root in non-financial enterprises, the middleman (banks) is cut out of the credit value chain, leaving non-financial enterprises to provide credit directly to borrowers. For instance, General Electric, a quintessentially industrial corporation, has financial services subsidiaries, GE Capital and GE Money, which offer a wide range of financial services, including banking, credit cards, and mortgages. As I will show, there is an increasing number of non-financial enterprises in Kenya who now offer digital loans in cash or in kind. The increased involvement of industrial and commercial enterprises in the provision of financial services is a clear demonstration of how these enterprises have financialized in both the developed and developing world. It is evident that the logic of 'making money from money' has penetrated non-financial enterprises in recent decades.

The third site of financialization is the household. Deregulation of the financial sector, as earlier mentioned, led to the creation of unprecedented amounts of consumer credit (Lapavitsas, 2013). This new bout of lending started in the developed economies where the process of financialization first unfolded. Credit card debt, payday loans, and private student loans in the US are just a few examples of credit products that have surged in use and popularity in recent decades. In the developing world, this is also apparent through the proliferation of digital credit.

As mentioned above, financialization is characterized by a shift from production to the manipulation of money for profit. This has led to a short-term approach to finance which includes credit. Short-termism is most evident through the intensified activities of investors and securities traders who aim at making quick returns from buying and selling highly speculative financial instruments. In her book *Casino Capitalism*, Strange (2015) provides a vivid depiction of the current global economic system,

where bankers on Wall Street, as well as ordinary workers on 'Main Street', engage in a high-stakes game of trading in securities akin to gambling in a casino. It is in the same logic that digital lenders capitalize on the appetite for short credit to make rent-like returns in the quickest time possible without regard for the longer-term consequences of their way of lending, as I describe later.

The ever-growing prominence of financial institutions in the economy in recent decades has led to the emergence of a rich elite, a new landlord class which wields or buys political influence through lobbying action. These powerful finance actors have been successful at influencing the policy-making process and shaping social and economic policy in ways that protect their ability to extract profit, even from the poor (Lapavitsas, 2013). Indeed, it is not expected that anyone would openly promote profiting from the poor because it is simply not a 'noble' thing to do. Even Prahalad (2005), who advanced the 'fortune at the bottom of the pyramid' fame, subtly canvasses his thesis; he argues that businesses should be careful to understand the market and tailor their products and services to the poor so as to bring about a 'win-win situation' for both the people and the businesses.

One such policy that some observers perceive to have been 'captured' by powerful financial actors is the discourse of financial inclusion. Institutions such as the World Bank, international consultancies such as CGAP and the Global Partnership for Financial Inclusion, and influential private foundations, such as the Bill and Melinda Gates Foundation, constitute the international lobby on financial inclusion. This powerful lobby is responsible for formalizing, shaping and driving the discourse on financial inclusion worldwide. Some financial inclusion critics, such as Soederberg (2013), see it as a veiled message that only seeks to enrich the few elites atop financial structures at the expense of the poor, mostly in the developing world.

1.8 The common bond and the 'degeneration' debate

In chapter five of this thesis, I delve deeper into the co-operative model and how co-operatives have attempted to advance financial inclusion in Kenya over the last two decades. It is, however, important to preface that discussion with an explanation of the concept of the common bond and a theoretical debate that has arisen regarding its relevance and importance, especially in the context of the evolving business environment.

For many decades after their emergence, co-operatives were organized around the idea of a common bond which is an attribute shared between members of a co-operative. This attribute could relate to

occupation, workplace, association, or geographical setting. The common bond in co-operatives is unique in that it creates a homogenous financial collective where members have a specified social connection or geographical location and can control the terms for saving and borrowing, something that typically does not exist for other financial institutions (Pavlovskaya, Borowiak, Safri, Healy & Eletto, 2020).

The literature on co-operatives shows no consensus about what precisely qualifies as a common bond or rather which common bond basis is ideal for co-operatives. One set of thinkers believes that co-operatives should essentially be organized around economic activities. For example, Mazzarol, Limnios, and Reboud (2011) posit that the creation of a co-operative is typically for an economic rather than a social purpose and even though they can have a social function, it is economic self-interest that primarily drives their formation and sustainability. Similarly, Kyazze (2010) and Wanyama, Develtere and Pollet (2008) observe that co-operatives tend to be formed around economic sectors and/or activities, for example agricultural co-operatives, housing co-operatives, and consumer co-operatives, among others. The theoretical premise behind this argument is that since economically disenfranchised individuals form co-operatives, essentially for economic purposes, the economic activity that members are engaged in should be the organizing feature in a co-operative.

Another group of thinkers argues that co-operatives should be formed within a defined geographical setting. Tuominen, Jussila, and Saksa (2006) describe co-operatives as local institutions which have a clear geographic boundary and are deeply embedded within the locality in which they operate. 'Community co-operatives', as they are otherwise called, thus place less emphasis on the particular economic interest in the co-operative enterprise (Somerville, 2007). The central argument for the formation of co-operatives based on the geographic proximity of its members is that it allows members to have detailed knowledge of the economic and moral situations of co-members (Kalmi, 2017). Along similar lines, Putnam (1993) and Borda-Rodriguez, Johnson, Shaw, and Vicari (2016) point out that a homogenous membership and geographical proximity create trust and reciprocity and ensure the existence of a common goal for co-operative action. Borda-Rodriguez et al. (2016) posit that when members of a co-operative engage in different activities (heterogeneous membership), this does not undermine the bond that members have developed on the grounds of their geographical proximity. In the same way, Byrne et al. (2012) stress that a deeply embedded co-operative has greater potential to influence a sense of connectedness felt by the members than one which is less locally embedded.

The common bond in the Rochdale Society in England, who pioneered the co-operative model in the late nineteenth century, exhibited both socio-economic and geographical dimensions. This is because it was formed by tradesmen (socio-economic dimension) in Rochdale town (geographical dimension). Similarly, early co-operatives in Kenya exhibited both the socio-economic and geographical dimensions, given that they were mostly formed by farmers who banded together in a particular locality to sell a particular cash crop such as tea, coffee, and pyrethrum. In Kenya, many co-operatives that were formed post-independence incorporated elements of both socio-economic and geographic dimensions, given that they were formed by virtue of a member's occupation and particular locale; for example, farmers growing a particular crop or teachers working at schools in a particular district. Consequently, for a time, the name of many co-operatives in Kenya described both the socioeconomic activity members were involved with and the locality where their members were drawn from. For example, dairy farmers in Githunguri town formed the Githunguri dairy farmers co-operative while teachers in Lamu County formed Lamu teachers SACCO, and so forth. This way of naming co-operatives has changed over the last decade, as I outline in chapter five.

Various accounts in the literature stress the importance of the common bond in the formation and proper functioning of co-operatives. The foremost importance of the common bond is that it is essential in fostering trust and building relationships in a co-operative setting. The rationale is that members do not pool financial resources with random peers, but with those they can trust, help, and receive help from, and members stand together in times of adversity because they already have something else in common, whether that be a shared occupation, employer, association, or locality (Pavlovskaya et al., 2020). Unlike any other type of enterprise, co-operatives have a unique ability to foster mutual trust among members (Sabatini, Modena & Tortia, 2014).

Trust between members has been acknowledged as a fundamental component of co-operative development and sustainability (Spear, 2000) because trust carries connotations of 'concern for the community', which is typical of a social enterprise (Laville & Nyssens, 2001). Trust serves the all-important function of reducing challenges of asymmetric information which are inherent in many financial transactions (McKillop & Wilson, 2011). Trust also helps overcome challenges such as free-riding, strategic default on loans, and conflicting interests between members of a co-operative (Birchall, 2011). In the presence of trust, transaction costs are lowered because informal self-enforcement of contracts can take place without the need for enforcement from a third party (Chloupkova, Svendsen & Svendsen, 2003). Narayan and Pritchett (1999) describe this as 'informal

insurance'. With trust, members of a co-operative could substitute their knowledge of one another's reputation and social circumstances for physical collateral.

The common bond also carries with it a relational aspect, not only among co-members but also between individual members and the co-operative as an entity. According to co-operative managers, this relational aspect is important in inspiring member loyalty which elicits active participation in the affairs of the co-operative. This view has been argued repeatedly in the literature. Birchall (2011) and Byrne et al. (2012) propound the view that this relational aspect gives co-operatives a natural competitive advantage over other financial organizations. In a similar vein, Berry, Carbone, and Haeckel (2002) argue that consumer value includes both the core product or service and a relational aspect; this is particularly true for service-type organizations such as co-operatives. Goldman (2011) suggests that co-operative members' loyalty reflects their member experience and is derived from relational aspects such as empathy, assurance, and responsiveness, more so than service-related considerations like convenience, cost, and the catalogue of products and services. Along similar lines, Byrne et al. (2012) point out that members of co-operatives value their relationship with the co-operative and that the relational aspect of the co-operative model supersedes the services offered to the member in importance. The relational aspect of co-operatives ought to be seen in light of the relationships that other institutional types have with their customers. Notably, typical financial institutions have a more transactional relationship with their customers, one that is more commercially oriented. This implies that co-operatives foster trust through closeness to their members and their relative flexibility to members' needs as compared to other financial service providers.

As the financial inclusion discourse has permeated the co-operative sector in the last two decades, there has been a lively debate in the literature about whether co-operatives should stick to the common bond principle or adapt to the changing times. This contrast is reflected in how scholars respond to the notion of opening the common bond. On the one side of this debate, some scholars take the view that having a closed common bond is in itself exclusionary and that it must be entirely opened up to make co-operatives inclusive. For example, Fuller (1998) develops the claim that the demarcation of common bond boundaries based on pre-existing common attributes, while being inclusionary for those on the 'inside', is ultimately exclusionary. Other proponents of this view argue that the idea of 'open and voluntary membership' contained in the first co-operative principle and that of the common bond are in direct conflict with each other. The first co-operative principle as highlighted in page 2 states:

> Co-operatives are voluntary organizations, open to all persons able to use their services and willing to accept the responsibilities of membership, without gender, social, racial, political, or religious discrimination.

The responsibilities of membership referred to above relate to purchasing shares in the co-operative, making periodic savings as specified in the co-operative's by-laws, and participating in the democratic governance of the co-operative. The principle implies that anyone should be able to join a co-operative, irrespective of whether they share a common identity with other members. As I describe in the next section, many co-operative practitioners in Kenya share this view.

On the other side of this debate are scholars who see opening the bond as a betrayal of the original idea and who go so far as to talk about the inevitable 'degeneration' of co-operatives that pursue this route. The logic is that as co-operatives become bigger, they 'degenerate' by becoming more aggressively commercial and drift from their social mission. Puusa, Hokkila, and Varis (2016) point out that co-operatives are increasingly abandoning their original mission as social movements in favour of their economic objectives.

Cornforth (1995) developed the claim of 'co-operative degeneration' and describes it as co-operatives succumbing to external market forces and the impact of internal characteristics forcing them to adopt the same organizational forms and priorities as capitalist businesses as a means to survive. Somerville (2007) describes degeneration as a situation where co-operatives lose their identity over time and become similar to other capitalist-type enterprises. This results when co-operatives look to increase their level of investment by non-members (those outside the common bond) through loans. Even when a non-member customer does not acquire any voting rights, opening the common bond can result in the enterprise becoming more like a capitalist business because of the imperative to boost the bottom-line and to satisfy the investors (ibid).

Further, Heras-Saizarbitoria (2014) suggests that co-operatives degenerate as a result of managerial practices that abandon the values that promote solidarity, which is best exercised by a smaller pool of members. Along similar lines, Puusa et al. (2016) highlight the growing tension between individual and communal interests in a co-operative setting. They find that when considering joining a co-operative, people no longer emphasize commonality which was the case when co-operatives had a closed common bond; instead, they base their decision on individual benefits that they are likely to accrue.

Somerville (2007) and Kokkinidis (2015) posit that this lack of solidarity leads to a passive membership and encumbers the exercise of internal democracy, one of the core principles of co-operatives.

A typical example of degeneration can be seen in British mutual and building societies which began in the last century by intermediating members' savings into housing loans within their own narrowly defined geographical areas. In recent years, these societies have transformed themselves into banks and some are listed on the London Stock Exchange. Feinberg and Rahman (2001) lend support to the degeneration thesis by observing that credit unions in the US have grown from serving their small niche to becoming full financial service providers and have thus become direct competitors to commercial banks. Cornforth (2014) points out that this drift in an organization's mission can occur through gradual and sometimes imperceptible changes to a co-operative's working practices or the nature and quality of its services.

My consideration of this debate is that the Rochdale pioneers made a more convincing argument than the latter-day critics of the closed bond. In the Rochdale society, membership under the 1844 by-laws was open in principle, although new members had to be approved, and membership was voluntary since members could leave with due notice (Fairbairn, 1994). The Rochdale pioneers believed that by clubbing together, the 'working class' could satisfy their needs in the face of an elite who did not care about those below them. The pioneers understood that openness had its limits – those admitted to membership had to understand the principle of solidarity, based on their lived experience in Rochdale.

The counterargument is in some ways disingenuous. It suggests that the closed bond is absolute and that removing all restrictions on membership is the only pathway to more inclusive and financially stable co-operatives. It is important to underscore that this counterargument came about in the early 2000s in the literature on co-operatives in Europe and the US, where financial inclusion is much less of a challenge. For example, McKillop, Ward and Wilson (2007) laud the Financial Services and Markets Act 2000 and the Regulatory Reform (Credit Union) Order 2003 which removed membership caps and increased the flexibility of the common bond, observing that credit unions in the UK are embracing the drive for a large membership. Similarly, while examining the growth of US credit unions, Goddard, McKillop, and Wilson (2002) find that smaller credit unions tended to have more variable growth than larger ones. This, they argue, is attributed to economies of scope (through diversified products and services) and scale which are readily available to larger credit unions. Using the typical organizational life-cycle theory, McKillop and Wilson (2011) categorize co-operative

movements into three categories – nascent, transition, and mature. Co-operative movements at the nascent stage of development tend to have a strict common bond, those in the transition movements are characterized by fewer restrictions on the common bond while mature movements have a loose common bond, implying that more successful co-operatives have a fully open common bond.

However, there has been an attempt at a compromise in the literature. This compromise presents a conservative approach to opening the common bond – incorporating multiple common bonds instead of opening the common bond fully. For example, in the US, there is a distinction between single-bond co-operatives and multi-bond co-operatives. The Credit Union Membership Access Act 1998 permits credit unions, under certain conditions, to draw membership from multiple common bonds. This liberalization of the common bond restrictions among credit unions brought about their increased prominence in the US (Goglio & Kalmi, 2017). Likewise, amendments to the British Credit Unions Act 1979 in 2012 remove restrictions on the common bond and enable credit unions to incorporate multiple common bonds within a single co-operative and further allow them to serve businesses and unincorporated associations such as community groups.

Young and Kim (2015) also offer a middle-ground to the degeneration debate and argue that co-operatives should find an equilibrium between their social and economic missions. They argue that social enterprises may experience 'mission drift' as they adopt business or market principles, or conversely, that too great an emphasis on social goals may weaken the organization as a business and possibly lead to commercial failure. Fairbairn (2001) describes the history of co-operative movements, pointing out that this evolution of the co-operative organizational form is inevitable because co-operatives are part of the market economy and exist in a changing world. Co-operatives should therefore not be seen as rigid and autonomous structures, but as 'flexible and evolving components within wider social, cultural, political and economic systems' (page 32). Along the same lines, Brewin, Bielik, and Oleson (2008) argue that co-operatives straddle their economic and social missions in their lifecycle as they seek to deliver a member value proposition that requires them to strike a balance between the often competing demands of their members who are both customers and owners.

Chapter five shows that the degeneration thesis does not help to describe the current state of Kenya's co-operative movement and that the debate around whether open membership or a common bond is what makes a co-operative cannot be settled empirically.

1.9 Contribution of the thesis

Arguments against financial inclusion are, in some respects, as ideologically loaded as those presented by the international lobby on financial inclusion and other scholars who promote the many benefits of financial inclusion. The high-level reports issued by the international lobby on financial inclusion highlighted in page 11 appear far removed from the circumstances of the poor people whose lives, these institutions insist, will be improved through financial inclusion. Critics seem to believe that the financial inclusion message has filtered down to the financial services industry and that the industry displays an unwavering consistency of the financial inclusion message proposed by the World Bank.

Many such arguments offered by proponents and critics of financial inclusion seem to be based on general principles rather than on engagement with the institutions and people on the ground. There is an overall shortage of research, based on actual fieldwork, regarding the specific manner in which the co-operatives and digital lenders go about extending credit. My consideration of the discourse on financial inclusion departs from the willful naivety on display in much of the literature by engaging with practitioners in the financial services industry and their customers. This thesis describes the co-operative and digital lending models in broad contours. Following the call by Mader (2016) for more evidence to appraise financial inclusion strategies, this study contributes to the body of knowledge on financial inclusion by providing the much-needed empirical evidence on the complex phenomenon of financial inclusion through the prism of the co-operative and digital lending models. Further, this thesis advances critical considerations that will be useful in finding a more viable pathway to true financial inclusion.

1.10 Organization of the thesis

This thesis is organized into eight chapters. This introductory chapter has provided the background and context of the study. The scope of the study has been captured in the research question and objectives. The theoretical framework of the study, which is based on the financial inclusion discourse, has also been explored and sets the stage for an exploration of the co-operative and digital lending models.

Chapter two details the methods employed for this study. The chapter first describes the research design and offers justifications for using the qualitative descriptive research design more specifically. In the chapter, I describe in detail the primary and secondary sources of data I consulted. I describe

the sampling techniques and strategies used to recruit informants for this study. I also describe the interview style I adopted. In the last section of the chapter, I reflect on my positionality in the research, the challenges it posed during the research process, and how I was able to overcome them.

Chapter three focuses on the history of the co-operative movement and banking sector in Kenya. The chapter describes the formative years of the co-operative movement in Kenya and the successive changes that took place in the co-operative movement in the pre-liberalization and post-liberalization periods. The significance of these changes to the financial inclusion project is discussed. I argue that the state control over the co-operative movement was a conservative campaign of African socialism which proved fairly successful. The chapter also sketches out the history of banking in Kenya. I argue that banking institutions were complacent to extend their services to the rural and poor customers until the emergence of mobile money in the late 2000s. This had the effect of financially excluded individuals turning to co-operatives who did not have a strong profit-imperative and were well embedded in their communities.

Chapter four presents thirteen case studies of people I encountered during fieldwork. These comprise five borrowers, three managers from digital lending platforms, four managers of SACCOs and a financial inclusion consultant. I describe my interactions with them, how they borrow or extend credit, and their conceptions of financial inclusion.

Chapter five delves into two critical changes to the co-operative model in the last two decades, namely the opening of the common bond and the extension of quasi-banking services to non-members. I describe how key institutions in the co-operative movement instigated these changes and how different SACCOs received their recommendations. The chapter looks at the motivations, the process, and the outcomes of opening the common bond and offering quasi-banking and how this impacted SACCOs' financial viability. I describe the significance of these issues to Kenya's financial inclusion project.

Chapter six explores the rise of the digital lending model in Kenya, the conditions that made this possible, and value propositions from digital lenders that made this form of lending popular. Key features of the digital lending model are discussed in relation to how they further financial inclusion. The chapter presents the impact of unsecured digital lending from the perspective of borrowers.

Lastly, I discuss the regulation of digital lenders, how and why the calls for regulation came about, and steps that stakeholders have taken to confront the issue.

Chapter seven describes how the financial inclusion discourse was disseminated to the financial services industry in Kenya. I make the case that industry insiders were initially taken by the discourse and responded to it by offering digital loans and opening the common bond, among other ways. I argue that over time, industry insiders have become disenchanted by the discourse given that it has not delivered benefits to the poor, in particular delivering them out of poverty and launching them into entrepreneurial careers.

Chapter eight discusses the notion of money, its origins, its forms, how it is issued and controlled, and how the monetary system is set up. Critically, I examine what these issues portend for the drive for financial inclusion. I link this discussion back to the previous chapters on financialization and argue that the trends in financialization and the current monetary system, which are invisible forces at play in the push for financial inclusion, are highly problematic. I argue that a credible pathway to financial inclusion would privilege borrowers. The chapter concludes the thesis by highlighting various strategies that people have developed to move beyond the fiat monetary system as a means to sustainably address financial inclusion.

CHAPTER TWO: METHODS

2.1 Introduction

This chapter details the methodological approach taken for this study. I first describe the design adopted for this research and offer justifications for adopting the said design. I then describe the setting of this study and explain why the setting was appropriate. In the third section, I dwell on the data collection process. I describe the sources of data and data collection tools. I also describe and offer justifications for the sampling methods used and the interview style employed. I later describe the process of analyzing the data I collected and provide a brief discussion about ethical considerations made for this study. In the last section, I clarify my positionality in the research. I describe challenges that I was exposed to by virtue of my positionality and reflect on how I overcame these challenges.

2.2 Research design

This study employed a qualitative and descriptive methodological approach. The goal of descriptive research is to describe a phenomenon and its characteristics (Nassaji, 2015) accurately and systematically as it naturally occurs (Dulock, 1993). The descriptive research design for this study was justified given that the study's aim is to describe characteristics of co-operatives and digital lenders and how they extend credit to understand how these two models advance, if at all, financial inclusion. As I describe later in detail, I do this through an analysis of the perspectives of various insiders in the financial services industry and the experiences of recipients of co-operative and digital loans.

A qualitative research design was suitable for addressing the main objective of the study, which was to understand the process of financial inclusion in Kenya through two important lending models, the co-operative model and the digital model. Qualitative research follows a naturalistic approach that seeks to understand a phenomenon in context-specific, 'real-world' settings where the phenomenon of interest unfolds naturally without manipulation from the researcher (Patton, 2002). Using Patton's (2002) description of a qualitative study, the 'phenomenon' under investigation in my case refers to financial inclusion and the 'context' is the co-operative and digital lending industries which exist side-by-side in Kenya.

The choice of a qualitative research design was doubly suitable because the study aims to understand or 'describe' the process of financial inclusion from the perspectives of industry insiders and their borrowers 'on the ground'. This follows from Nassaji (2015) who asserts that qualitative research involves the collection of data from various sources to gain a deeper understanding of individual participants, including their opinions, perspectives, and attitudes. Merriam (1988) explains that qualitative research is descriptive in the sense that the researcher is primarily concerned about the understanding how the study subjects make sense of their experiences and how they structure their universe. Drawing interpretations from the 'people on the ground' not only allowed for more nuanced descriptions and understandings of the co-operative and digital lending models but was equally useful in understanding the rather complex 'phenomenon' of financial inclusion.

2.3 Study setting

This study was conducted in Kenya, specifically Nairobi City which is the capital of the country. The study was situated in Nairobi City for several reasons. Firstly, Nairobi is the financial hub of the country with offices for commercial banks, digital lenders, and financial service regulators. Nairobi City also has the largest concentration of financial co-operatives (SACCOs) in the country, which was a particular interest of this study. Moreover, I anticipated that the commercial activities within Nairobi City would inevitably make lending activities by digital lenders and SACCOs more intensified here than elsewhere in the country. As anticipated, digital borrowers and industry insiders in Nairobi had an abundance of experiences about the study area.

Further, Nairobi was an ideal study site given that I was able to reach a broad range of borrowers that constituted the population of this study, at the most economical cost. I was able to move relatively easily to the central business district and numerous estates within Nairobi City to meet my informants. Even though the study was initially meant to be situated in Nairobi County, my travels during the fieldwork period allowed me to visit and secure interviews with an informant who works for a coffee growers co-operative in Nyeri County and a manager of an employer-based SACCO located in Nakuru County. Borrowers and industry insiders consulted for this study comprised individuals of different genders, ages, occupations, and economic statuses. This informant diversity helped me to draw my analysis from a rich and balanced range of informants and thus to overcome any unimagined bias on my part.

2.4 Data collection: Sources and tools

I used a combination of primary and secondary data in this study. This section describes in detail the range of secondary material that I consulted and also gives details of how I collected primary data and the challenges that I faced in the process.

2.4.1 Secondary data

This study started with me doing a desk review of secondary sources and writing a research proposal for the study. I consulted a vast range of secondary sources in this regard, including but not limited to the SACCO Societies Act, the Kenya Banking Act, Microfinance Act, CRB regulations and prudential guidelines, and a variety of institutional reports and other relevant policy documents produced by government agencies. The same is true of relevant scholarly publications on the subject. I continued reviewing secondary material for the duration of the fieldwork, analysis, and writing of this thesis. I have ensured that all data from the various secondary sources are appropriately cited.

Incidentally, several legislative and regulatory developments unfolded during this research. Several new laws and draft bills were introduced. These include the CRB Regulations 2020, the CBK Amendment Act 2021, the SACCO Societies Regulations (Non-Deposit Taking Business), the Employment Amendment Act 2019, and the Digital Lenders Association of Kenya (DLAK) Code of Conduct, all of which had important bearing on my study.

Secondary data was crucial to me in constructing a timeline of the development of the co-operative sector and digital lending industry in Kenya, more so because, in the last two decades, literature has paid little attention to these sectors. Secondary data was equally useful to me in understanding different actors' past and ongoing roles in and contributions to financial inclusion in Kenya.

2.4.2 Primary data

I collected primary data through interviews with industry insiders and recipients of loans from co-operatives and digital lenders. Blaxter, Hughes, and Tight (2010) suggest that interviews offer researchers the opportunity to uncover valuable information that is 'probably not accessible using techniques such as questionnaires and observations'. Answering the research question required detailed accounts and perspectives of the two categories of informants drawn from their experiences with the two lending models. As such, I chose interviews as the method best suited to this purpose.

Data collection took place between August 2020 and June 2021. This period was unfortunately marked by the Coronavirus Disease (COVID) pandemic and extensive public safety measures. This included a widespread trend in people working from home, cessation of movement, curfews, and physical distancing, among other measures. With no end to the pandemic in sight and several surges in the infection rates, I forged ahead with the data collection under these limitations and this move proved worthwhile.

The limitations imposed by the pandemic required a lot of flexibility on my part to primarily accommodate the safety concerns of my informants and secondarily to make progress on data collection. For example, I interviewed nine of my informants, representing roughly 20% of all informants consulted, through video conferencing, specifically via Zoom. I conducted these virtual meetings in the same format as face-to-face interviews and I also recorded them. Further, for some time, some informants could only physically attend work for two or three days a week, on a rotational basis. This imposed challenges with scheduling face-to-face interviews with informants. Luckily, co-operatives are service-based organizations whose operations are mostly manual and require the physical presence of client-facing staff. This made it slightly easier to secure interviews with co-operative managers and their staff.

Even though fieldwork for this study started four months later than scheduled, I was able to make relatively quick progress given that I had used this time to reach out to potential informants, especially those working in financial institutions. Further, there was a gradual relaxation of public safety measures after the first quarter of 2021. As a result, I conducted slightly more than a quarter of my interviews between April and June 2021.

2.4.2.1 Sampling

Before I delve into how sampling for this study was done, it is instructive to highlight the population that was scoped in this study. The 2019 national population census estimated Kenya's adult population – those 18 years and above - to be 24.5 Million people (Kenya National Bureau of Statistics, 2019). Roughly 3.8 Million of Kenya's population resides in Nairobi according to the report. The report estimates that only about 47% of Nairobi's population (1.8 Million people) have employment of some kind - permanent employment, self-employment or casual/wage work. This indicates that 53% of Nairobi's population is outside the labour force and dependent on those who are working.

The most updated statistics by the International Co-operative Alliance (ICA) show that there are an estimated 3,052 SACCOs in Kenya, including those that are dormant or inactive (ICA, 2021). These SACCOs are distributed into institution-based, communal based and those were initially formed by people sharing the same occupation. The number of inactive or dormant SACCOs is however often imprecise and may vary from one source to another. In their most recent annual report, SASRA estimated that there were roughly 5.5 million SACCO members countrywide in 2020 (SASRA, 2021).

At the time of my fieldwork, it was intimated to me that there are possibly over one hundred digital lenders in Kenya. However the Digital Lenders association of Kenya (DLAK) which I will describe later had just over 20 registered members at the time of my fieldwork. The total number of digital borrowers is much less known given that there are many digital lenders in Kenya and also due to the fact that many of them borrow from multiple platforms at any given time as I will later explain.

The study employed non-probability sampling techniques, specifically a combination of purposive, snowball, and random sampling. I consulted a total of forty-seven respondents who may be primarily divided into two categories – industry insiders and borrowers.

The first category of informants comprised twenty-two industry insiders who were drawn from a purposive and snowball sample. These were practitioners working in various organizations in the Kenyan financial services industry. As I describe in detail in the next section, these organizations comprised co-operative societies, digital lenders, commercial banks, industry regulators, a CRB, a debt collection agency, and financial inclusion experts from various consulting firms. The practitioners who contributed to this study were middle- to senior-level managers and chief executives who had practical knowledge of the credit industry and financial inclusion in Kenya. Interviewees were appropriately distributed across the different organization types and levels of the financial services industry. Fifteen practitioners were purposely sampled owing to their experience and knowledge on the subject while seven were recruited through a snowball process.

The descriptive and qualitative design of this study motivated the use of a purposive sample for the first category of informants. This is because the study intended to consult knowledgeable insiders in the financial services sector and borrowers who could provide detailed personal accounts of their experience in extending and obtaining loans from co-operatives and/or digital lenders respectively. Tongco (2007) describes purposive sampling as the deliberate selection of an informant due to the

qualities the informant possesses. The informant ought to be reliable and informed on the subject being researched (ibid). Likewise, Dulock (1993) suggests that informants of a descriptive study should be selected on the basis that they possess the information or characteristics that are the focus of the study.

For this study, I did not target a specific number of respondents. Unlike in survey research, where the sample size is decided at the beginning of the project and sampling follows formalized statistical procedures, purposive and snowball sampling does not have a set number of informants; sampling decisions are made during fieldwork (Emmel, 2013). Purposive sampling, therefore, offers the flexibility to attain theoretical saturation, which is imperative when using the grounded theory approach that this study adopts.

Emmel (2013) suggests that the strength of purposive sampling lies in its intentional bias which allows for the selection of knowledgeable, reliable informants. In selecting a purposive sample, I paid attention to three main considerations proposed by Tongco (2007). The first step was a deliberate process of determining the type of information required from informants. I came up with broad interview questions while being careful not to impose too much structure on the question or lead the potential informants. These broad interview questions were informed by the research question and objectives which I enumerate in chapter one. I then mapped out all actors in the financial services industry to evaluate who may be suited to answer the questions of concern to me. The second step was defining both desired and undesired qualities of the informants. I came up with brief screening criteria for my potential informants. For industry insiders, this included looking at their current and previous work experience.

The third step was assessing the reliability and competency of potential informants. Tongco (2007) suggests that this poses a challenge since the reliability and competency of an informant rely on the judgment of the researcher, which may be subject to bias. I overcame the challenge of assessing competency by turning to my professional acquaintances in the financial sector where I had previously worked. A significant proportion of my purposive sample thus comprised my professional acquaintances. These acquaintances turned informants had between seven and thirty-five years of work experience in the financial services sector and held middle to senior management positions in different institutions in the sector. I describe my positionality in the research in more detail later in this chapter.

It is important to add that Tongco (2007) makes a distinction between reliability and competency; she suggests that while competency relates to how qualified the person is to answer questions about the subject under study, reliability refers to honesty and truthfulness of the informant. I overcame this by avoiding leading questions and using the intensive interviewing technique where I allowed the informants to give detailed answers from their experiences. I would deduce deeper meanings and understandings from their accounts, tone, and expressions. For example, I used descriptive questions to get a sense of how they regard the financial inclusion discourse from their explanations. I describe the interviewing style in better detail in the next section.

The second category of informants comprised twenty-five respondents who had taken out loans from co-operatives or digital lenders or both. These informants were drawn from a random and snowball sample. To draw a random sample of borrowers, I had to inquire from the potential informants whether they were or had previously been members of a co-operative or whether they had borrowed from a digital lending platform. These informants were interviewed based on their willingness to participate and until a saturation point was reached, that is when no additional information emerged. Concerning selection bias for this sample of informants, I deliberately interviewed everyone who was referred to me by way of a snowball sample. Roughly half of the respondents for this category were thus drawn from a snowball sample, a larger proportion compared to the snowball sample for industry insiders.

As pointed out earlier, I selected informants around several counties (both urban and rural) in Kenya with most borrowers from Nairobi City. These samples were not meant to be representative of the total population of users of these loan products but were adequate to give me sufficient information to address the research question. The aim here was to get a personal account of their experience when taking out and repaying these loans and their assessment of how beneficial these loans were to them as individuals. The saturation point for this category of informants was achieved at twenty-five respondents.

I adopted snowballing as the complementary sampling technique for selecting industry insiders and borrowers. Thompson and Collins (2002) describe snowball sampling as obtaining a non-probability sample where a few identified members of a population are asked to identify other members of the population, those so identified are asked to identify others, and so on. Snowball sampling, therefore,

complements purposive and random sampling, given that it helps in identifying key respondents who would otherwise not be in the initial purposive sample.

At my request, informants from my initial purposive and random samples voluntarily referred new informants who helped me construct a sampling frame from which I sampled additional informants after reviewing their suitability using the same criteria I described earlier. In a few instances, the snowball sampling was useful in identifying characteristics of the population that I was not aware existed at the onset. A case in point was the discovery of nondescript digital lenders who were essentially former moneylenders who had turned their business into 'briefcase' digital lending operations. Importantly, the snowball sample helped me to get an adequate number of knowledgeable informants to attain data saturation.

2.4.2.2 Categories of informants

I consulted a total of forty-seven respondents who may be primarily divided into two categories – industry insiders and borrowers. The first category of informants comprised twenty-two industry insiders: ten informants from the co-operative industry, eight informants from the digital lending industry, and four other industry insiders.

Of the ten informants from the co-operative industry, eight were managers of co-operatives of different kinds. Five of these informants were managers of deposit-taking SACCOs while two were managers of non-deposit-taking SACCOs. I also spoke to a manager of a non-financial co-operative, in particular a coffee growers' co-operative which is categorized as an agricultural co-operative in co-operative taxonomy. I also interviewed two retirees who had previously worked at the Co-operative Registrar's office for roughly three decades each. These two informants bore witness to significant changes in the Kenyan co-operative sector, namely its growth, liberalization, the wave of collapse, and subsequent revival of the sector, as I detail later. Eight of my ten informants working in the co-operative industry were males above forty years old who had more than ten years of work history in the co-operative sector. Two of the informants were females each with more than ten years in the co-operative sector.

I consulted eight informants who were managers in various organizations involved in digital lending. Of the eight, two informants were managers in charge of digital lending wings of two local banks. Five of the informants in this category were managers of non-bank (private fintech) digital lenders. Two of these non-bank lenders were internationally based while two were locally based. The local lenders were

invariably smaller than their international counterparts. My informants from local digital lenders were two office holders of the DLAK, an industry association constituting roughly twenty digital lenders. I also spoke to a product development specialist who previously had been employed by Safaricom and was closely involved in the development of Fuliza, an overdraft facility for mobile money (M-Pesa) wallets. These informants from the digital lending industry were comparatively younger than those from the co-operative industry with the oldest informant being forty. Five of the eight informants were male.

I spoke to a senior manager working for the regulator of the SACCO industry. This informant has worked in different capacities in the co-operative industry for the last twenty years, even before the regulatory authority was formally established. He therefore had a wide range of experiences and nuanced perspectives on financial inclusion through co-operatives. I also spoke to the manager of a debt collecting agency that worked closely with different lenders, in particular digital lenders, who offered insights on how organizations went about debt collection and on the repayment behaviour of borrowers.

Since my study was on the phenomenon of financial inclusion, I was keen to speak to other independent observers who were not affiliated with any of the two industries. One of these observers was a long-time banker who, at the time of this research, worked as a manager with a well-known local consulting firm. She had worked extensively on sector-wide and institutional reforms in the financial services industry. Another informant I consulted was a self-styled personal finance and entrepreneurship coach. At the time of my research, he wrote a popular newspaper column on personal finance and ran what he described to me as a 'financial academy' where he offered training on financial management, both to individual and corporate clients.

The second broad category of informants for this study were twenty-five recipients of SACCO and digital loans. As I had suspected before the commencement of fieldwork, an overwhelming proportion of co-operative members were also digital borrowers. As such, there was an overlap in these two categories of informants. I interviewed twenty-two digital borrowers, eighteen of whom were also members of various SACCOs. Only four digital borrowers that I interviewed were not SACCO members. Of the twenty-five borrowers, three were SACCO members who had not taken out digital loans. These three informants were considerably older than the digital borrowers and were all formally employed and seemed well-off financially, wealthy even.

A majority of the twenty-two digital borrowers were under forty years of age, and the rest were over forty but still within the working age. The sample of borrowers, as it related to both SACCO members and digital borrowers, was evenly split between females and males. The sample of twenty-five was also evenly divided between informants who were employed, self-employed and unemployed. Even though my sample showed no difference in the recipients of digital loans, the sample exhibited distinct patterns concerning the borrowing and repayment behaviour of the categories of these informants, as I describe later.

A majority of the SACCO members I interviewed were formally employed. They belonged to either employer-based SACCOs or SACCOs which were affiliated with their respective occupations. For example, I interviewed a lawyer who was a member of Sheria SACCO for lawyers and an accountant who belonged to Mhasibu SACCO for accountants. Similarly, I interviewed a flight attendant who was a member of Wanandege SACCO, an employer-based SACCO for employees of the national airline. Few SACCO members I interviewed were self-employed but the self-employed members mentioned that they earned a significant enough and regular income from their businesses to make monthly savings as required by their SACCOs. Informants from this category were roughly evenly split between females and males and seemed well educated.

The income level of borrowers I interviewed was also deliberately varied. I interviewed individuals who were in low-paying jobs, operated micro businesses or were otherwise unemployed. I also interviewed individuals who earned moderate incomes from running small businesses or from formal employment or contract (gig) work. The third category were individuals who occupied an elevated financial and social position, that is they enjoyed high and predictable incomes from either formal employment or self-employment.

2.4.2.3 Interview style

Given the chosen research design, I had to adopt an interview style that would allow respondents to share their experiences at length to allow for themes to emerge naturally from their accounts. With this in mind, I adopted an intensive interviewing approach for this study. Charmaz (2014) describes intensive interviewing as a one-sided, guided conversation that explores an informant's perspectives and experience about the research area. Intensive interviewing relies heavily on open-ended questions to obtain detailed responses and requires the informant to have first-hand experience with the research

topic. With intensive interviewing, the researcher participates by directing the conversation, encouraging, observing, and listening with empathy (ibid).

Intensive interviewing was doubly appropriate for this study because of its in-depth, interpretive nature which combines both control and flexibility. Before the interviews, I prepared an interview guide that comprised only open-ended questions which allowed interviewees to provide detailed responses. Other interview questions arose from my own reflection on the responses and for purposes of clarification. Also, I tailored the interview questions to each informant while taking into account their professional experience and background. The interview guide allowed me to steer the conversation back on course whenever it was clear that the conversation had wandered off my general area of concern.

Although the interviews for this study were semi-structured, they were not incredibly formal. I drew on informants whom I knew to be either SACCO members or digital borrowers, or both, and whom I personally knew from living and working in Nairobi. My previous employment in the financial services sector also gave me access to a pool of informants whom I knew to be knowledgeable on the SACCO sub-sector and digital lending industry.

As I had anticipated before conducting the fieldwork, the interviews were complex situations. Respondents rarely provide solely factual answers to questions – they also give indications of how they evaluate the processes they are describing in the course of their answers. They give these indications through their choice of words to give a description, their body language, or the tone they adopt in giving their answers. Therefore, I had to avoid direct and leading questions in favour of attempting to read the informant's endorsement of, or reservations about, the financial inclusion discourse in terms of how interviewees answered my questions. As Riessman (2008) points out, giving room to more narrative responses from informants allows them to recount past events concerning their present circumstances, thereby providing a more considered understanding of the issues they raised.

In the process of conducting interviews, I employed an 'easy to complex' strategy where I posed easy, straightforward questions initially and then built up to more complex questions which required deeper discussion as the interview drew on. The exchange leading up to the interview occurred naturally and depended on the location and the circumstance of the respondent at the time of the interview.

Following a brief introduction and description of the study, I posed general questions to initiate the interview and to elicit discussion. Interviews with borrowers took roughly thirty minutes to one hour while those with practitioners took between one hour and an hour and a half. I conducted two pilot interviews for the two categories of key informants, which assisted me in structuring the interview questions and getting initial thoughts on the subject.

Further, I endeavoured to ensure that my questions did not pose any kind of threat to the interviewees. The two pilot interviews were useful in this regard. From the pilot interviews, I quickly gathered that personal finances are private affairs, and even though informants were willing to participate in the interview, it was essential that I framed my questions in a way that would not be intrusive. I noted that by framing the interview questions in a more general way, respondents were more comfortable and often ended up giving more intimate accounts of their borrowing history. I also gathered from my pilot interview that information-driven credit appraisal techniques, which are prevalent among digital lenders, constitute intellectual property and are well-guarded business secrets. As such, informants were unwilling to divulge specific details about their credit appraisal procedures. However, they were comfortable giving more general details such as industry trends in credit appraisal. Proper structuring of interview questions was therefore an important component of my interview process and required continuous refinement throughout my fieldwork.

I used three languages during interviews: Swahili, English, and a creole language called Sheng which is essentially a mix of Swahili, English, and other local languages. The choice of language was entirely dependent on the language spoken by respondents or on their preferences. Being fluent in all three languages, I was able to draw deeper interpretations from my discussions. This was particularly true for most borrowers who preferred to express themselves in Swahili. For any Kenyan, the choice of using Swahili to express oneself would not be strange at all given that Swahili is the national language and, as such, most people easily, possibly subconsciously, express themselves in Swahili, especially when not in more formal settings. Most extracts from my interviews are presented in their English translation, but in some cases, Swahili and Sheng phrases are used to maintain the rawness of what was said, and are then translated into English.

2.5 Data analysis

I employed the grounded theory in analyzing data collected for this study. Charmaz (2014) suggests that the grounded theory enables the description of a social phenomenon, its main attributes, how it changes, and the core processes that lead to these changes. The choice of the grounded theory for this study was advised by its suitability in enabling a description of the process of financial inclusion through the co-operative and digital lending models in Kenya. The approach also enabled a detailed description of successive changes that occurred in developing these two models and their import. Further, the grounded theory was justified for this study given that it facilitated an iterative process where I simultaneously conducted data analysis and data collection. This process was not only immersing but also flexible. Analyzing data in this way was particularly important given the relatively broad categories of informants and data sources that I consulted for this study.

Using a grounded theory approach required me to conduct the interviews in stages. Informants consulted in this study fall into several categories, namely co-operative managers, practitioners in digital lending entities (bank and non-bank), co-operative members, digital borrowers, borrowers who borrow from both co-operatives and digital lenders, and a few key informants who are neutral actors – regulators, financial inclusion consultants, and a debt collection agent. I scheduled the interviews in a way that allowed me to move between categories and go back to various categories of informants. Conducting interviews in this 'back and forth' fashion allowed me to fill in gaps and refine connections in the data I had collected. Asking specific and consistent questions in the interviews further aided me with constant comparison analysis where I compared new findings with existing findings from the different data sources for purposes of identifying similarities and differences.

I started with initial data analysis using the first few interview recordings, field notes and memos, and a range of secondary data sources. Initial data analysis establishes consistencies and differences in the data collected. At this stage, I identified connections and relationships between global events and events in Kenya around the subject of financial inclusion. This analysis also led me to sketch a timeline of the development of the co-operative and digital lending models. I identified key actors, significant events, and situations in the development of the two models through this timeline. At the initial stage, a comparison of data sources for similarities and differences brought out a range of concepts that took into account the full complexity and diversity of the data. I regarded these concepts as provisional and constantly developed the concepts through comparison. The ultimate objective of constant

comparative analysis was to link and integrate themes in such a way that the emerging thesis captured all instances of variation. I conducted further analysis to organize the dominant concepts into categories or codes and integrated these categories to build my thesis.

2.6 Researcher positionality and reflexivity

The term positionality describes a researcher's worldview and the position they assume in a research task and its social and political context (Rowe, 2014). Some aspects of positionality are culturally ascribed or generally regarded as being fixed, for example, gender, race, and nationality. Others, such as political views, personal life history, and experiences, are more fluid, subjective, and contextual (Chiseri-Strater, 1996). Rowe (2014) and Holmes (2020) contend that the position a researcher assumes in a study influences how research is conducted, its outcomes, and results.

While positionality is often considered critical for ethnographers who immerse themselves in the cultures and daily experiences of their subjects, it is also important for me to consider reflexivity – how my background and surroundings possibly shaped this research. Self-reflection and reflexivity are both necessary prerequisites of an ongoing process where the researcher identifies, constructs, critiques, and articulates their positionality (Holmes, 2020). This necessarily requires the researcher's self-consciousness about their social, cultural, and political context, and the self-assessment of their stance during the entire research process. The implications of these issues may directly or indirectly influence the design, execution, and interpretation of the research data findings.

Savin-Baden and Howell-Major (2013) suggest three steps that a researcher should follow to identify and develop their positionality. The first step is to situate themselves in the research subject by acknowledging their views and values which may influence the totality of the research. The second step is to locate themselves among the participants. This entails the researcher considering how they view themselves, as well as how others view them. The third step is to position themselves in the research through a critical analysis of the research context and process.

As I have mentioned, I previously consulted for clients in the Kenyan financial services sector. I therefore had relatively good insight into the landscape and workings of the financial services sector. My positionality in this regard had apparent advantages, but also limitations. My contact with the financial services sector was useful in helping me identify knowledgeable informants who also referred me to other informants. However, I was exposed to selection bias as it relates to my initial purposive

sample. My strategy to counter my positionality with regard to my close contact with the financial services sector was to aggregate views from different industry insiders and borrowers who covered the breadth of the financial services sector. Specifically, I interviewed managers from ten different co-operatives and eight different digital lenders. I also interviewed three financial inclusion experts and a regulator who offered a more neutral view of the subject. Utilizing a snowball sample to complement the purposive sample was also useful in this regard.

Further, I have been a member of a SACCO for the last ten years since I was first employed. I have also occasionally taken out digital loans from different lenders throughout the last five years. While this allowed me to have an appreciation of the way these specific lenders operate and general issues in the industry, I ran the risk of imposing my knowledge of the financial services sector and my customer experience with these lenders on the research process. I interviewed borrowers who were members of vastly different co-operatives and who borrowed digitally from many different platforms.

Additionally, I intentionally posed questions to the informants whose responses would otherwise be obvious to me by virtue of my positionality as stated. While I anticipated some of the responses, this strategy gave rise to more nuanced responses and led to a more detailed analysis. In doing this, I suppressed my own experiences with co-operatives and digital lenders in favour of the views of my informants. This self-reflection exercise not only helped in clarifying my position in the research but also allowed for a reduction of bias and partiality in the research process (Rowe, 2014), even when the circumstances and context changed (Holmes, 2020).

2.7 Ethics and permissions

The Humanities Research Ethics Committee approved this research on 1 June 2020 under reference number HUM024/0320. I prepared an informed consent letter for my potential informants which the ethics committee approved alongside my research proposal. In summary, the informed consent letter outlined the purpose and nature of the study and gave details of the ethics approval obtained. The letter further gave details of the rights of the informant, including the nature of their participation and their guaranteed anonymity, and provided informants with a feedback channel where any concerns from the informant could be directly channeled. I provided every informant with a physical or electronic copy of the informed consent letter.

All interviewees were guaranteed anonymity for themselves and for the particular organizations they worked for. To this end, informants were asked to read and sign the letter of informed consent before the interview commenced. However, some borrowers were not comfortable with written consent forms. In such cases, I would run through the content of the consent letter and they would give verbal consent, which was considered appropriate for my purposes. This was also true for the eight informants interviewed through video conferencing. In instances where I needed to quote directly from the interviews, I have anonymized the informants and their organizations using pseudonyms that I indicate as such in the text to prevent any potential harm that could arise to the respondents and their organizations. I should acknowledge that some Kenyans may correctly guess the identity of some rogue digital lenders that I have anonymized. This is because the Kenyan media has widely reported on the particular issue of aggressive collection strategies that these lenders employ and the CBK and fellow digital lenders have pointed out these aggressive collection strategies in numerous press briefings.

I audio-recorded interviews with the permission of the informants and in line with the informed consent letter. Audio recordings served to keep an audit trail of fieldwork and were particularly important to me to revisit repeatedly during data analysis. I also used memos to record important observations, reflective notes, and new lines of inquiry that surfaced during fieldwork. As indicated earlier, I organized interview recordings and field notes into themes and sub-themes which informed the findings of this study.

2.8 Conclusion

This chapter has appraised the methods used for this study. Using a descriptive and qualitative research design to study the subject of financial inclusion was appropriate given that the views of industry insiders and the people 'on the ground' who are the targets of financial inclusion strategies are often taken for granted. Further, interviewing both industry insiders and borrowers was important for me to understand financial inclusion from both the supply and demand sides. Purposive and random sampling was appropriate for me to use in selecting a diverse sample while an additional snowball sample was useful in attaining saturation.

In addition to ethical considerations which I have discussed in detail, I have also reflected on my positionality in the research process. My relative proximity to the financial services industry and my

position as a member of a SACCO and a digital borrower were both useful and problematic to me as a researcher. However, selecting a diverse sample as well as privileging the views of my diverse range of informants over my personal views and experiences brought about my new understandings of the co-operative and digital lending models.

The next chapter turns to the history of co-operative development in Kenya and covers the successive changes that transpired from co-operatives' inception and the importance of these changes in modeling co-operatives as vehicles for financial inclusion.

CHAPTER THREE: HISTORY OF THE CO-OPERATIVE MOVEMENT AND BANKING SECTOR IN KENYA

3.1 Introduction

The co-operative movement in Kenya has a rich history spanning over 100 years. Kenyans formed agricultural co-operatives as a means to escape the sting of poverty and exploitation from the colonial regime. In the late 1960s, various co-operative types such as building societies and financial co-operatives started emerging and by the late 1990s financial co-operatives now free from government oversight changed their business model, offering banking services to non-members. I explore the history of Kenya's co-operative movement in two distinct periods: the period of state control which I refer to here as the pre-liberalization era, and the post-liberalization era when co-operatives operated free from government control. I describe developments in the co-operative movement in these successive periods and their significance to the push for financial inclusion.

In discussing the pre-liberalization era of co-operatives in Kenya, I advance the argument that the co-operative movement under state control was a conservative approach to African socialism where the government aimed to spur economic development by consolidating the activities of co-operatives. I also discuss the near collapse of co-operatives in the post-liberalization era and the significance of this in styling co-operatives as credible financial institutions.

In this chapter, I trace the history of banking in Kenya and how banks co-existed with co-operatives and later with non-bank financial institutions (NBFIs). I describe how a majority of Kenyans were sidelined by patronizing banking services, from the colonial period to the late 2000s when mobile money came into the picture. This discussion serves to stress the importance of co-operatives in reaching out to the financially excluded and provides a staging ground for my discussion in chapter five on the digital lending model.

This chapter is organized into five main sections. After the introductory section, the second and third sections respectively discuss the pre-liberalization and post-liberalization eras of co-operatives. The sections describe key developments in the co-operative movement during these periods and the significance of these developments, particularly relating to the extension of financial services to the

financially excluded. The fourth section traces the history of banking in Kenya, highlights the importance of co-operatives to the financial inclusion project and provides a background for my discussion about the digital lending model in chapter five. The last section recaps and concludes the chapter.

3.2 Pre-liberalization era of co-operatives in Kenya

Co-operatives can be traced to the age of the industrial revolution when social dislocations in the Industrial Age and paternalism from the mercantile class led tradesmen in Rochdale, Great Britain to club together to start the first consumer co-operative in 1844 (Fairbairn, 2001). The co-operative model spread quickly and led to the formation of the first financial co-operative, also in the Global North, in Germany in 1850 (McKillop & Wilson, 2011). Over time, different types of co-operatives began to emerge, including worker co-operatives, agricultural co-operatives, and building societies, among others. Soon enough, the co-operative model would find its way to Kenya through white settler farmers.

The pre-liberalization era of co-operatives straddles the colonial period, from when the first co-operative was set up in 1908 to 1963 when Kenya achieved her independence, and a significant portion of the post-colonial period when the co-operative movement was steered by the government. The post-liberalization era of co-operatives in Kenya started in 1997 and continues to the present day. These two periods are also characterized by several co-operative development policies and pieces of legislation that shaped the present state of the co-operative sector. This section gives an important detailing of these developments, their significance, and in particular, their implications for financial inclusion.

To trace the history of the co-operative movement in Kenya, I primarily relied on data from various secondary sources. I also spoke to two informants who had worked in different capacities during the period when many of these changes I will discuss were taking place. The first informant was my father, Magale Senior, who worked in the state department of co-operatives, also called the Registrar of Co-operatives' office, for thirty-six years before retiring in 2020. He worked in different capacities in the department, including as an inquiry officer, a district co-operative officer in various districts in the country, and as a principal supervisor just before he retired. My father introduced me to a former colleague of his, Omollo (pseudonym), with whom he had worked at the registrar's office since the

early 1980s. Omollo started his career as a clerk in the state department of co-operatives and rose through the ranks before moving out of the civil service when he was employed as a credit manager in a large dairy co-operative later in his career. This mix of primary and secondary data sources helped me to gain a deeper understanding of the developments in the co-operative sector. The multiple data sources were also useful for triangulation: I corroborated information gathered from one source with information from other sources to test their validity.

3.2.1 The co-operative movement in the colonial era

The first co-operative society in Kenya, Lumbwa co-operative society, was set up in 1908 by white dairy farmers. At the time, the British colonial government made the formation of co-operatives a preserve of the minority white settlers, and this restriction held for the following four decades. The formal registration of co-operatives started after the enactment of the Co-operative Societies Ordinance of 1931. This was followed by the registration of the Kenya Co-operative Creameries (KCC) and the Kenya Farmers Association in 1931, the East African Timber (Co-operative) Society in 1932 (Zeleza, 1990), and the Kenya Planters Co-operative Union in 1937 (Gatuguta, Kimotho & Kiptoo, 2014).

Throughout this period, Africans were sidelined from participating in the co-operative movement until 1946 when another co-operative societies ordinance was enacted. The new ordinance provided for the creation of the department of co-operatives headed by a registrar to supervise the activities of co-operatives (Zeleza, 1990). The ordinance gave new impetus to co-operation among native smallholder farmers who banded together to market their agricultural produce. This led to the establishment of agricultural co-operatives, such as the Kisii Coffee Growers Association and Taita Vegetable Co-operative (Zeleza, 1990).

The Swynnerton Plan of 1954 by the colonial government initiated agrarian reforms which permitted native Kenyan farmers to engage in commercial cash crop farming albeit with some restrictions. For example, Wanjiku (2011) and Condliffe, Kebuchi, Love, and Ruparell (2008) point out that coffee farming among Africans was restricted to 100 trees per quarter acre, and there were further restrictions concerning the size and location of the farms. In the years to follow, marketing of cash crops, such as tea, coffee, pyrethrum, cotton, and others, could only be done through co-operatives (Atieno & Kanyinga, 2008). Moreover, Wanyama (2007) describes how state and donor support through

agricultural credit schemes, knows as the Co-operative Production and Credit Schemes, were administered through co-operatives, which gave farmers an incentive to join co-operatives. As solidarity was taking root, many Africans formed agricultural co-operatives for the purposes of marketing their produce and purchasing agricultural input in bulk.

Grassroots activism and solidarity were the ideological roots of the co-operative movement in Kenya, as with the Rochdale experiment. However, whereas in Rochdale, members of the working class started co-operatives in an industrialized setting, poor peasant farmers under the yoke of colonialism started co-operatives in Kenya. These farmers were dispossessed of land and could not grow certain crops while the weaponization of taxes, such as hut, poll, income, and land taxes, had the desired effect of forcing more indigenous Africans into wage employment (Waris, 2007). Their answer to these daunting socio-economic problems was to adopt the co-operative model, which seemed to have worked for the white settler farmers, where they would help themselves by helping each other.

3.2.2 Wave of African socialism

African socialism loosely describes a fusion of Marxist socialism and African tradition and culture which places more responsibility and control of the economy on the government and emphasizes coordinated production to achieve a classless society. African socialism started in the late 1950s and 1960s when many African countries were gaining self-rule and the freedom to build their nations as they knew best. This socialist experiment was promoted by freedom heroes such as Julius Nyerere of Tanzania, Kwame Nkrumah of Ghana, Sekou Toure of Guinea, and Leopold Senghor of Senegal, among others, who proposed transformative, nearly utopian, visions for their countries. The first point of call was to unveil new flags, national anthems, and new currencies as signs of their independence.

The overarching aim was to free themselves from the vestiges of colonialism through socialist transformation. Akyeampong (2018) points out that on the eve of independence, these leaders had a choice between capitalism, communism or socialism as a way of organizing their economies. Capitalism was reminiscent of imperialism and colonial oppression which these leaders had fought to rid African society of. They also desired to consolidate the country's resources which had been pillaged by the colonial government; communism was therefore deemed undesirable. State planning was therefore seen as the quickest path to prosperity and the way to true independence (ibid).

Arguably the most prominent model of African socialism was *ujamaa* (translated as 'brotherhood' from Swahili), pioneered by Julius Nyerere. After the independence of Tanzania in 1964[4], Nyerere rolled out an ambitious socialism blueprint for his country, essentially making Tanzania a developmental state. In 1967, the ruling party, the Tanzania African National Union, launched their policy on socialism and self-reliance, christened the Arusha declaration. In this blueprint, they stressed the role of the state in economic life to 'prevent exploitation of one person by another or one group by another and to prevent the accumulation of wealth to an extent which is inconsistent with the existence of a classless society (Tanzania African National Union, 1967). To this end, Nyerere would subsequently nationalize banks, public utilities, and other industries. In 1973, Nyerere would oversee the compulsory relocation of peasant farmers into co-operative villages, in what is commonly referred to as villagization. Lal (2015) notes that this was to facilitate government contact with citizens and augment bonds of reciprocity and ethics of hard work.

Villagization was not unique to Tanzania – there were variants of this policy throughout Africa. After gaining self-rule in 1975, the Front for the Liberation of Mozambique (known by its acronym FRELIMO) embarked on socialist programmes in rural Mozambique. Key among these initiatives was the creation of *aldeais communais* or communal villages in rural areas. O'Meara (1991) notes that this was with the ruling party's realization that 90% of the population was scattered in the rural areas with farming as their mainstay. Rogerson (1981) points out that this rural economic transformation was primarily aimed at boosting food production, easing the supply of social services, and, importantly, disrupting class forces in the rural areas. As with *ujamaa* before it, O'Meara (1991) notes that villagization in Mozambique initially received wide support from its citizens.

Despite many bold promises of this new economic order, many socialist initiatives had little to no success. While considering African socialism policies in Guinea, Ghana, Tanzania, and Senegal, Akyeampong (2018) points out that they all failed. He notes that the most prolific architect of African socialism, Nyerere, stepped down from power in 1985 after conceding that his attempt at *ujamaa* had

[4]The United Republic of Tanzania was formed on 26 April 1964 as a result of the union of mainland Tanganyika and the Zanzibar archipelago which had gained their independence from the British colonial government in 1961 and 1963 respectively.

failed. In the highlighted examples of Tanzania and Mozambique, this failure was attributed to several factors. Lal (2015) suggests that villagization reflected and intensified social differentiation among individuals and communities instead of standardizing the landscape of rural Tanzania. Coelho (1998) makes the same observation about planned villages in Mozambique. This had the effect of exacerbating poverty and inequality. Villagization also led to exacerbated food shortages. In Tanzania, this was due to unstable agricultural production (Lal, 2015) while for Mozambique, O'Meara (1991) notes that during the raging civil war, the Mozambican National Resistance (RENAMO) insurgent forces made the production and distribution of food a target. Coelho (1998) notes that this disrupted a significant number of communal villages.

African socialism also failed because of politics, abuse of power, and administrative incompetence. Schneider (2007) argues that socialist initiatives are inextricably linked to authoritarian politics. Lal (2015) describes the draconian political culture of the Tanzania African National Union government that sought to suppress local opposition and made security the preoccupation of the government. Similarly, Sumich (2020) notes that socialism in Mozambique was characterized by new forms of political pretense. Coelho (1998) points out that unfair land distribution by corrupt local authorities led to class stratification in rural Mozambique. While African socialism was initially seen as a well-reasoned attempt at true independence, it was soon likened to colonial approaches.

3.2.3 Co-operatives as a nuanced path to African socialism

Kenya was also part of the swelling tide of African socialism. However, while Tanzania and other countries implemented bold socialist policies, Kenya's form of socialism was more conservative. The roadmap to socialism was not linear in African countries. Akyeampong (2018) suggests that emphasis on African socialism varied for its various advocates, perhaps reflecting the unique circumstances of each new nation's challenges. In the sphere of African socialism, co-operative societies were to Kenya what villagization was to Tanzania and Mozambique. However, instead of organizing society as a whole as with villagization policies, the Kenyan government pursued a more conservative approach to socialism by encouraging the formation of co-operatives as a means of boosting economic development. This is also observed by Zeleza (1990) who points out that after independence, the state strongly encouraged the formation of co-operatives. This was because the state saw them as important in boosting agricultural production of cash crops which was the main economic activity and main

foreign exchange earner. This is also consistent with Fairbairn (2001) who observes that in developing countries, the state has often played a large role, including attempting to create co-operatives.

Soon after independence in 1963, the Kenyan government (the government) through Sessional Paper No. 10 of 1965 on African socialism promoted 'Africanization' in all spheres of the economy to eradicate poverty. Subsequently, the Co-operative Societies Act No. 39 of 1966 was enacted which replaced the 1946 Ordinance. The Act formalized state control of co-operatives in Kenya. The 1964–1970 National Development Plan stated that the government would 'assume a greater role in supervising co-operatives on financial and managerial matters' (Government of Kenya, 1964). Soon after, the Co-operative Societies Rules were formulated in 1969 to operationalize the Act and set out strict operating procedures for all types of co-operatives.

The close involvement of the government in the co-operative movement after independence was because the government considered co-operatives to be mechanisms for pursuing economic development rather than for promoting the interest of the co-operative members (Wanyama, 2007). Porvali (1993) suggests that this was because the government identified co-operatives as playing a crucial role in the development of agriculture among other economic activities. In this line of thinking, all major cash crops, such as tea and coffee, could only be marketed through co-operatives. To this end, several important national institutions were established during this transition period to complement the co-operative sector. Examples of these include the Kenya Tea Development Authority in 1964, the Coffee Development Authority in 1968, the Pyrethrum Board of Kenya in 1977, and others.

The government also sought to consolidate the contribution of co-operatives by superintending over virtually all aspects of their running. This was done through the immense powers bestowed on the Commissioner of Co-operatives (the Commissioner) in the registration and management of co-operatives. Wanyama (2007) outlines many of the overbearing powers of the Commissioner in the pre-liberation era. This included the registration, merger, and dissolution of co-operatives. The Commissioner also approved the co-operatives' annual budget, authorized borrowings and expenditure, and was in charge of auditing their accounts. Further, the Commissioner was in charge of all personnel issues which included remuneration, hiring, and dismissal of graded staff, and could even replace elected officials of the co-operative. The involvement of the state in the affairs of co-operatives was both far-reaching and stifling. As a result, service delivery and efficiency of co-

operatives were poor. This also caused the co-operatives to be run as if they were government-owned institutions instead of privately owned member organizations.

Omollo recalled that some of the duties that he had been assigned to related to the day-to-day operations of co-operatives which were ideally supposed to be performed by co-operative staff and management. He gives an example of the loan application process in the early 1990s. He recalls that members had to wait for two months or more to get a loan approved; this was because the physical loan application forms had to be sent to the Commissioner's office in Nairobi and processed by clerks at the Commissioner's office, after which a physical cheque for the loan would be sent back to the member. He noted that things have changed remarkably since then and that by 2010 when he retired, loan applications would take just about three days to one week if the amount applied for required approval from the management committee.

Despite tight state control over co-operatives, the Kenyan co-operative movement took off remarkably after independence. At independence in 1963, there were 1,030 registered co-operative societies (International C-operative Alliance, 2021). Between 1963 and 1966, 820 new co-operative societies were registered (Zeleza, 1990). By 1969, there were 1,894 registered co-operatives (Gatuguta et al., 2014) and by 1982, this number went up to 2,652 (Zeleza, 1990). Notably, however, agricultural marketing co-operatives constituted the majority of the registered co-operatives. This was chiefly because most co-operatives were concentrated in the rural areas where agriculture was the main commercial activity. For example, of the about 900 registered and active co-operatives in 1968, over 700 or nearly two-thirds were agricultural co-operatives (Zeleza, 1990).

The fashioning of the co-operative movement as a socialist initiative can also be seen through important legislation and government policy instruments that were adopted after independence. The first co-operative development policy formulated by the government was the Sessional Paper No. 8 of 1970, in which the government sought to consolidate co-operative activities through government support and supervision as well as to intensify education and training of members. In the same year, the Co-operative College of Kenya (now The Co-operative University of Kenya) was started to train personnel of co-operative societies and unions as well as government officers who would help in the supervision of activities of co-operatives. Around the same time, the Co-operative Bank of Kenya (Co-op Bank) was set up with a capital injection from the government, followed by an insurance

agency (now Co-operative Insurance Company of Kenya) which took on the task of underwriting risk insurance for co-operatives.

In the 1970s, new common bond types started to emerge based on members' occupation or by virtue of members having a common employer. For this reason, the 1980s and 1990s witnessed rapid growth in the number of co-operatives in Kenya. This was because many prospective members could not join existing co-operatives due to the common bond restriction and this resulted in people forming co-operatives across different occupations and institutions.

After independence, co-operatives started offering loan products to members using members' savings. School fee loans were, and remain, the flagship loan product for co-operatives. Co-operatives would later offer emergency loans and home development loans among others. At the time, these loans were ring-fenced and could only be used for the specific purpose for which they were meant. To ensure this, third-party documentary evidence was required when applying for a loan. This could be in the form of school fee notes for school fees, court bail notes for court bonds or fines, medical bills or notes from the doctor for emergency medical needs, and so forth. Co-operative managers observe that this was done primarily because co-operatives were not well capitalized at the time and therefore this was the only way to control the little resources the co-operative had so that members could only take out loans when they really needed them. In later years, co-operatives gradually abandoned the need for third-party evidence, given that co-operatives built more liquidity and therefore they did not need to follow up on the use of funds.

3.2.3.1 Coffee co-operatives as a socialist initiative

To bring this nuanced conception of African socialism into sharper focus and understand the impact of its approach, I zoom in on the coffee sector in Kenya where co-operatives have played a prominent role. Coffee farming in Kenya started in the colonial period when it was a preserve of white settler farmers. In the period, white farmers established the Kenya Coffee Association in 1933 and the first coffee auction was held two years later. In 1946, the Coffee Marketing Board was set up for marketing, warehousing, auctioning, and financing for white coffee farmers (Condliffe et al., 2008). One year after the adoption of the 1954 Swynnerton plan which allowed Africans to farm cash crops, albeit under tight restrictions, Kenya Coffee Auctions Limited was set up and the Nairobi Coffee Exchange was established to facilitate coffee auctions.

After independence, the government developed pragmatic policies to encourage the formation of smallholder coffee production and marketing co-operatives, expansion of processing facilities within co-operatives, and improvement of coffee payments to smallholders (Wanjiku, 2011). The first of these developments was the establishment of the Coffee Development Authority in 1964 to support co-operatives and small farmers and to provide farmers with technical assistance. In the same year, the Coffee Research Foundation[5] was set up to develop coffee disease and insect pest management protocols and technical advisory.

Notable was the improved marketing of coffee through the Nairobi Coffee Exchange where the government ran a weekly open auction system. Co-operatives played the important role of collecting coffee beans from their members and delivering them to the exchange. This auction system enhanced transparency and a pricing hierarchy with the higher quality AA beans fetching higher prices. The marketing of coffee also received a boost in 1966 when Kenya joined the International Coffee Agreement which set production quotas for each country. This led to a rise in coffee exports due to the improved marketing opportunity driving up the quality of coffee produced by co-operative members and coffee estates.

These highlighted efforts resulted in a steady increase in coffee productivity and caused coffee marketing co-operatives to flourish after independence (Condliffe et al., 2008). Wanjiku (2011) notes that these efforts led to a coffee boom between 1976 and 1977. She notes that until the 1980s, the co-operative-driven coffee sector was Kenya's largest foreign exchange earner, before losing out to tea and tourism in subsequent years. The African socialism project in Kenya was therefore apparently successful.

3.2.3.2 The death of African socialism

In the late 1980s, donor countries and the Bretton Woods Institutions made available vast amounts of money to low-income African countries for the implementation of structural adjustment programmes. Mohs (1988) points out that structural adjustment programmes were aimed at putting government finances into better order by cutting public expenditure by reducing the number of state employees, reducing subsidies, lifting capital controls to allow for cross-border capital flows,

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[5] The Coffee Research Foundation was subsequently transformed into the Coffee Research Institute under the Kenya Agricultural and Livestock Research Organization

liberalizing interest rates and privatization, and raising government income through tax reforms. Soederberg (2013) also notes that the International Monetary Fund made lending conditional on such deregulation measures. Towards the end of the twentieth century, the government started implementing extensive deregulation measures to promote unhindered, private-sector-led economic development, among other aims.

The rather rapid shift from a planned to a market-driven economy brought about some adverse socio-economic outcomes. One of the hardest-hit sectors after the implementation of structural adjustment programmes was the agricultural sector which was the main economic activity in the country. The coffee sector, which I discuss in the previous section, witnessed extensive deregulation measures through the implementation of structural adjustment programmes in the 1990s. This included the programmes pulling the sector out of co-operative management and ending financial support to co-operatives, and the Kenya Planters Co-operative Union and the Coffee Research Foundation limiting the role of the Coffee Board of Kenya as regulator, privatizing the coffee auction, and allowing a portion of coffee to bypass the auction and be sold directly to exporters (Condliffe et al., 2008). Between 1998 and 2007, coffee grower co-operatives began to die off due to a drop in coffee exports, coffee quality, and yields (Wanjiku, 2011).

This trend was replicated across other sectors and sub-sectors of the economy. Agricultural co-operatives had previously handled 98% of pyrethrum, 95% of cotton, and 65% of dairy produce but these numbers plummeted given that farmers were ill-prepared to participate in a competitive market environment (International Co-operative Alliance, 2021). Baka (2013) also points out that the manufacturing industry in Kenya witnessed significant job losses, given that most of the surviving and collapsed companies had adopted retrenchment as a cost-cutting method in an attempt to survive.

In 1987, the second co-operative policy, Sessional Paper No. 4 of 1987 themed 'Renewed Growth through the Co-operative Movement', was unveiled. In this policy, the government recognized the private nature of co-operatives. Following the paper, the responsibility of organizing and managing co-operatives was left to the members and their management committees while the government played an advisory role. This change was motivated by conversations in co-operative circles at the time which were backed up by several studies. For example, two World Bank studies, Hussi, Murphy, Lindberg, and Brenneman (1993) and Porvali (1993), which explored the Kenyan co-operative sector alongside a few others in Africa, acknowledged the potential role that co-operatives could play in the

development process, but only if they were restructured and disentangled from the state to be run on market principles. Hussi et al. (1993) found that whereas the government had a role to play, especially in training and technical assistance, the interventionist policy by the government tended to reduce member participation and control. Further, Borda-Rodriguez et al. (2016) argue that independence and autonomy are important for co-operatives' resilience.

The third co-operative policy came in the form of the Sessional Paper No. 6 of 1997 on 'Co-operatives in a Liberalized Economic Environment'. In this policy, the government reviewed and rationalized its involvement in the management of co-operatives and provided a legislative framework under which co-operatives could operate in a competitive economic environment. This led to the enactment of the Co-operative Societies Act No. 12 of 1997 which completely removed the government's role in the running of co-operatives. The aim of liberalization was the creation of commercially autonomous and member-based co-operative organizations that would be democratically and professionally managed and self-reliant (Wanyama, Develtere & Pollet, 2009).

The consequences of Kenya's conservative approach to African socialism through co-operatives were less drastic than the ones described for Tanzania and Mozambique. Whereas the state's control over the co-operative movement was stifling and precluded co-operatives from being run as members saw fit, it fostered stability and growth of the co-operative movement. Needless to say, the risks and forgone benefits of free enterprise and capitalism in the African socialist order will never be known. Akyeampong (2018) notes that the collapse of the Soviet Union in 1989 on the back of unsuccessful outcomes of African socialist policies marked the triumph and ascendancy of capitalism as the dominant economic paradigm in the world. The next section turns to the era of liberalized co-operatives after the fairly successful socialist experiment in the co-operative movement.

3.3 Post-liberalization era of co-operatives in Kenya

The post-liberalization era of co-operatives in Kenya is marked by two phases – the collapse of co-operatives followed by a revival of the sector. Both phases were significant in laying the foundation for a relatively stable co-operative sector in Kenya.

3.3.1 Near collapse of the co-operative sector

After the liberalization of the co-operative sector in 1997, the running of co-operatives was left entirely in the charge of elected committee members and managers. Co-operatives were no longer required to seek the approval of the Commissioner to spend, borrow or invest. Wanyama (2007), however, contends that the withdrawal of government involvement in the sector was abrupt and co-operatives were inadequately prepared for the competitive market. It bears stressing that, at the time, managers charged with the day-to-day running of the co-operatives were primarily non-professional volunteers who were hardly compensated and, in many cases, lacked the skills and experience of running co-operatives using business-like principles. This, coupled with the freedom that was brought about by liberalization, caused the collapse of many co-operatives in the ensuing years.

Wanyama (2007) puts forward a range of reasons why various co-operatives collapsed, including failure to hold elections, nepotism, theft of co-operative resources, refusal of management committee members to vacate their positions after elections, management wrangles, endless litigations, and unauthorized investing activities.

Magale Senior noted that after liberalization, political wrangles saw some large co-operatives split and eventually collapse. The split of co-operatives was particularly prevalent among co-operatives dealing in coffee, which at the time was the leading foreign exchange earner in the country. He recalled:

> 'Everyone wanted to be a chairman or a committee member. A giant co-operative like Mathira Growers Co-operative Society split into 13 smaller co-operatives – Mathira North, Rutuma, Barichu and others. This duplication made running them very expensive and so most of them died off while some merged again.'

He recounted a heated special general meeting in one large coffee co-operative in Nyeri district (now county) where he had gone as a representative of the state co-operative department to assist in mediating management wrangles that had ailed the co-operative:

> 'The wrangles often turned physical. I saw the same thing with Ndaro-ini Coffee Growers which broke off from Gikanda Farmers' Co-operative because farmers from the Ndaro-ini area felt underrepresented in the management of the mother co-operative. Even after they broke off, the fights continued because of the division of assets.'

Magale Senior observed that some agricultural co-operatives dealing in pyrethrum and cotton gradually collapsed after the sectors went into decline following the deregulation measures implemented years earlier. For example, the collapse of the pyrethrum sector affected over 200,000 farmers who were co-operative members (Mulagoli, 2011). Atieno and Kanyinga (2008) and Baka (2013) further underscore the significance of political interference in the collapse of primary co-operatives such as the KCC and the Kenya Planters Co-operative Union, given that decision-making was done on the basis of political expediency rather than managerial prudence. Their observation agrees with Birchall (2014) who observes that co-operatives in developing countries are generally more exposed to political interference than their counterparts in the developed world.

The collapse of the KCC in 1992 for the reasons mentioned above was particularly significant to the co-operative movement. The KCC was not one of the earliest co-operatives to be formed but it was considered a 'sacred cow', given its large membership and importance in the provision of milk in the country. While it is not clear how many were affected by the collapse of the KCC, Leksmono, Young, Hooton, Muriuki, and Romney (2006) note that, at the time, up to 800,000 dairy farmers, mostly from small households, partly depended on the sector. The collapse of the KCC led many farmers to turn away from co-operatives and, in some cases, informal self-help groups intended to manage their businesses efficiently (Czachorska-Jones, 2019). Leksmono et al. (2006) point out that, by 2004, informal vendors were selling roughly 86% of the retail milk following the collapse of the KCC. In subsequent years, the KCC changed ownership a few times before the government took it over and made it a parastatal which served to restore dairy farmers' confidence in the institution (Atieno & Kanyinga, 2008).

With regard to the events that led up to the near collapse of the co-operative sector in the early 2000s, the findings of this study are consistent with Atieno and Kanyinga (2008) and Wanyama (2007). Insights from interviews with co-operative practitioners reveal that there was a trend among co-operatives to invest in sizeable commercial and residential real estate projects which not only led to liquidity issues for the co-operative but also opened avenues for theft of co-operative resources through inflated bills of quantities and kickbacks from contractors. Many co-operatives also suffered insolvency as a result of loans to officials of the co-operative (insider loans) which went unrepaid and, in some cases, unaccounted for in the books of accounts. For some employer-based co-operatives in the private sector, liquidity problems resulted from delayed or failure to remit employee deductions (for monthly savings and loan repayments) to the co-operative. There was also rampant abuse of

power by managers and board/committee members who would use their influence to fast-track approval of loans and even grant loans where members did not strictly qualify for them.

3.3.2 Revival of the co-operative sector

The accelerated collapse of co-operatives in the years proceeding liberalization prompted the government to intervene to avert a complete collapse of the sector and address problems ailing the sector. This was done through two consequential pieces of legislation. The first legislation was the Co-operative Societies (Amendment) Act 2004 which restored some powers to the Commissioner in the superintendence of co-operatives. These powers included conducting inspections and inquiries into activities of co-operatives, surcharging officials found guilty of maleficence, dissolving and liquidating co-operatives, and providing technical extension services. Nevertheless, registration of co-operatives continued to be the primary role of the Commissioner. The Act further established the Co-operative Tribunal as an alternative dispute-settling mechanism for the co-operative sector. Other pieces of legislation in different sub-sectors were passed to complement reform efforts in the co-operative sector. For example, to forestall the further collapse and splintering of coffee co-operatives as earlier described, the Coffee Act 2001 was passed which dictated that a co-operative cannot have fewer than five factories.

The series of reforms also led to the disaggregation of co-operatives and the abolishment of multipurpose co-operatives due to misaligned objectives that had previously led to their collapse. The 'multipurpose' identity of co-operatives had been abused and had been used to venture into dubious investing activities which led to the collapse and near collapse of some co-operatives. In this new dispensation, co-operatives were required to specifically spell out the activities of the co-operative. The result was the disaggregation and registration of co-operatives with an auxiliary focus, such as housing, transport, and investing co-operatives, among others.

Even though reforms instituted in the mid to late 2000s proved effective in stabilizing the co-operative sector, several important reforms proposed in the SACCO Societies Act 2008 and in subsequent regulations from the SACCO Societies Regulatory Authority (SASRA) are yet to be implemented. One example is the Deposits Guarantee Fund which was supposed to protect members' savings in case of the collapse of the co-operative. In mature co-operative movements, such as the US and Britain, membership in a statutory deposit insurance scheme is compulsory and has been important in

protecting members when co-operatives become insolvent due to internal problems or some market volatility (Ryder & Chambers, 2009). Another proposed reform was the establishment of a Central Liquidity Management Facility which was meant to facilitate short-term lending between co-operatives whenever they experience temporary liquidity challenges.

Subsequently, the enactment of the Public Officer Ethics (Amendment) Regulations in 2010 led to the establishment of the Ethics Commission for Co-operative Societies whose role was to enforce the Co-operative Societies General Code of Conduct. The code served to ensure integrity and discipline among co-operative managers and board/committee members who had earlier been designated as public officers under the Public Officer Ethics Act 2003.

After the turbulent years, the co-operative sector has seen stable growth in terms of membership and all key financial parameters – total assets, total loans, and total deposits (SASRA, 2020). Currently, the Kenya co-operative sector boasts over 25,050 registered co-operatives and a membership of over 14 million persons (International Co-operative Alliance, 2021).

3.3.3 The emergence of SACCOs

Section 3.2.1 explains that co-operative societies in Kenya were initially formed in the colonial era by peasant farmers to help them market their produce and buy farm inputs. At the time, Kenya was not industrialized and therefore smallholder farming was the mainstay of the indigenous people. After independence, the country's economy began to diversify rapidly and, as a result, the sectoral distribution of co-operatives changed considerably. The government also encouraged the formation of localized multi-purpose co-operatives to improve service to members and the co-operatives' economic viability by leveraging economies of scope and scale.

From 1964, financial co-operatives, later called savings and credit societies, began to spring up (Zeleza, 1990). The earliest of these was Vya Savings and Credit Society, formed by a parish community in Machakos town, and Mwea Savings and Credit Society, formed by rice growers in Kirinyaga County (ibid). These co-operatives took periodic savings from common-bond members and converted them into small-ticket loans which were co-guaranteed by other members. The savings and credit model relied on prudent management of savings to ensure that there is no breakdown in the matching of members' savings and borrowings. The savings and credit co-operative model gained traction in the proceeding decades, as I describe below.

It is important to stress that the growth of the savings and credit co-operative model in Kenya, particularly from the 1980s, did not happen in isolation. Several related occurrences in the financial services sector made financial services available to the financially excluded, who were overwhelmingly poor. Key among them was the emergence of NBFIs in the early 1980s, as highlighted later in this chapter, and the emergence of microfinance institutions in the mid-1990s, which I now turn to briefly.

Section 1.5 mentions that microfinance came into prominence in the 1980s occasioned by the Grameen movement in Bangladesh. The centerpiece of microfinance was the idea of group lending, where the poor would pool their meagre resources and bear joint liability for each other's small loans. Armendariz de Aghion and Morduch (2005) posit that group lending helped circumvent information asymmetry that characterized credit markets in developing countries and resulted in adverse selection and moral hazard issues. The microfinance model spread quickly in the developing world and was seen as a path-breaking way to tackle global poverty.

The microfinance wave in Kenya came in the form of non-governmental organizations (NGOs), such as the Kenya Rural Enterprise Programme (known as K-Rep), Faulu Kenya, and the Kenya Women Finance Trust, which used donor funds to roll out micro-loan schemes in the early 2000s. In 2006, the Microfinance Act 2006 required that these NGOs and other institutions offering microfinance services operate as MFIs under the licence and supervision of the CBK. The first MFIs to be licensed were former NGOs who earlier had run microcredit programs. However, MFIs at the time could only issue loans from shareholder funds but were not allowed to take demand deposits from the public, otherwise referred to as the 'business of banking'. These conditions held until the formalization of the Microfinance (Deposit-Taking Microfinance Institutions) Regulations 2008 which allowed MFIs to take demand deposits from the public provided they adhered to strict prudential guidelines set out in the Act to safeguard the deposit-taking component of the businesses. This new law also saw deposit-taking MFIs, also called microfinance banks, come within the ambit of the main prudential regulator, the CBK.

In the last two decades, a significant number of MFIs have been registered in Kenya. Sector statistics from the Association of Microfinance Institutions Kenya (2020), show that in 2020, there were 12 microfinance banks, 34 credit only MFIs, and three wholesale MFIs. The proliferation of MFIs in Kenya, particularly in the last decade, intensified competition in the financial services sector as a whole as players fashioned strategies to tap into the lower end of the market. For example, Karlan and Giné (2007) indicate that, in the last decade, MFIs have tweaked their lending model and have transitioned

from group-lending loan products, which were the centerpiece of the microcredit model, to individual lending. There has also been remarkable innovation and increased use of digital access channels by MFIs. These developments in the microfinance sector and the industry competition that they occasioned had considerable implications for the co-operative sector.

The liberalization of the co-operative sector led to co-operatives devising innovative ways to reach out to more members and come up with new products and services to meet their members' disparate needs. One such innovation came in the mid-2000s when co-operatives began taking over-the-counter deposits, also called call or demand deposits, from both members and non-members of a co-operative. Unlike the previous situation where deposits were non-withdrawable or rather only withdrawable upon exiting the co-operative, call deposits were withdrawable akin to typical bank deposits. Initially, small departments within the co-operative, at the time referred to as banking sections, would take these over-the-counter deposits. It is important to consider that by taking demand deposits, co-operatives were effectively performing financial intermediation which, at the time, was the preserve of banks. However, there was no law expressly prohibiting co-operatives from taking call deposits from the greater public.

Several material developments in the financial services sector motivated co-operatives to take deposits. First, in the early 2000s, commercial banks imposed requirements for minimum bank balances, which left many small depositors unbanked. Co-operatives, therefore, saw an opportunity in providing savings facilities to this neglected customer segment. Secondly, at the time, commercial banks were concentrated in urban areas and towns. This left most of the people residing in rural areas unbanked or underbanked at best. Conversely, co-operatives had a relatively strong presence in rural areas and therefore there was an opportunity in banking the rural people. Thirdly, as earlier highlighted, the enactment of the Microfinance Act 2006 led to the emergence of MFIs all across Kenya. MFIs, like co-operatives, focused on banking small depositors and savings groups. Co-operatives thus faced intensified competition from MFIs and commercial banks, necessitating them to devise innovative ways of mobilizing savings from members and non-members to both survive and grow.

For several years there was an uneasy co-existence between co-operatives and banks given that co-operatives had encroached into the business of financial intermediation without the burden of regulation, as was the case with commercial banks. The evolution of the co-operative business model led to calls for tighter regulation of co-operatives involved in deposit-taking business. Omollo, who had been in the industry for over thirty years and, at the time of writing, worked as a sector regulator,

recalled the inaugural stakeholder workshop on possible regulation of deposit-taking co-operatives held in 2004. He explained that the co-operative model was particularly unique and, as such, stakeholders did not have a clear picture of what regulation for the sector would look like. In his words, 'at the time, the sector was not ready (for regulation)'. Intensified stakeholder engagements on the ripe issue of regulation of co-operatives involved in deposit-taking occasioned the passage of a new law, the Savings and Credit Co-operative Organizations (SACCO) Societies Act 2008.

The need for a specialized Act for SACCOs took account of the uniqueness of the SACCO model and SACCO operations which made them not fit neatly in the existent statutory instruments governing other types of co-operatives, namely the Co-operative Societies Act 1997 as well as the Banking Act and Microfinance Act which cast wide. The SACCO Societies Act formalized renaming financial co-operatives as SACCOs. The law also made a distinction between deposit-taking SACCOs and non-deposit-taking SACCOs – those who did not take demand deposits from the public. My informant explained that the passage of the new law had motioned deposit-taking co-operatives to register their banking sections separately as SACCOs exclusively dedicated to providing lending services. Perhaps the most transformative provision of the SACCOs Act was the establishment of the SASRA which was tasked with licensing and regulating deposit-taking SACCOs.

The newly established SASRA moved quickly to institute the SACCO Societies Regulations 2010 to operationalize the new law. These regulations were specifically targeted at deposit-taking SACCOs. Magale Senior explained that the primary aim of the regulations was to institute prudential guidelines for SACCOs to safeguard members' savings. For example, to address the issue of poor liquidity in SACCOs, the regulations established stringent liquidity and capital adequacy ratios. SASRA granted all deposit-taking SACCOs a four-year grace period to build up their capital base to 10 million Kenya shillings, among other requirements, to obtain a licence. He explained that the new law further specified the nature of investment activities that SACCOs could be involved in and capped the amount of member deposits that could be invested in capital projects, an issue that my informant explained had seen many co-operatives collapse in earlier years.

The SACCO sub-sector has grown since its formalization in 2008. Currently, there are roughly 3,052 registered SACCOs in Kenya (International Co-operative Alliance, 2021) with roughly 5.5 million members (SASRA, 2020).

3.4 History of banking in Kenya

As elsewhere in the world, banks are the oldest formal financial institutions in Kenya. In understanding the role of these important institutions in the advancement of financial inclusion, it is important to understand how they came to be and how developments in the sector have shaped their operations over time. This section sketches out the emergence and significant developments in the Kenyan banking sector with reference to the push for financial inclusion.

3.4.1 The emergence of banking in Kenya

The history of banking in Kenya traces back to the pre-colonial period on the Swahili Coast stretching from Kenya to the north, and Tanzania and Zanzibar to the south. Portuguese, Arabs, Indians, Europeans, and the indigenous Bantu tribes dominated trade on the Swahili Coast. In 1887, the British set up the Imperial British East Africa Company to facilitate their trading activities in the areas controlled by the British Empire. In 1896, the National Bank of India started banking the Imperial British East Africa Company through agents in the coastal town of Mombasa and between 1896 and 1901, the bank was instrumental in facilitating the construction of the Kenya-Uganda railway line.

The railway was meant to open the hinterland for business. Kimari and Ernstson (2020) note that the railway led to the establishment of Nairobi, roughly midway between Mombasa and Kampala, as a site for major warehouses. Nairobi developed into a critical commercial and financial hub to serve white settlers from the surrounding highlands. The railway and expanded trading opportunities saw the National Bank of India open inland branches, starting with Nairobi, in 1904. In 1910, the banking ordinance, which provided for the regulation of banks, was passed and the National Bank of India became the first licensed commercial bank in Kenya. Several banks were licensed in Kenya in the subsequent years, including the Standard Bank of South Africa and the Indian-based Kathiawad and Ahmedabad Banking Corporation.

The colonial period in Kenya commenced in 1920 after the East Africa protectorate, which stretched from Kenya to Uganda, was declared a colony of the British Empire. The subsequent years saw an influx of international banks, including the Algemene Bank Nederland, the Barclays Bank, the Indian-based Bank of Baroda, the Bank of India, and Pakistani-based Habib Bank. At this time until independence, banking services by international banks were not available to Africans and were the preserve of Europeans, Asians, and Arabs who had settled in Kenya. Poor Africans who worked for

white settlers could only access banking services from the Post Office Savings Bank which only had a few branches in places where there was staff from the colonial regime.

3.4.2 Africanization of the banking sector

After independence, CBK was established in 1966 and took over the bank clearing house and the issuance of currency. Before this, throughout the colonial period to independence, the East African Currency Board undertook these functions in the entire East African region. Some international banks left the country while the remaining banks started opening their services to Kenyans. However, these services remained inaccessible to a majority of Kenyans who were still poor, were not formally employed, and lacked productive assets to borrow against. Only white settlers and a small minority of Kenyans who were relatively wealthy patronized banks for many decades after independence.

Some local banks also launched in Kenya after its attainment of self-rule. The first local bank was the Co-operative Bank, established in 1968 with capital from a few directors and the government. In the same year, the National Bank of Kenya was set up to become the first fully owned government bank. In 1970, the government bought a full stake of the National and Grindlays Bank[6], which at the time was the largest commercial bank in the country, and renamed it Kenya Commercial Bank. By 1970, the government had a virtual monopoly over the banking industry in Kenya. At the time, banking services were still not accessible to a vast majority of Kenyans who were still poor and did not own productive assets. Africans therefore resigned themselves to co-operatives for their financial needs.

This monopoly would be disrupted in subsequent years as NBFIs started springing up in 1982 after the government had relaxed financial control measures in line with prescriptions of the International Monetary Fund (Muriithi & Louw, 2017). These NBFIs were in the form of finance houses and building societies which started as a result of significant barriers for customers to enter the banking industry, such as the requirement for customers to have a minimum capital of 2 million Kenya shillings and to maintain a cash reserve ratio. However, in subsequent years, the CBK would impose restrictions on NBFIs to maintain cash reserves and curtailed their operations further. For example, building societies could not participate in the clearing house, could not offer current accounts, and could not deal in foreign currency. NBFIs, however, appealed to a niche market of rural and low-income borrowers and savers who did not need sophisticated products and services.

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[6] The National and Grindlays Bank was a result of a merger between the National Bank of India and Grindlays Bank in 1958.

However, banking institutions also had a few limitations owing to operational banking law at the time. For example, commercial banks were not allowed to engage in mortgage lending, given that this was seen as mismatching maturity of the debt and demand-deposits from savers. Consequently, in the early 1990s, the CBK adopted 'universal banking'[7] and started encouraging NBFIs to convert into commercial banks and merge where feasible. Consequently, between 1994 and 2000, a total of 27 NBFIs merged or converted into fully-fledged commercial banks[8].

The emergence of NBFIs intensified competition in the financial services sector. Notably, the different provisions in the banking law had differentiated banks and NBFIs in terms of the services they could provide and saw these institutions leverage their positions to meet the demand of an expanding market. This intensified competition also brought about aggressive practices, especially among NBFIs which were started by non-professional businesspeople who Muriithi and Louw (2017) suggest were 'only interested in profit and self-gratification'.

The Kenyan banking sector witnessed significant instability in the 1980s and 1990s as a result of the intensified competition described above. Muriithi and Louw (2017) note that there were two waves of the collapse of banks and NBFIs. The first wave came between 1984 and 1989 when two banks and ten NBFIs collapsed. The second wave happened between 1993 and 1996, affecting seven banks and ten NBFIs. Muriithi and Louw (2017) attribute these collapses to governance issues, inadequate staff with requisite skills in banking, imprudent lending practices, and the weight of non-performing loans which mostly resulted from insider lending to prominent politicians.

A raft of reforms initiated by the CBK followed and included tightened requirements for licensing of banks, minimum capital requirements, mandatory deposit insurance, and prohibited earning of interest on non-performing loans (Muriithi & Louw, 2017). These reforms came through a string of amendments to the Banking Act and the Financial Act 2008. The CBK set up the Kenya School of Monetary Studies in 1994 to offer banking training and upskilling to banking staff. Improved corporate governance, aggressive cost management, and prudent liquidity management have seen the sector record positive growth from 2003 with occasional poor performance from some banks (ibid).

For most of the decades following independence, both international and local banking institutions in Kenya only served a select niche of wealthy customers who resembled white settlers in the pre-

[7] Universal banking refers to consolidating under 'one roof' and brand a wide spectrum of financial services offered by banks and NBFIs, such as investment services, credit services, savings accounts and others.
[8] https://www.centralbank.go.ke/commercial-banks/conversions/

independence period. Brownbridge (1998) attributes this to the high cost of deposit mobilization, particularly among local banks, which made them lend at high interest rates to inevitably high-risk borrowers (mostly politically exposed persons and a few low-income customers) in an attempt to make a profit. This is because indigenous banks inevitably face greater risks than established foreign-owned banks (ibid). Muriithi and Louw (2017) assert that despite the gains in reforming the banking sector, which has grown from the early 2000s, banks have largely been unable to reach the majority of the rural population.

A particular challenge for banking institutions after independence until the last decade has been their inability to unlock credit for a majority of the population. Banks employ the traditional form of lending where loans are secured by assets. In the early 2000s, the big banking corporations in Kenya started offering unsecured loans which dispensed with the need for collateral in form of assets but required a surety from the borrower's employer. As such, unsecured loans from banks were only accessible to relatively few people who worked in the civil service or for blue-chip private companies with which the banks could enter so-called 'check-off' agreements. CBK (2019) estimates that by 2006, only 26.7% of Kenyans had bank accounts, and even fewer accountholders could therefore access formal credit. Such constrictions caused people on the margins of the economy to rely on non-bank financial intermediaries, particularly co-operatives.

3.4.3 Mobile money as a disruptor

Until the 2000s, the operations of banks in Kenya, as elsewhere in the world, were different from banking as we know it today. For decades, bank customers had to carry physical 'pass books' which contained their ledger of deposits and withdrawals to access banking services. Later came cheques which were for a long time a preserve of companies and very wealthy individuals and took a long time to clear. The emergence of automated teller machines (ATMs) in the 1990s was perhaps the first step in leveraging technology to improve round-the-clock access to a limited number of financial services. This made financial services largely inaccessible and their cost prohibitive. The invention of M-Pesa in 2007, which I describe in chapter one, disrupted the financial services sectors significantly. M-Pesa eased the process and cost of transferring money for many users. The commercial banks who had enjoyed decades of non-disruption and profitability were caught flat-footed and saw M-Pesa as a disruptor and a credible competitor.

What followed was a short period of resistance from the powerful incumbents who wanted M-Pesa discontinued. They argued that M-Pesa was encroaching on their domain by acting as a (temporary) bank account and facilitating money transfers that posed potential money laundering risks, all while being free from regulatory scrutiny. In terms of Safaricom, the commercial banks argued that the Banking Act did not provide the basis to regulate products offered by non-banks like mobile network operators. After some backroom lobbying by Safaricom, the CBK took a 'test-and-learn' approach to the regulation of M-Pesa and in February 2007 issued a 'letter of no objection to operate' which allowed M-Pesa to operate legally under limited conditions.

Kenyans adopted mobile money quickly and in large numbers – by 2014, 73% of adult Kenyans had opened M-Pesa accounts (Demirgüç-Kunt, Klapper, Singer & Van Oudheusden, 2015), abandoning some of the services offered by commercial banks. Immediately, commercial banks and MNOs found common course in the extension of financial services to a majority of the population with the hope of earning fees charges on mobile-based financial services. Starting in 2010, mobile banking platforms devised a convenient way for customers to make deposits and withdrawals. Later, the mobile banking platform would be fashioned as a channel for banks to extend short-term credit to their customers. This ushered in a wave of financial intermediation and 'financial inclusion' by different financial institutions but, most importantly, by commercial banks who significantly altered their operations, products, and commercial strategies. Chapter five describes this wave of digital lending in Kenya in more detail.

3.5 Conclusion

To comprehend how co-operatives attempt to advance financial inclusion, this chapter has unpacked the origins of these organizations and outlined how they developed and operated over time in the global context and in Kenya where disaffected Kenyans saw the formation of co-operatives as a means out of the indignity of their poverty. Even though co-operatives were successful in getting disenfranchised individuals to work together for their mutual benefit, the co-operative movement has been far from perfect. After independence, the Kenyan government modeled its African socialism policy through interventionist policies in the co-operative sector. Although these policies saw co-operatives lose their appeal as autonomous, member-based organizations, their implementation was instrumental in co-operatives' stability and growth. Further, the near collapse of the sector in the early 2000s threatened the ability of SACCOs to be vehicles of financial inclusion for people of modest

means. Concerted efforts in reforming the sector have, however, restored confidence in co-operatives and have seen the sector grow remarkably in the last two decades.

Banks have historically been the traditional providers of financial services globally. This chapter has described the unwillingness of banks to reach out to poor and seemingly unprofitable customer segments, namely the rural populations and the poor, for many decades after independence. The emergence of NBFIs momentarily reached out to these excluded groups albeit with challenges before the CBK stepped in to re-assert the dominance of banks through universal banking policies and legislation. By 2006, roughly one-quarter of adults in Kenya had bank accounts and even fewer could access formal credit. The rest of the population was served by semi-formal financial institutions such as co-operatives and informal lenders. The emergence of mobile money in 2007, however, gave the financial inclusion project a lifeline and forced banks to devise ways to reach out to their established customers and new customers through mobile banking and digital lending, as I discuss later.

CHAPTER FOUR: CASE STUDIES

4.1 Introduction

As described in chapter two, I interviewed people working for SACCOs and people working for digital lending platforms. Furthermore, I interviewed people who are members and customers of SACCOs and who make use of the services provided by digital lenders. Being a member of a SACCO and using a digital lender are not mutually exclusive – people who are members of SACCOs can also use the services they now provide to non-members, and they can also make use of the services provided by digital lenders. SACCO members are often customers of digital lenders, while the reverse is not typically the case. Further, in a recent trend, a few large SACCOs have also become digital lenders who give digital loans to their members. I interviewed a few industry practitioners who have been involved with these institutions at some level, either as a regulator, as former employees, or as consultants.

My interviewee sample did not comprise larger defined populations. In any case, it was difficult to pigeonhole the informants into distinct categories because of the reasons described above. However, I made an effort to cover some of the variations within the categories of people working for SACCOs and digital lending platforms, members of SACCOs, and people making use of the services SACCOs provide to both members and non-members and the services that digital lenders provide to customers. To this extent, I selected people working for SACCOs with large numbers of members and SACCOs with fewer members, and employees at different levels within the hierarchies of these SACCOs, namely employees who had worked in SACCOs for many years as well as younger employees with brief experience. I also varied my informants to take into account their experience in starting and running digital lending platforms, their involvement in developing digital lending platforms, and their interaction with different types of digital lenders, namely internationally based lenders, locally based lenders, bank-based and non-bank digital lenders.

In this chapter, I introduce some of the variations in the informants described above by setting out thirteen case studies. I had the opportunity to interview some of the informants on multiple occasions, usually more than once, and I have long-standing personal and/or professional links with some informants. These case studies also highlight the fact that the informants occupy different positions

within the SACCO sector or within the digital lending industry, and are in different positions as users of the various services provided. Many aspects of the stories told in the case studies are readily comprehensible at this point of the thesis. However, the reasons for and full implications of these different cases are made clear in the three chapters to follow where I frequently refer back to these case studies in order to draw out their significance for my overall argument.

4.2 Case studies

Case 1: Makosa the security guard

Makosa is a male in his mid-thirties. He is employed by a security company as a guard posted at a warehouse facility of an agrochemical company in Nairobi. I first met Makosa while calling on a friend who works as a warehouse manager where Makosa works. In our encounters, I gather that we both come from the same village upcountry and, while talking with him about our family backgrounds, I realize that my mother is married into his family clan, which in our shared tradition effectively makes us relatives. Whenever I visit my friend, Makosa and I break out into fairly lengthy chats about his job and the various election races that are hotting up. Makosa is only too glad to chat his way through his shift with his 'relative'.

From our numerous encounters, I become interested in learning more about Makosa's background. Makosa mentions that he has been employed by the security company for four years. He has had several postings during that time, including at a bank, at a high-end residential estate, and at various office buildings in the central business district. He works day shifts three times a week and night shifts three times a week and rests for one day each week. During this time, he has not had any scary incidents at work, but he decries his long working hours. He also regularly refers to his meagre wages which he mentions are paid per hour worked at the end of every week.

I am interested to know how Makosa manages with his meagre wages and particularly if he takes out digital loans to smooth his consumption. He mentions that he was dependent on digital loans for roughly five years. He explains that each month, he would get several small mobile loans from different platforms. He recalls that at one point he had five different loans outstanding. It was at that point that he started defaulting on the loans one after the other. He explains that the rollover fees, additional interest, and penalties were so punitive that he gave up on repaying the loans.

After defaulting on all four digital loans, Makosa was getting at least ten demand calls per day from digital lenders and debt collection agencies asking him to repay his digital loans. He tried switching phone numbers but since the mobile number was registered in his name, the debt collectors still got to him. He resorted to being non-responsive to calls from numbers he did not know.

In early 2021, Makosa learned through an SMS that he had been blacklisted by the CRBs for lack of payment. He explains that he can no longer access any type of loan including digital loans as he is considered a high credit risk. He says that even if by some miracle he pays the loans fully, it will take a long time before he can access any credit. He explains that his financial life is now in ruin because of his over-indebtedness and that he is left to borrow from friends and relatives during emergencies, something he finds very unpleasant. For the foreseeable future, Makosa expresses, he will have to contend with his long working hours and meagre pay to make ends meet.

Case 2: Odongo the boda-boda rider

Odongo (pseudonym) operates a motorcycle taxi and delivery service, popularly known as 'boda-boda', for a living. My first encounter with Odongo was in 2020 during the lockdown of the COVID pandemic when he was making deliveries to our home. At the time, my wife, who works as a brand manager, was working from home and Odongo would make frequent deliveries of branded merchandise samples for her approval. During these brief interactions, we would chat generally about the surging pandemic and the various government measures to contain the pandemic, such as mask mandates, the cessation of movement in and out of Nairobi City, and the dusk-to-dawn curfews.

One day, while running an errand for my wife, I meet Odongo by chance outside a popular mall and I immediately recognize him and approach to greet him. As he hurriedly takes his tea, I strike up a brief conversation with him. Every minute is precious to Odongo. He is covered in old leather gear and is wearing a bright green reflector jacket and muddy gumboots. Odongo has been in the boda-boda business for four years. He started his modest business after working as a security guard when he came to Nairobi from upcountry ten years ago. He tells me that his unemployed wife and three young children are still upcountry. I gather that Odongo rents a single room in an informal settlement near the mall where he operates from. He explains that living in Nairobi is expensive and that he tries all means to minimize his living costs and works long hours on his boda-boda to provide for his family upcountry and send his children to school. Recalling his days as a security guard, he tells me that he

was constantly unhappy, broke, and in need of a challenge where he could dispense his youthful energy.

I steer our conversation to discussing how the boda-boda business works. Odongo explains that he became interested in the boda-boda business after talking to several of his friends who had left wage employment to start their own boda-boda businesses as a way to chart their path to financial freedom. At the time, his long-term goal was to own a fleet of boda-bodas in Nairobi and upcountry. He explains that he procured his motorcycle through a higher purchase agreement, and he is still paying for it every month. He explains that he charges between 50 Kenya shillings (half a US dollar) and 100 Kenya shillings (one US dollar) to transport his clients to the neighboring estates. Odongo also gets delivery orders from his regular clients whose trust he says he has earned. He charges slightly higher for this concierge service.

After our initial discussion, I gather that Odongo represents people who would neatly fit the description of a person 'at the bottom of the pyramid'. I explain my research project to him and he is willing to talk to me some more. I immediately become interested to know if Odongo takes out digital loans. He explains that he is subscribed to four different digital lending platforms – M-Shwari, Fuliza, OKash, and Okolea. M-Shwari and Fuliza are provided by a partnership between Safaricom and NCBA and KCB Banks while Okash and Okolea are private (non-bank) digital lending platforms and are characteristically more expensive. Odongo has used M-Shwari for nearly ten years and has recently subscribed to Safaricom's Fuliza overdraft facility. He explains that both platforms are reliable since they are provided by Safaricom. He explains that he started using OKash and Okolea roughly four years ago after receiving unsolicited SMSs from the two platforms nudging him to take out the digital loans.

In responding to the question of why he takes out multiple loans and what he uses the loans for, Odongo expresses that he takes out digital loans to buy petrol and pay for minor repairs on his boda-boda. He also explains that he makes very little from his boda-boda business to take care of his own needs and that of his family and to make the monthly repayments for his motorcycle loan. In light of this, he has to take out digital loans regularly. I become naively curious about how he keeps up with the loan repayments. He laughs and explains a clever 'Ponzi' scheme where he schedules his digital loans in such a way that he takes out one loan to repay one or two other loans falling due. He admits that despite this elaborate borrowing scheme, he is often late in repaying his loans, particularly if he

has an emergency. He describes one such emergency: an unfortunate incident where he was involved in an accident after his boda-boda had slipped while he was rushing to make a delivery. He explains that he had to take out a digital loan to pay for treatment and meet his household expenses for the few weeks that he could not work.

For Odongo, the opportunity cost of not borrowing to meet his competing needs far outweighs the cost of the loan or any future outcomes such as over-indebtedness. I naively ask if he is a member of a SACCO. To this question, he responds that his paltry income precludes him from joining any SACCO or even operating a bank account. I discern that Odongo is dependent on digital loans to survive and is trapped in a perennial cycle of borrowing. Further, given the fact that he is multi-borrowed, he is over-indebted as he has great difficulty meeting his loan repayment obligations. Odongo expresses that he still has aspirations of owning a fleet of boda-bodas, but his present priority is getting himself out of debt.

Case 3: Brian the contract worker

Brian (pseudonym) is the ultimate gig worker. I have known Brian for most of my life, having gone to the same primary school and having attended the same college. I have always known Brian to have a knack for music and instruments. He plays the piano, guitar, and drums and is a self-taught music producer. In college, Brian was part of numerous music bands and always had complimentary tickets to concerts, some of the few perks of our friendship. He has told me that he finished college to make his mother happy. He explained that his mother's dream was to see all her children graduate from college, something she had not achieved herself owing to her modest background. Despite holding an undergraduate degree in psychology, he followed his passion for music after graduating ten years ago.

I meet Brian at the Kenya National Theatre, a popular hangout for creatives, where he is meeting his production crew. He is wearing dark sunglasses and I am taken by his red mohawk and ripped t-shirt which he quickly explains is a new fashion trend. He sees me and leads me to a bench where we start conversing. We talk about his humble beginnings as a music producer and the numerous music stars he has worked with, some who have since faded away from Nairobi's music scene. He reminds me of his first home studio in his religious mother's house and her opposition to his music career.

Brian works as a music director in a local television production company. He explains that he is not employed by the production company but is rather contracted whenever the company starts producing

a new television series and he is paid per episode. He explains that his chosen line of work is precarious and that he often goes for two or three months without a gig.

My interest in speaking with Brian is to learn about his experience with digital loans which, during our previous encounters, he mentioned he frequently uses. Brian explains to me that he uses two digital lending applications – Tala and M-Shwari. He has been using the two lending platforms for over five years and has built a high credit limit on both over the years. For Brian, taking out digital loans is not precisely driven by convenience but is a necessity at times. He explains that he takes out digital loans from Tala and M-Shwari every month. He uses the loans to meet cash flow shortages in the last week of the month before he gets paid and to meet his expenses for months when he is not under contract. Brian also borrows for convenience. He explains that he takes out digital loans to make impulse purchases now and again. Although he has had a few late payments, he mostly repays his loans on time. He suspects that his frequent use and often timely repayment of the loans is the reason he has a high credit limit on the two platforms.

During the interview, I gather that Brian has joined Mwalimu SACCO, one the biggest open-bond SACCOs in Kenya. Mwalimu SACCO was initially a teachers' SACCO but opened membership to the public about ten years ago. Brian operates a front office services activity (FOSA) account with the SACCO which allows him to access basic banking services, in his case mostly savings facilities. He explains that when he gets windfalls from making advert jingles for corporate clients, he saves the money with the SACCO which pays him higher interest than banks.

Brian is, however, not a paid-up member of the SACCO which means that he cannot operate a back office service activity account that would allow him to access co-guaranteed loans and receive dividends on his shares. He explains that his erratic income does not allow him to make the mandatory monthly contributions/savings with the SACCO. Further, he explains that even though his SACCO has a digital loan facility, he cannot access the loan since he is not a paid-up member of the SACCO. Brian has to contend with digital loans from other digital lenders, loans from his friends and relatives, and occasional windfalls.

Case 4: Aisha the young lawyer

Aisha (pseudonym) was a fresh law graduate at the time of our initial conversation. She was doing her pupilage at a small law firm in Nairobi. Her pupil master was only able to pay her a small stipend

which barely covered her bus fare and lunch. She had to take out three digital loans a month to supplement her stipend. She mentioned that she had great difficulty repaying her loans. She explained that she had to take out digital loans, no matter their cost, to finish her six-month pupilage which was a mandatory requirement for admission as an advocate of the high court of Kenya. She expressed that once she was admitted as an advocate she would have prospects of securing employment and practicing law which she was very passionate about.

In a more recent encounter with Aisha, during a celebration of her admission to the roll of advocates, I learn that she had secured employment as an associate at a law firm in the city six months prior. I am interested to know the state of her interaction with digital loans – I presume much has changed now that she has a steady source of income. She explains that, indeed, things have improved a little for her financially – she has just completed her probation period at her employer and is now a permanent and pensionable employee. She is clearly excited about this development.

Aisha tells me that when she got employed, her father, himself a lawyer, had advised her to join his SACCO and start building savings. Her father had been a member of Sheria SACCO (sheria meaning law in Swahili) for over thirty years. He joined as a young lawyer and he had mentioned to her that the SACCO had helped him make a few investments, including building their countryside home. He had asked her to save with the SACCO and use the money to pursue a master's degree as soon as possible.

I am curious to know what else inspired her choice to join Sheria SACCO. She explains that most law firms in Nairobi have less than ten employees and are therefore too small to have a SACCO. This is the case with her firm. She explains that most of her senior colleagues and lawyer friends belong to Sheria SACCO. Sheria SACCO was once a professional SACCO for lawyers but recently incorporated multiple common bonds, such as employees of the judiciary and of the office of the attorney general who were non-lawyers, spouses of members of civil servants, and employees of select private organizations. To join Sheria SACCO, Aisha had to buy the minimum share capital of 20,000 Kenya shillings (200 US dollars) and pay a few additional charges. She expresses that the share capital was too steep for her to pay at once and the SACCO allowed her to pay it off over two months. Aisha is required to save a minimum of 2,000 Kenya shillings monthly with the SACCO and make a mandatory 200 Kenya shillings (2 US dollars) contribution to the SACCO's benevolent fund. The SACCO uses the benevolent fund to make set funeral contributions to the member when they lose someone within their nuclear family or to the member's family when the member is deceased.

Aisha cannot ascertain the total number of members of her SACCO but suggests that the SACCO is medium sized even though it has allowed for multiple common bonds. Unlike other large SACCOs that have a presence in many regions in the country, Sheria SACCO only recently opened a second branch and does not offer digital loans like other larger SACCOs. Aisha suggests that the SACCO's requirement for new members to buy minimum share capital is quite prohibitive. For now, Aisha is still building her savings and she hopes to take out a SACCO loan to pay for a master's programme in roughly two years.

Aisha's mother has recently retired from the civil service, and now both her father and mother have left the city for their farm in the countryside. Even though her parents have helped her pay her first month's rent and deposit and have handed down some household items to her, fending for herself in the city has placed new demands on her finances. She not only has to pay rent and buy groceries but also has to pay her SACCO monthly contribution and her student loan with the Higher Education Loans Board. She describes her situation as being 'thrust head-first into the deep end of adulthood'.

At this stage, I am immediately curious whether she still uses digital loans and how this has changed from the previous time we talked. Aisha mentions that she indeed still uses digital loans from two different lenders as before. She still uses the loans to supplement her small income, something she had hoped would change after she got employed. She mentions that even though she enjoys a greater degree of predictability in her finances, her income alone falls short of the cost of living and working in the city. Digital loans are therefore still an essential part of her finances.

Aisha suggests to me that she struggles not to take out digital loans because she keeps getting nudges to borrow and to increase her credit limit. She faults the marketing tactics of digital lenders and argues that they are, in effect, predatory. She explains that 'if they send you an SMS for a fridge, for example, you may not even pay attention to the advert because you only need so many fridges. But if you advertise money, then we're talking! That SMS may find you at a very vulnerable moment'. According to her, she is looking forward to marketing regulations in the impending regulations on digital lending. She mentions that the promotion of financial services is provided for in the Finance Bill 2018, which was shelved, but she hopes it makes it back through the new regulations.

Case 5: Vivienne the corporate banker

Vivienne (pseudonym) is a well-educated professional banker in her forties who lives and works in Nairobi. I came to know Vivienne a few years ago from my church. In my numerous interactions with her over the years, I have come to know that she works as a senior relationship manager in the corporate banking division of a large bank. Her job entails facilitating day-to-day banking needs for a portfolio of existing clients, such as complex transactions and foreign exchange deals. She also meets heads of institutions, senior finance managers, and other high-flying professionals from blue-chip corporations in a bid to acquire new corporate clients for the bank. Vivienne joined the bank fourteen years ago as a graduate trainee, right after finishing her undergraduate degree. She rose through the ranks to become a senior relationship manager. While working at the bank, she completed her accounting qualification and an Executive Master of Business Administration programme. She is a paid-up member of professional industry associations. In many respects, Vivienne is a consummate professional and a member of Nairobi's high society with significant social status in her personal and professional circles.

After numerous attempts to get her to sit down with me for an interview, I manage to arrange that we meet at a restaurant in the central business district where her offices are located and where she is scheduled to meet a corporate client later in the day. From where I am seated, I can see her pull in in her sleek, red Mercedes. She comes out dressed in a grey suit and carrying a seemingly expensive handbag. I wave at her, and she immediately notices and points to a quieter corner of the restaurant. I quickly follow. We order coffee and start chatting.

In one of my earlier interactions with Vivienne, I gathered that she is a member of a high-end closed-bond SACCO, Bankers SACCO (pseudonym), which draws its membership from people in the banking profession. Owing to the massive resources of its members, Bankers SACCO has made a number of commercial and residential real estate investments and is known for paying attractive dividends to its members each year. I gather from her that she has been a member of the SACCO for over ten years and that she has built substantial savings over that time. She explains that due to the closed bond in her SACCO and restrictive requirements around share capital and monthly contributions, the membership of the SACCO is relatively small. She explains that her SACCO is dominated by bankers and former bankers who form part of the corporate elite in Nairobi. She mentions several well-known corporate magnates who belong to her SACCO and explains that

Bankers SACCO has served her well over the years. She took out SACCO loans to fund her Executive Master of Business Administration course at a business school overseas and buy her dream car, a Mercedes.

My initial interest in interviewing Vivienne was to find out about her experiences as a SACCO member which she had mentioned in our previous encounters. As we continue with our conversation in the restaurant, I gather that she occasionally makes use of digital loans, in particular M-Shwari. In response to the question of why the choice of M-Shwari and not any of the other numerous digital lenders in the market, she expresses that M-Shwari comes with Safaricom's brand credibility as opposed to other nondescript digital lenders. She explains that unlike the unregulated digital lenders, Safaricom is regulated by the Communications Authority of Kenya and that this forces them to institute consumer protections and ensure product reliability. She also explains that she uses M-Shwari because her closed-bond SACCO does not offer digital loans on account of its small membership. From her banking knowledge, she explains that digital loans only make business sense if the lender extends as many loans to as many borrowers as possible and maximize loan repayments. Pointing out a few examples, she explains that SACCO digital loans are only common among a few open-bond SACCOs which have a large membership.

In response to the question of what she uses digital loans for, Vivienne speaks of two recent instances when she took out M-Shwari loans. The first was when she visited an artisan market, known as the Maasai market, where she purchased a pair of Maasai sandals. She explains that ladies always need a pair of flat shoes or sandals in the car as it is uncomfortable driving in heels. She explains that she had been driving barefoot for almost a week and wanted to buy flat shoes. Given that she could not pay for the sandals, which she desperately needed, using her debit cards at the Maasai market, she resorted to taking out an M-Shwari loan given that she did not have enough cash in her mobile wallet to make the purchase.

Vivienne also tells me of a time when she left her office in a hurry to meet an important client. In the hurry, she forgot to take her purse. She explains that she had to take out an M-Shwari loan to pay the lunch bill and refuel her car on the way back to the office. For Vivienne, digital loans afford her convenience to make small, time-sensitive expenses when she is low on cash or is in situations where she has no access to money she already has elsewhere. She expresses that she has no difficulty

whatsoever in repaying her digital loans. She also expresses that unlike the 'tiny' digital loans, SACCO loans are ideal for large investments and purchases given their high value and long tenure.

Case 6: Jeanne of Pioneer Nanoloans

Jeanne (pseudonym) is a computer scientist by training with vast experience in the design and development of digital financial services. Jeanne has held several positions before her current role as chief executive officer of Pioneer Nanoloans (pseudonym), one of the largest international non-bank digital lenders in Kenya. Jeanne previously worked for Safaricom as a product manager. In this role, she was closely involved in the design of several digital lending products which involved partnerships with various local banks. Jeanne was particularly proud of her involvement in developing Safaricom's M-Pesa overdraft facility, Fuliza, which became their biggest lending platform.

During our interview, Jeanne tells me that she left the MNO in 2019 to work as the head of digital financial services at a local bank. She explains that, at the time, many banks were setting up mobile money platforms and digital lending platforms. She was therefore tasked with 'digitizing the bank' and building a mobile lending platform for the bank. Emphasizing the importance of her mission at the bank, she mentions that she was given an open budget for her first two years. This allowed her to quickly bring in additional expertise to develop both a mobile banking and a mobile lending application.

Jeanne was recently recruited to head Pioneer Nanoloans. Pioneer Nanoloans was launched roughly seven years ago and was one of the first non-bank digital lenders. Jeanne mentions that Pioneer Nanoloans currently serves six million customers. Pioneer Nanoloans offers loans of between 1,000 Kenya shillings (10 US dollars) and 30,000 Kenya shillings (300 US dollars) which carry a loan tenor of either 21 days or 30 days. Jeanne claims that Pioneer Nanoloans employs risk-based pricing such that when a customer is onboarded, they start borrowing at an interest rate of 15% but this rate is reduced to up to 5% over time as they prove their ability to repay. She mentions that most of the borrowers on the platform are males aged between 21 and 40 who mainly reside in urban centers. Jeanne is eager to mention that 70% of the borrowers on the platform surveyed over time mentioned that they use their loans as working capital for their small businesses.

Jeanne is a big advocate of digital financial services. She speaks passionately about the strides made by M-Pesa, mobile banking, digital lending services, and the global acclaim that these services have earned

Kenya. According to Jeanne, several factors contributed to the growth of the digital lending industry in Kenya. She also explains that the mature mobile money industry is the bedrock of digital lending because M-Pesa created the payment rails for seamless disbursement and collection. Jeanne suggests that the relaxed regulatory attitude is catalytic to digital lending; she points out that many countries allow non-deposit-taking lending without a licence, something the CBK allows. She also mentions that the falling cost of android smartphones has enabled digital lenders to gather customer information, what she describes as 'digital dust', enabling the lenders to underwrite loans using their proprietary algorithm. In her view, digital loans have been transformative to small, short-term borrowers, more so to micro-entrepreneurs.

I press Jeanne a little more to get her perspective about the 'digital dust' she mentioned they collect on borrowers and how this could potentially lead to adverse inclusion. She is not forthcoming in this regard. She is prohibited from divulging any information about credit scoring, given that digital lenders' credit appraisal techniques constitute intellectual property. She, however, mentions that they use some 200 data points, including CRB data, to assess each customer for a digital loan. She suggests to me that no one in the market will tell me how they score their customers because the credit-scoring algorithm is the basis of completion for digital lenders. She explains that the person with the most information likely has the best algorithm and that whoever has the best algorithm, wins. She boasts that her algorithm is the best in the industry, noting that she has the lowest default rate in the market and that she has many customers who have taken out their fiftieth loan.

Jeanne, however, completely refutes the notion of adverse exclusion and that digital loans lead to debt traps. Concerning the use of digital loans for consumption, Jeanne agrees that it is generally not a good idea. She suggests that this pointed to a financial literacy issue rather than a problem with the product itself. She, however, suggests that borrowers should be given the space and control to choose what they want to do with a digital loan, suggesting that financial literacy will dictate that they put it to productive use. According to her, 'consumer choice determines consumer outcomes'. However, Jeanne was quick to suggest that the scrutiny around digital loans being used for consumption is hypocritical and unfair to digital lenders. She compares digital lending to banks giving credit cards, noting that no one ever asks banks what people use credit cards for.

While speaking about the lending habits of digital lenders, Jeanne suggests to me that this is a 'case of few bad apples'. She reluctantly admits that she is aware of digital lenders who message contacts in a borrower's phonebook to demand repayment and other lenders who levy hidden charges and usury

interest so that the borrower ends up owing multiple times what they borrowed. Jeanne is quick to blame these rogue practices on small digital lenders whom she describes as fly-by-night operations and one-man shows. She explains that some digital lenders do not have physical offices or contact centres from where they can respond to customer complaints. Jeanne reiterates that after the advent of digital lending, many loan sharks with questionable ethics took their business to digital platforms but still maintain their crude lending tactics. She suggests that these few 'bad apples' are the source of public discontent about the digital lending industry.

At the time of our conversation, there was a live public discourse about the regulation of the digital lending industry, and a parliamentary committee was set up to look into regulating the sector in consultation with industry stakeholders. Months earlier, the DLAK had just been formed. Jeanne is one of the founding members of DLAK. She suggests to me that DLAK was formed to cater to the interest of non-bank digital lenders, more so given the impending regulation of the sector. She explains that government does not like to deal with individual entities, especially small ones, and that they constituted DLAK to have a stronger voice in the ensuing conversation about regulation. She mentions that they are also trying to make a strong case for self-regulation through a code of conduct that all DLAK members are encouraged to follow.

Throughout my conversation with Jeanne, she gives an unwavering endorsement of digital lending. She suggests that lenders of different kinds can now profitably reach the elusive bottom of the pyramid by deploying technology and, in so doing, deliver many benefits of financial inclusion.

Case 7: John the serial tech entrepreneur

John styles himself as a tech entrepreneur and is an office-bearer at the DLAK. I learned of John from the news where he was featured as a guest discussing mostly issues surrounding digital credit. John is well spoken and struck me as knowledgeable on matters about digital financial services in general. I was therefore naturally drawn to speaking to him, both as an entrepreneur in the digital lending business and as an official of the industry association.

For our first interaction, John was very receptive to my request for an interview. He invited me to his office early on a Monday morning before he started his day. He cut the image of a busy and organized person. He pulled out his notebook and listened attentively as I introduced myself, looking me straight

in the eye as if to intimidate me. I thanked him for according me the interview and promised not to go over one hour as earlier agreed.

John started by telling me about his background. He described himself as a 'businessman'. He mentioned that he had been among the first non-bank business owners to offer secured short-term loans against motor vehicles, known as logbook loans. His money-lending business grew and had offices in four major towns – Nairobi, Mombasa, Eldoret and Nakuru. He explained that he had made a good living off logbook loans but the market had soon become flooded and the business model had become more and more outdated with the emergence of digital loans which addressed the same need for short-term liquidity.

As the digital lending industry was growing, John abandoned his logbook lending business and began developing an online lending platform – AC loans – with the backing of capital from a few local individual investors. AC loans started operations in the early months of 2019 and got the interest of many borrowers in a short period. Borrowers could borrow between 500 Kenya shillings (5 US dollars) and 20,000 Kenya shillings (200 US dollars) repayable either daily, weekly, or monthly. Interest was unable to meet the demand for credit on their platform. He explained that they also had been unprepared to handle significant levels of default. John explained that lenders group loan defaulters into two categories, namely 'can't pay, will pay' and 'can't pay, won't pay'. He explained that 'can't pay, will pay' defaulters fail to repay the loan because they either forgot or have genuinely fallen on hard times. Borrowers in this group respond to calls from the lender or debt collector and are willing to adhere to a repayment plan. In contrast, 'can't pay, won't pay' defaulters are strategic defaulters who upon default do not answer demand calls from the lender or are simply unreachable, or refuse to repay the loan outright. AC loans ultimately folded under the weight of unrepaid loans. John admitted that this perhaps had been a sign that they needed to work on a better algorithm that could better predict credit risk.

With lessons from his experience with AC loans, John started developing a new digital lending platform, this time a mobile-based application. He named it Kash, a much more relatable name as he saw it. As he noted, 'I wanted to make those very painful lessons I learnt with AC count for something'. The first lesson that John had learnt was having sufficient liquidity to meet the demand of the market. To this end, John partnered with an international venture capital fund who were looking to invest in

the burgeoning digital lending industry in Kenya. The second lesson he had learnt was to spend time fine-tuning his credit risk algorithm.

At the time of our interview, John was still developing his algorithm. He was enthusiastic about this and spoke passionately about the gap they were trying to address in the market. He went as far as suggesting that they were trying to keep small businesses afloat. As I would come to learn, this is a common narrative that tech entrepreneurs like John hold. He mentioned that the market had a lot of potential and that he could envision a time when lenders would give mortgages through digital lending applications, far from the situation at the time where digital lenders offered a maximum amount of 100,000 Kenya shillings (1,000 US dollars) while many lenders offered limits of less than half this amount. John even predicted that the future of digital lending would be driven by artificial intelligence, such that digital lenders would preempt your need for a digital loan before you needed it, the way big tech companies target customers based on their web search engine history. Evidently, John was passionate about digital lending and its future.

We ended our interview with a chat about the impending regulation of the digital lending industry. Against my expectations, John mentioned that he supported regulation and that this was the official position of DLAK. He suggested however, that regulation should be consultative and progressive, and that good regulation should take into account industry perspectives while addressing consumers' legitimate concerns. I was curious to know what he meant by good and progressive regulation. John was quick to give the example of friendly regulations that allow M-Pesa to operate and grow exponentially and catalyze many other innovations. In contrast, he gave the example of interest rate capping[9], a regulation that did not achieve its intended goal. He noted that instead of helping to expand credit, the regulation caused many lenders to withhold lending because they were unable to properly price credit risk. He suggested that regulation that does not take into account the perspective of industry players, could lead to unintended outcomes.

[9] Section 33B of the Banking (Amendment) Act 2016, passed in September 2016, legislated that the interest rate chargeable for a credit facility by institutions licensed under the Act (commercial and microfinance banks) be no more than 4% above the Central Bank Rate, set and published by the CBK. This included digital loans. This was meant to curb the runaway high interest rates charged by the banks and expand access to credit. However, this led to significant reduction in lending activity by banks which eventually led to the removal of Section 33B in November 2019.

My second encounter with John is at a conference[10], two years after my fieldwork. I learn that John has halted all development of Kash loans, a product of which he was the brainchild and about which he was passionate. In trying to probe further why Kash loans did not launch, he explains that the international investors pulled out because of delays in developing the application. He explains that investors wanted him to rush the product to the market, but he just was not ready to go live. This, he explains, was informed by the painful business loss he had suffered a year earlier with AC loans.

John is clearly much less passionate about digital lending. At one time, he was one of its foremost public advocates. He has since given up on digital lending, observing that whereas it could be profitable to the lenders, it is not a sustainable business model. At the conference, John mentions that DLAK is working on formally changing its name to the Digital Financial Services Association of Kenya. He mentions that digital lending recently had such bad press that the association is fast losing public favour and that this move is necessary. To me, this is an indication that what was once thought to be a brilliant idea has come to be viewed by the public as exploitative and much less beneficial than once thought.

John is now trying his hand at digital insurance, a much less crowded field. He started developing a new insurance fintech, or an insurtech company as he describes it, in early 2022. John's new fintech offers health insurance for boda-boda riders. He mentions that boda-boda accidents account for the majority of road accidents in Kenya and that there is ample market for his new product. However, he acknowledges that insurance is not a widely appreciated and understood offering in Kenya. Nevertheless, he seems to have made some progress with his business as he presents impressive numbers of new and utilized insurance contracts.

As he explains more about his new business, I gather that John appears to be wiser this time around. He has partnered with a fuel company to offer his product through a kind of loyalty programme. In his new business model, the boda-boda riders do not have to pay the monthly insurance premiums. This is not the first time John is experimenting with a new fintech model. In fact, it would be his third after the successive failures of AC and Kash loans. In this new model, he hopes to concentrate on a niche market rather than the mass market and to be the first to take such a product to the market.

[10] Human Economy Research Programme Conference on 10 to 14 October 2022, themed 'Persistent Barriers, New Frontiers: Fintech Futures in Africa', held at Future Africa Campus, University of Pretoria, South Africa.

Case 8: Lydia of Biashara credit

At the same conference where I met John, I come across a young Kenyan tech entrepreneur, Lydia (pseudonym), who has first-hand knowledge of the fintech ecosystem in Kenya and has interesting perspectives about digital lending. I did not interview Lydia during my fieldwork but I had lengthy conversations with her through the five-day conference about her digital lending platform and her views on the financial inclusion discourse more generally.

A software engineer by profession, Lydia founded a digital lending platform, Biashara Credit (pseudonym), in 2021. Biashara offers working capital loans of between 100 and 2,000 US dollars to small- to medium-sized enterprises. To start Biashara, she raised millions of US dollars in pre-seed investment from a combination of local and international venture capital funds. This decent pool of capital has enabled her to embark on a growth strategy which included launching Biashara in three new African markets between 2021 and 2022, to much acclaim. Lydia has been numerously featured on various media platforms as one of the women to watch in Africa's tech space.

Lydia mentions that her decision to target micro-entrepreneurs was informed by the people who are productively engaged and have a better ability to repay their loans. She notes that her platform caters to already operational businesses which she mentions have the potential to scale up and pose minimal credit risk as opposed to businesses that need start-up capital. According to her, the individual digital credit market in Kenya is not only saturated but the model does not seem sustainable for both borrowers and digital lenders. With this in view, she decided to give loans in terms of inventory as opposed to in cash. Lydia's choice to offer loans in terms of inventory is to avoid the misapplication of loans by users by channeling the funds to unproductive uses such as day-to-day consumption and vices such as sports betting.

Unlike other digital lending platforms which take an impersonal approach, Biashara's business model involves some human interface with small-business owners. Upon a business owner enrolling on the Biashara platform, the fintech deploys field monitors to the business who meet the business owner and collect some data on the borrower, including their personal characteristics and aspects about their business, such as their fast-moving goods and their daily turnover. Lydia mentions that they use this information to feed their credit-scoring algorithm, which she describes as 'robust'.

Lydia is eager to explain that Biashara co-exists with existing mechanisms of credit extension, particularly store credit. She also observes that small-business entrepreneurs in Kenya have a long-standing tradition of lending to their customers whom they know well. For example, in Nairobi's low-income neighborhoods and slums, storekeepers offer short-term, often interest-free, store credit to their regular customers and keep a manual ledger of all debts and repayments. Indeed, one should consider the FinAccess survey (CBK, 2019) which reports that store credit is the most popular source of credit in Kenya with 30% of Kenyans obtaining credit from local shopkeepers.

Case 9: Siaya of Cop SACCO

I was introduced to Siaya (pseudonym) by a friend whom I interviewed as a member of Cop SACCO. Siaya is a well-educated professional in his late forties. He has been involved in co-operatives for over thirty years in different capacities. He was a credit officer and a branch manager of a teachers-based SACCO before moving to Cop SACCO as the deputy chief executive officer and then being promoted to chief executive officer in 2012. Cop SACCO is well known in Kenya and I was interested in speaking to Siaya about the changes the SACCO has undergone, which have seen them attract wide admiration in the sector, and about some of the products they offer, in particular their digital loan product.

Siaya's office wall is decorated with numerous industry awards which he is eager to show me. The biggest trophy reads 'Recognition of Excellence in Enterprise Information Technology Adoption in the SACCO Sector'. He explains that his SACCO won the award when they launched their digital lending platform. A Financial Reporting (FIRE) runner-up award for 'Prudent Financial Reporting' was sponsored by the prestigious local accounting body, Institute of Certified Public Accountants of Kenya. He also shows me a shield labeled 'Best-run SACCO' which was awarded by SASRA at the previous international co-operatives day celebrations, best recognized by its Swahili translation Ushirika day. His Master of Business Administration degree and another certificate for achieving fellowship status at the Institute of Certified Public Accountants of Kenya also hang on his wall. Siaya is clearly proud of his achievements and those of his SACCO.

We spend the first few minutes of our conversation talking about the origins of Cop SACCO and its products and services. Siaya mentions that Cop SACCO was started in 1972 under the Co-operatives Act with roughly 600 members before being formally registered as a SACCO in 2008 under the

SACCO Societies Act. He takes me through a number of their products and mentions the savings product which he refers to as 'disciplined savings', where the SACCO has set a minimum amount of non-withdrawable savings. Traditionally, a SACCO requires members to make a minimum monthly contribution, mostly through a check-off system. However, the SACCO now encourages its members to save at any time and has brought in technologies, particularly mobile technology that allows them to save at any time through mobile money channels. He mentions that the membership is normally distributed in terms of savings in the SACCO. He observes that the member with the largest savings in the SACCO has saved roughly 20 million Kenya shillings and that the members include several millionaires. Cop SACCO also has a welfare programme for members, similar to the benevolent fund offered by Sheria SACCO where Aisha is a member. This welfare programme requires members to make a set monthly welfare contribution in addition to the normal monthly contribution, which goes towards funeral arrangements in case of the death of the principal member, their spouse, child, or biological parent. This, Siaya explains, allows members to meet funeral needs without necessarily taking out a SACCO loan, which was a common use of SACCO loans in the earlier years.

Siaya is a big proponent of opening the common bond. He argues that the SACCO business can only grow by growing membership. This is because more members translate into more savings, more loans, and greater revenue. He views the opening of the common bond as being in line with the co-operative spirit and principles, especially the first principle on open and voluntary membership described in page 24 and principle seven on concern for the community. He argues that having restrictive membership in the form of a closed common bond is inconsistent with these principles and impedes financial inclusion.

Siaya explains that Cop SACCO opened its common bond in 2010, being among the first SACCOs to do so. The SACCO initially opened membership to spouses of common-bond members, then opened membership to employees of 'sister organizations" and finally to the general public. He explains that this was done to ease the original members into the idea of a growing membership and to avoid a fallout between management and members or, even worse, a mass exodus of members which would have resulted in the collapse of the SACCO. He explains that he was under great pressure from the management committee to increase the members register and that this was a key performance indicator when he was employed as chief executive officer of the SACCO. He explains that SACCOs took their cue from public sector reforms that had started earlier in the 1990s when the government introduced performance contracting for public officers in state-owned corporations. Today, Cop

SACCO has a fully open common bond and has over 61,000 members and an impressive asset base of 39 billion Kenya shillings. Siaya points me to the latest SASRA supervision report which shows that all but three tier-one[11] SACCOs have an open common bond and that these SACCOs account for 56% of the SACCO sector, while 57 out of 81 tier-two SACCOs, representing 70%, have an open common bond.

While explaining the significance of an open common bond, Siaya argues that opening the common bond has brought about efficiencies and growth in SACCOs. He mentions that members are increasingly keen on quality services, regular and attractive dividends, and timely loan approvals. He notes that after opening the common bond, Cop SACCO has rolled out a number of products and services which include FOSA services and digital loans, and most recently a dividend advance. He stresses that SACCOs have been working hard to shed the image of small, old-fashioned institutions and that these efforts have seen them become direct competitors to banks and digital lenders. He boasts that bankers are constantly looking to partner with Cop SACCO because they realize the important role that SACCOs play in mobilizing small savings.

Siaya argues that social relations in SACCOs can be both beneficial and detrimental to the SACCO. As an example, he recalls his earlier years when the SACCO was much smaller and the chairman and management committee members of the SACCO would send members to him to expedite their loan applications and approve the loans even when they did not strictly qualify for the loan. He also recalls that, at the time, loans to management committee members and SACCO staff, also called insider loans, were significant and largely non-performing – a situation that put the SACCO at great risk of collapse. According to him, these issues were rampant in the sector before 2010 but have since been banished. This is because opening the common bond has made credit policy enforcement much stricter given the oversight of internal audit functions and oversight of SASRA which places tight liquidity ratios and requires monthly reporting on non-performing loans.

[11] According to SASRA's 2021 SACCO Supervision Annual Report, 42 tier-one SACCOs have assets over 5 billion Kenya shillings, 81 tier-two SACCOs have assets between one and five billion, and 239 tier-three SACCOs have assets below one billion.

Case 10: Sarah of Uni SACCO

Sarah previously worked in a university's student finance department as an accountant before joining the University (Uni) SACCO as a senior accountant. Currently, Sarah is the FOSA manager at the main branch of Uni SACCO, the busiest of Uni SACCO's three branches. Her work entails attending to customer complaints that have been escalated by the customer service team and coordinating all operational aspects of the branch, from daily reconciliations to member engagement.

Uni SACCO was started in 1975 when the university was still an agricultural college based in a small town outside Nairobi. The SACCO was started by teaching and non-teaching staff at the college. The SACCO opened its common bond in 2020 and has since grown to a membership of 6,000 with assets of over 1.6 billion Kenya shillings. SASRA categorized Uni SACCO as a tier-two SACCO, and Sarah describes it as a medium-sized SACCO.

Sarah traces the opening of Uni SACCO's common bond to the abolishment of university parallel programmes. Parallel programmes were introduced in the 1990s to allow students who scored C+ in their secondary school exams to attend university parallel programmes. Prior to this, students were required to score a minimum of B+ to qualify to attend university as government-sponsored students and complete what was then called Module I. Parallel programmes, or Module II programmes as they were commonly known, were introduced in the late 1990s as an innovative way for universities to supplement their operational capital by opening access to students previously unable to attend public universities. Sarah recalls that top university dons viewed parallel programmes as commercializing higher education and as an affront to serious scholarship.

Sarah mentions that in 2012 when she was new at Uni SACCO, there were seven public universities but by 2020, there were about 30 public universities and more than 40 private universities. 'That was preposterous, Kenya becoming the next India, they have almost 1000 universities there', she laughs. This led to debates about abolishing parallel programmes which eventually was done in 2020. Sarah recalls that this move was sudden and hurt universities' finances, prompting universities to freeze hiring and slow down expansion as they struggled with debt. She recalls that her university had outstanding remittances to the Kenya Revenue Authority, the National Hospital Insurance Fund, the National Social Securities Fund, pension schemes, insurance companies, and SACCOs. This was not unique to her university. She mentions that her husband, who works in the payroll department of

another public university, mentioned to her that his employer could not honour various obligations such as payroll taxes, retirement benefits, and insurance premiums for employees.

Sarah recalls that Uni SACCO was severely hit by liquidity issues after 2020 given that the university was not able to remit members' SACCO contributions and loan repayments deducted from payroll to the SACCO. She recalls that the SACCO initially capped the loan size to 100,000 Kenya shillings per new applicant and became more aggressive in pursuing late loan repayments. She recalls that Uni SACCO had to liquidate most of its investments, including shares, fixed deposits, and chunks of land to meet the liquidity shortfall. To make matters worse, banks put a freeze on lending to most public universities and the university SACCOs.

'At that point, we knew something had to give. The SACCO was collapsing before our eyes, our jobs were on the line… and members were enraged at us', she exclaims. She suggests that this anger among the membership was rather supposed to be directed at the university which was the cause of the problem. The SACCO urgently needed new capital from new members and the management committee started seriously considering opening the common bond. They started priming members for the idea of opening their common bond by sending them information emails and conducting a survey. At the end of 2020, the members voted for fully opening the common bond.

With hindsight, Sarah recalls it was the only thing to do at the time, given that the SACCO was only a few months from collapsing. However, I gather that Sarah is not fully convinced about the idea of an open common bond for a number of reasons. First, she explains that opening the common bond caused the SACCO staff to lose touch with the members. She mentions that previously, she knew the majority of the SACCO members well, which faculty or department they worked for, and even whose loan they had guaranteed last. 'And they all knew me', she says. However, after opening the common bond, Sarah mentions that she became disconnected from members. 'We became a bank! We completely lost the deep personal interaction with our members, and we will never get it back', she describes.

Sarah is particularly irked by the idea of reverting to asking for collateral for loans, which she explains precludes many people from accessing credit. Sarah mentions that Uni SACCO offers two types of loans, namely loans secured by guarantors and fully secured FOSA loans. She explains that loans secured by guarantors, for a long time the centerpiece of the SACCO model, are becoming much

harder to access given that members, especially those who do not work at the university, struggle to get guarantors. She recalls that the guarantee mechanism worked well when the SACCO had a tight-knit membership under a closed common bond. In light of this challenge, Uni SACCO has now built the capacity to take securities for loans when a member is unable to recruit guarantors, making the SACCO indistinguishable from a bank.

She also laments the disruption of the SACCO's governance structure. She mentions that the SACCO recently amended its by-laws to allow for a delegate system of conducting members' meetings. While acknowledging that it is infeasible to have an annual general meeting of 6,000 members, Sarah is uncomfortable with the idea of 300 delegates making decisions that are binding to the 6,000 members. She views the delegate system as lacking in accountability and stripping members of their right to participate directly in the decisions of the SACCO, as was the case before. In general, Sarah is uncertain about the idea of an open common bond and what it holds for the future of her SACCO. This is interesting coming from her given her job as a FOSA manager primarily involves dealing with non-member customers of the SACCO.

Case 11: Leah of Auditor SACCO

I started my career as an auditor with a 'Big 4' audit firm and have been a member of Auditor SACCO (pseudonym) since 2012 when I was employed at the firm. Auditor SACCO was formed in 1999 by employees of the firm with the common bond being employment at the firm. The SACCO maintains a closed common bond to date. The SACCO currently has 527 members who are either present or former staff at the firm like me. The SACCO's management committee members are employees of the firm who volunteer their services to the SACCO and are rotated through a vote every three years. Unlike the bigger SACCOs like Cop and City SACCO where elections are usually heated, elections at Auditor SACCO are a low-key affair. This is because committee members in the bigger SACCOs have influence over significant investing activities of the SACCO, which is at times abused. Two accountants handle the day-to-day Auditor SACCO operations and they share an office at the firm's premises.

I spoke to Leah, one of the accountants who also doubles as the SACCO manager, to understand how the SACCO operates compared to larger and open bond SACCOs. Leah is an accountant by profession, now in her late forties. She was first employed by the audit firm for a few years as an audit

associate and was asked to take care of the SACCO's accounting for a short period when it started. However, she has been with the SACCO ever since. 'Three months turned into twenty years; time flies as they say', she laughs. For a long time, she was the only one running the SACCO until she asked the committee to recruit an assisting accountant four years ago to allow her time to concentrate on the reporting aspects of the SACCO. For more than twenty years, Leah's job has been rather predictable and has entailed processing loan applications and disbursements, enrolling new members, monthly bookkeeping, preparing year-end financial statements and organizing the members' meetings. From my numerous past interactions with Leah, as a member of the SACCO, I know that she is organized and meticulous. She is also pleasant to deal with as a SACCO member. It is no wonder that she has been with the SACCO for this long.

While discussing members of the SACCO, Leah explains that the SACCO was started purposely to allow members to access cheap credit. She says that SACCOs have the lowest interest rates and the least restrictions to accessing credit. She compares SACCOs to banks that still require security of some kind, among other conditions. Leah observes that all members of the SACCO have a bank account, and most actually have multiple bank accounts. According to her, the objective of the SACCO has always been clear – to provide cheaper credit to members. As such, the SACCO is not interested in providing FOSA banking services or digital loans to its members because they could always access these services elsewhere. She says that this is the reason why Auditor SACCO has 'never even thought of opening its common bond'.

I resonate with Leah's sentiments about the purpose of the SACCO. From my interaction with dozens of members of the SACCO through the five years I was with the firm, it is common for members to use loans to purchase cars, buy plots of land or build their houses through the SACCO. As a member, I have had the opportunity to access cheap credit at the SACCO. After three years at the firm, I was promoted to audit senior. My new position necessitated me to buy a car given that my work involved changing clients roughly every two weeks and some clients were located outside of Nairobi. I also needed a car to transport audit assistants, most of whom did not own cars, to different assignments. It was also a requirement to have a car to claim mileage allowance, which I was entitled to as an audit senior. My SACCO was the cheapest option, given that it offered the loan at an interest of 12% on a reducing balance basis compared to banks that had rates upwards of 18%.

In many respects, Auditor SACCO could be considered an elite SACCO. To join Auditor SACCO, a person who meets the common bond requirement is required to buy shares worth 30,000 Kenya shilling (300 US dollars), and each member is required to make a minimum monthly contribution of 5,000 Kenya shilling (50 US dollars) which is among the highest I had seen while conducting this research. Indeed, many members I know and spoke to make monthly contributions to the SACCO of more than five times the minimum amount required. Despite having a small membership, Auditor SACCO has significant financial resources. In 2020, SASRA passed the SACCO Societies (Non-Deposit Taking Business) Regulations which require non-deposit-taking SACCOs with resources of over 100 million Kenya shillings (1 million US dollars) to be regulated by SASRA. Auditor SACCO falls squarely in this criterion. In December 2021, Auditor SACCO conducted a special general meeting of members to chart the way forward in light of the new regulations.

From my conversations with other SACCO managers, I had learnt that SACCOs conduct a member education day to talk to members about guarantorship, the SACCO's products and services, and other related subjects. I, however, could not recall Auditor SACCO having conducted a members' education day even once. I was therefore curious to talk to Leah about this peculiarity.

She answers right away, 'You, and most members here, are chartered accountants and most certainly graduates. Do you really need financial education? That is not a need or a priority in this SACCO!' Leah mentions that instead, the SACCO allocates for social responsibility spending on causes such as walks and runs, suggesting that this was more consistent with the standing of the SACCO.

Leah suggests that social networks in a SACCO with a closed common bond are tighter. This makes it easier for a member to address their credit needs with people they engage with almost daily. She mentions that the SACCO has a very low delinquency rate and that she has very few cases of overdue loans, which relates to members who have separated with the company. In her characteristically humble way, Leah admits that she knows nearly all members of her SACCO by name. While asking about the SACCO's credit appraisal procedures, Leah mentions that the SACCO has an established credit policy and that she tries her best to follow the policy to the letter. Leah is reluctant to tell me that the SACCO has a fairly flexible way of evaluating loan applications. However, she mentions that each loan application is evaluated on a case-by-case basis, and she has on occasion approved loan applications where the members had not fully met the loan requirements.

For example, she mentions that she just approved a loan for a member, a new audit manager at the firm, who had not completed the six-month minimum savings period but whom Leah knew could easily pay back the loan, due to his sizeable salary. Like many other SACCOs, Auditor SACCO has a requirement that a member needs to have saved with the SACCO for a minimum of six months before they can take out a loan. This requirement is meant to help them build their savings and create social connections with other members who can in future guarantee their loans. Leah, however, insists that such flexibility in credit appraisals could be problematic, more so for larger SACCOs, as this could set a precedent for management committee members and SACCO staff to abuse SACCO procedures.

For Leah, the SACCOs function best when they have a closed common bond. According to her, a closed bond fosters close interaction between members which helps them build trust and reciprocity. She suggests to me that a closed bond gives members a greater sense of belonging which allows them to actively participate in the SACCO, both financially and in terms of decision making. She also suggests that the only way to keep default rates low in a SACCO setting is through maintaining a closed bond. For these reasons, she does not see opening the common bond as beneficial for members of Auditor SACCO.

Case 12: Patrick of Fertilizer SACCO

During my fieldwork, a friend introduced me to Patrick (pseudonym), the manager of Fertilizer SACCO (pseudonym). The challenge with meeting Patrick was making the trip to Nakuru, 200 kilometers away from Nairobi, where he lives and works. While on a trip out of town in February 2021, I call on Patrick at his small office on the factory premises of Fertilizer Limited.

Before long, we are interrupted by one of Patrick's members, Patel (pseudonym), who is a shift manager at the factory and who has come to drop off his loan application form. I later learn that Patel is a second-generation Indian-Kenyan and that his relatives own the factory. Patel offers to take us for a short trip around their recently commissioned plant and we oblige. He quickly organizes personal protective equipment, including gumboots, a helmet, and overall, all white in colour, perhaps in a bid to show us how sophisticated their operation is. I learn that Fertilizer Limited manufactures various varieties of fertilizers for sowing and top dressing, and an inoculant for legumes.

After the detour, Patrick and I retreat to his office to have our discussion. Patrick explains that Fertilizer SACCO has existed since 1999, shortly after the company was started. Fertilizer SACCO

has a closed common bond that it derives from the company itself. The SACCO has slightly over 1,000 members who are all employees of Fertilizer Limited. Most of Fertilizer SACCO's members are low-skilled factory workers who also represent the majority of the company's workforce. Moderately skilled workers such as machine operators and floor supervisors also make up a fairly significant portion of the membership. The smallest group of members are skilled professionals of different kinds who mostly have managerial roles in the company and work at the company's corporate office.

Patrick explains that he has more than ten years of experience working in the SACCO sector. He explains that before being employed as the manager of Fertilizer SACCO, he worked for two other SACCOs – a Nairobi-based university SACCO and a large open-bond SACCO. He shares his office with an accountant and, together, they run the SACCO's affairs of processing loan applications, processing loan disbursements, handling financial reporting for the SACCO, recruiting new members and organizing members meetings and education days. Patrick is clearly a busy person. Patrick and his accountant report to the management committee which is made up of Fertilizer Limited staff elected by members of Fertilizer SACCO.

I am curious about how Fertilizer SACCO recruits new members. Patrick responds that they usually request a list of new hires from the human resources department every few months and then start to engage with them. He explains that this method has been successful and that a significant proportion of Fertilizer Limited's workforce are members of the SACCO. I follow up with a discussion about why the SACCO has not yet opened its common bond, which seems to me as an industry-wide trend. He explains that this is partly because of the SACCO members' views and partly due to deficiencies within the SACCO and some market conditions in the sector. On members' views, he explains that the SACCO loans are exclusively given on the guarantee of other members and that for the guarantee mechanism to be efficient, there needs to be a cohesiveness among members which would be lost if membership is opened to people who do not work for Fertilizer Limited. Patrick explains that he is himself still a member of the university SACCO where he used to work. However, since he left Nairobi for Nakuru, he has lost touch with his former acquaintances at the university and had to join Fertilizer SACCO where he can more readily address his financial needs. As he explains, 'It is much easier to get a loan from here where people at the company with whom I interact daily can guarantee my loans. This is the feeling across the membership'.

Patrick also explains that he himself is not particularly opposed to the idea of an open common bond. Having worked for a large open common bond SACCO, he recognizes that Fertilizer SACCO is a

much smaller SACCO in terms of financial resources and level of sophistication. He explains that a majority of the members of Fertilizer SACCO are low-skilled workers who are lowly paid. He explains that the average monthly contribution from his members is 1,500 Kenya shillings (15 US dollars), just slightly above the minimum monthly contribution of 1,000 Kenya shillings (10 US dollars). He explains that the overwhelming majority of members, who are lowly paid factory workers, contribute the set minimum amount of 1,000 Kenya shillings while better-paid, skilled workers and managers like Patel make more significant contributions. 'Even though we have a one-member-one-vote principle here, you can easily see that the managers basically 'own' the SACCO. Fertilizer SACCO would not be running today without their contributions.'

Patrick also explains that because of its insubstantial resources, Fertilizer SACCO has not built the capacity to open its common bond. For example, he explains that the SACCO has not built the internal capacity to take collateral as security for SACCO loans which could be used in place of guarantors and that the SACCO still used protected spreadsheets to manage its members' savings and accounting unlike large, deposit-taking SACCOs who have sophisticated systems which are comparable to those run by commercial banks. 'We are light years behind; we just do not have the wherewithal to compete with the more established open bond SACCOs', he remarks.

The rest of our discussion centers on their loan application and credit appraisal process and the SACCO's credit products which were comparable to most SACCOs. Before visiting Patrick, most SACCO managers I had spoken to were drawn from SACCOs which were clearly financially invulnerable. I leave Fertilizer SACCO with an understanding that there are many other SACCOs whose financial future is bleak to say the least, and who have assumed the default position of keeping their bond closed due to their inability to compete in a market that is quickly getting saturated while at the same time being at the brink of collapse because of the mostly small contributions which can barely keep the SACCO running.

Case 13: Meyo the personal financial guru

I spoke to Meyo (pseudonuym), a long-time banker who currently works as a consultant having previously worked extensively on sector-wide and institutional reforms in the financial services industry. Meyo is a self-styled personal finance and entrepreneurship coach. He runs a financial academy and writes a popular newspaper column on personal finance. I have been an avid follower of Meyo's column and was interested to get his insights about what financial inclusion entails in reality.

I also wanted to get his perspective on the co-operative and digital lending models on which I had gathered he has experience as a consultant. My perception was that as an independent consultant, Meyo would offer a more balanced view than that of industry insiders.

In a nutshell, Meyo describes his mission as helping people get their finances in order. I gather that Meyo interacts with individuals of different backgrounds and income levels. Through his financial academy, Meyo organizes 'personal finance boot camps' where he lessons on personal finance and investment. He also organizes a 12-week personal financial management programme several times a year for which he charges 44,000 Kenya shillings (440 US dollars) on average. In my estimation, many of the people who attend Meyo's boot camps are people with moderate incomes. Meyo also conducts free entrepreneurial classes, in what he refers to as a 'street business school', to people in slums on how to initiate and sustain micro-enterprises.

Meyo also describes himself as a debt counsellor, by which he means that he helps people manage their debt and rebuild their credit scores. He observes that many of the people he speaks to struggle with debt of different kinds. In his experience, people who struggle with debt from banks and other formal institutions are without exception also trapped in a cycle of taking digital credit. Meyo notes that the short tenure and small value of digital loans make them only suitable for consumption purposes.

In describing what he does, Meyo tells me that his 'street business school' focuses on talking to budding entrepreneurs about their business ideas and helping employed individuals get a secondary source of income, which he describes as passive income. He mentions that most small-business entrepreneurs that he interacts with in Nairobi's low- and middle-income areas operate very small businesses with little to no scale-up potential. Some of these micro-entrepreneurs include people selling foodstuffs and groceries by the roadside, people operating small tuck shops, people running water shops, tailors, and people running home bakeries. He suggests that indeed these micro-entrepreneurs face the challenge of accessing sufficient start-up and working capital for their ventures but insists that digital loans are not an answer to this age-old challenge. Meyo explains that these micro-entrepreneurs often qualify for very tiny loans of roughly one to three thousand Kenya shillings (10 to 30 US dollars) which cannot reasonably sustain any business. In his view, the popularization of digital loans as business loans is a form of 'false advertising'.

In my conversations with Meyo, I gather that he is more cynical about the digital lending model than he is about SACCOs because of the relationship SACCOs have with their members. He argues that even though many SACCOs have opened their common bonds, they still retain a minimum level of interaction with members through annual general meetings, member education days, and the physical nature of most SACCO operations. He compares this with the digital lending model where the relationship between the borrower and the lender is mediated exclusively through technology. Meyo explains that when interacting with borrowers who are struggling with debt, many of them mention that they feel more of an obligation in repaying their SACCO loan than their digital loans. He further explains that to get a SACCO loan, one has to physically walk into a SACCO office, interact with the credit officer, then convince three or more guarantors to co-sign the loan before being given the loan. However, for a digital loan, the member's relationship with the lender is technology-based and one only needs to own a mobile phone and a decent credit score.

Meyo seems to be supportive of opening the common bond. He mentions that many SACCOs in Kenya tend to be institution-based as opposed to community-based. He suggests that when a prospective member is not affiliated with an institution or profession, they are typically precluded from joining SACCOs altogether, unless the SACCO has an open common bond. He explains that in the mature co-operative movements, credit unions are community-based and suggests that this makes financial inclusion deeper. Meyo suggests that SACCOs are social and economic vehicles and to achieve these aims, they need to be accessible to anyone who needs their services. Meyo adds that while he welcomes opening the common bond, it was evident that new members that benefitted from this effort are those who can keep up with the requirement to save with the SACCO monthly, which often is not the poor.

Meyo explains that understanding the people who are the subject of financial inclusion is at the heart of any meaningful financial inclusion effort. He explains that a large portion of Kenya's population still lives below the breadline. I corroborated this with a recent World Bank report (see Andrews et al., 2021) which states that 40% of the population lives below the poverty line of two dollars per day, making Kenya the third poorest lower-middle-income country globally ahead of Zambia and Nigeria. Any financial inclusion effort should address the 40% who live in poverty and not people who are more financially secure.

I press Meyo about his perspective on the proliferation of digital lending. His view is that the proliferation of digital lenders is positive for financial inclusion to the extent that a borrower can choose which of the over 100 digital lenders he or she wants to use and can choose the digital lending product that suits his or her needs. He suggests to me that in the context of financial inclusion, expanded access does not mean much if there are very few players in the market. His logic is that access ought to be complimented by two other critical facets of financial inclusion, namely affordability and quality of the service, which can only result if the financial services industry is competitive. Meyo criticizes M-Pesa's virtual monopoly over the mobile money industry, noting that whereas many people could hold mobile money accounts with M-Pesa, they have little say on the charges levied. This is a problem because M-Pesa has become such an essential part of Kenyans' lives. He worries that Safaricom has now become a lending behemoth with its Fuliza overdraft and hopes that the rumoured regulations by the CBK will allow digital lenders of all types to operate and compete freely.

CHAPTER FIVE: A CRITICAL ANALYSIS OF THE PROPOSED IDEAL SACCO MODEL AND THE QUESTION OF FINANCIAL INCLUSION

5.1 Introduction

Chapter three deals with the development of Kenya's co-operative movement from the pre-liberalization era to the tumultuous period after the sector was liberalized in 1997 until the emergence of SACCOs in 2008. The year 2008 was a critical mark in Kenya's SACCO sub-sector because of the passage of the SACCO Societies Act and the changes that this new law brought along. The most transformative provision of the new law was the creation of a regulatory authority for the sector, SASRA, whose mandate was to license all co-operatives involved in providing savings and credit facilities, christened SACCOs, and, more critically, provide prudential oversight of SACCOs involved in deposit taking. This chapter deals with the development of Kenya's SACCO sub-sector after 2008.

The first section of the chapter discusses the emergence of the idea among influential international organizations operating in Kenya that the new SACCOs should open or at least relax their common bonds. I give details of these organizations' argument that opening the common bond was vital to securing the financial viability of SACCOs in the face of growing competition. Opening the bond, they argued, would make it possible for SACCOs to increase their membership and therefore the monthly contributions that members of SACCOs were obliged to make. Opening the bond would also make it possible for SACCOs to take deposits from and offer cheap banking services to people who were not their members – customers drawn from the public. The first section identifies which organizations were involved in putting these arguments forward, explores what motivated them to do this, and shows what they did to get their arguments and actions taken seriously in Kenya.

The next two sections document how the new SACCOs responded to these ideas. Some SACCOs have followed these prescriptions to the letter since 2008. They opened the bond to increase the number of their members and then followed this up by taking deposits from non-members and providing them with bank-like services that were cheaper and in other ways more attractive than those offered by Kenya's banks. I show that these SACCOs have, by and large, managed to achieve the goal of securing their financial viability by following the recommended steps. But the rest of the chapter makes two points. One is that the SACCOs that have taken these steps have not all succeeded to the

same extent, and I explore the reasons why this should be so. The second point is that all the SACCOs that have been successful to a greater or lesser extent make up only a small proportion of the total number of SACCOs in Kenya at the time of writing. In other words, the international organizations' recommendations regarding the way to successfully develop SACCOs and ensure their financial viability have worked, but they have worked for only a minority of Kenya's SACCOs. Indeed, many SACCOs find no incentive to open their common bond or are simply unable to do so given that they are limited on many fronts. This seems to me to be an important issue, and I devote space to considering why the success of the international organizations' recommended strategy for securing the future of SACCOs should have been no more than partial. The last section discusses the question of financial inclusion in relation to opening the common bond and providing banking services to non-members.

5.2 Proposals about the ideal SACCO model

The pivot from co-operatives to SACCOs following the passage of the SACCO Societies Act in 2008, led to new proposals about what the new SACCOs needed to do to achieve financial security. These proposals emanated from influential international organizations such as the Cooperative Facility for Africa (CoopAfrica), a regional technical programme of the International Labour Office, and the World Council of Credit Unions (WOCCU) which was backed up by the World Bank, the Bill and Melinda Gates Foundation and the Financial Sector Deepening (FSD) Trust network. Soon after, the newly established SASRA would add its voice in support of these proposals. The proposals by these organizations are important to consider not just because of the enduring influence of these organizations over Kenya's SACCO sub-sector but more importantly because of how they have shaped Kenya's SACCO sub-sector over the last decade and a half, as I show in this chapter.

The main proposal from international co-operative organizations was for SACCOs to open or at least significantly relax their common bond to accommodate people who did not meet the set membership criteria (those who were outside the common bond). This proposal envisaged that SACCOs would be able to collect more money from members in the form of obligatory contributions. More contributions would then allow the SACCO to extend more cheap loans to members and derive more revenues from investing members' savings in real estate, mutual funds and so forth to give the members attractive dividends and grow the SACCO business.

The second proposal was for SACCOs to start providing quasi-banking services, popular referred to as FOSA services, to realize their true commercial potential. FOSA services would be available to members of the SACCO and to non-members (the general public) who were locked out from using services provided by SACCOs. FOSA services were designed to compete favourably with banking services provided by commercial banks. To legally provide these services, SACCOs would be required to subject themselves to prudential oversight by SASRA. They would be required to open their common bond and recruit more members and FOSA customers in order to provide cheaper services. By making these two changes, the international organizations argued, the SACCOs would be assured of their financial viability and be able to deliver significant benefits to the poor.

These two proposals came in the period when the financial inclusion discourse, which had started around the mid-2000s, was gaining ground. As I describe in chapter one, the financial inclusion discourse promoted the extension of financial services of different kinds to the financially excluded, who are typically poor, in the hope that this will deliver them out of poverty, among other benefits. The two proposals were therefore in resonance with and a response to the financial inclusion discourse. In fact, a few co-operatives had already started taking over-the-counter deposits through their 'banking sections' by the mid-2000s. Several factors that prevailed at the time precipitated this move. The first was that commercial banks had imposed a minimum balance on bank accounts, which left many people unbanked. Co-operatives had taken advantage of this market opportunity to spread their reach to small savers. Co-operatives also took advantage of the fact that most banks were concentrated in urban centers and towns which left many people in the rural areas underserved.

The second factor was that microfinance was experiencing a rapid ascent in Kenya around the same time. The Microfinance Act 2006 had just come into effect and had led many MFIs to register and commence operations, catering to small savers and borrowers. As described in chapter three, the first MFIs to register were NGOs like Faulu Kenya and the Kenya Rural Enterprise Programme who had been previously involved in extending microloans to the poor. It bears mentioning that MFIs catered to the same customer segment that SACCOs were serving since the imposition of the minimum bank balances. Thirdly, mobile money had just been launched in 2007 and commercial banks were scrambling to launch mobile banking platforms aimed at providing a variety of financial services to customers at the lower end of the market where SACCOs and later MFIs operated. These platforms would first be used to facilitate savings and withdrawals, and later, in 2012, credit. Co-operatives were therefore providing banking services mainly to pull ahead of their competition. To Wanyama et al.

(2008) who have churned out several publications for CoopAfrica, the provision of quasi-banking services by SACCOs was a promising development, one that could help tackle poverty. They advised that this 'new mode of cooperation' be spread to the less-adapted SACCOs.

The proposals from international co-operative organizations were therefore not particularly novel; they were based on what was already happening in the co-operative sector albeit not in a remarkable way. What is remarkable about their involvement in pushing for the two proposals was the significant practical steps that they initiated, aimed at helping co-operatives (subsequently the new SACCOs) provide banking services to the poor. Some of these practical efforts were initiated slightly before the enactment of the SACCO Societies Act in 2008. For example, WOCCU initiated the 'SACCO Growth Program' which ran from 2006 to 2009 with funding from the Bill and Melinda Gates Foundation, which tested pro-poor outreach strategies, methodologies and financial products to dramatically increase SACCO membership, especially among low-income populations. Between 2006 and 2010, WOCCU ran another programme, the Kenya SACCO Capacity Building Program, in collaboration with the FSD Trust Kenya which was aimed at building the capacity of co-operatives to meet proposed regulatory standards and other aspects such as financial and governance monitoring which were aimed at growing the SACCO business.

After the SACCO Societies Act came into force in 2008, WOCCU was closely involved in the design of the proposed independent regulatory body for SACCOs, SASRA. Subsequently, WOCCU was part of a taskforce that developed the SACCO Societies (Deposit-Taking Business) Regulations issued in 2010 to provide operating guidelines for deposit-taking SACCOs. WOCCU was also instrumental in the production of model operation manuals for the new SACCOs and supported the introduction of modern management systems in several Kenyan SACCOs from the late 2000s. WOCCU also ran a project named 'Providing Access to the Poor Using Technology', again with funding from the Bill and Melinda Gates Foundation, where they made available a core banking system which could be utilized by deposit-taking SACCOs. WOCCU's involvement in this regard set the stage for the supervision and management of deposit-taking SACCOs.

SASRA also favoured the idea of forming larger SACCOs through opening the common bond and through merging smaller SACCOs as the ideal way for SACCOs to achieve financial security. In their inaugural report, SASRA (2010) endorsed the idea of opening the common bond to ensure the sustainability of SACCOs through diversifying their sources of deposits and diversifying risk. In the

report, SASRA observed that the traditional fields of membership are fast shrinking and that SACCOs need to tweak their models in this way to reposition themselves as 'national SACCOs'. In their 2011 report, SASRA (2011) reiterated that the key driver for the growth in SACCOs lay in the provision of quasi-banking services (FOSA services). SASRA has sustained the call for SACCOs to open the common bond and provide quasi-banking services over the last decade. In their most recent report, SASRA (2021) strongly advocates for the opening of the common bond and the merging of smaller SACCOs, warning that not making these changes would compromise their financial viability and their ability to drive positive outcomes for the poor. Indeed, the current and former SASRA chief executive officer as well as the SASRA board chair have been on record promoting the same message on multiple occasions.

In my discussion with managers and members of different SACCOs, I noted that some SACCOs were small in size and operation while some were large, and some appeared to be doing well financially while some were struggling financially. The products and services on offer by the different SACCOs also varied quite significantly. It seemed to me that this is an important issue that was worth exploring further. The following two sections deal with two broad categories of SACCOs I encountered, namely financially secure SACCOs and financially vulnerable SACCOs. I discuss how different SACCOs falling in these two categories received and treated recommendations from WOCCU and others and how this has led to their present financial position.

5.3 Financially secure SACCOs

The first broad category comprises SACCOs that have achieved financial security by following the advice from WOCCU and others, either fully or partly and in some cases by ignoring this advice. The measure of financial success I use is members' deposits equal to or more than 100 million Kenya shilling. Here, members' deposits refer to the pool of non-withdrawable monthly contributions collected from members. SASRA determined this seemingly arbitrary figure when they came up with new regulations for non-deposit-taking SACCOs, the SACCO Societies (Non-Deposit Taking Business) Regulations 2020[12]. In SASRA's view, SACCOs holding such significant deposits from

[12] In January 2021, SASRA issued the SACCO Society (Non-Deposit Taking Business) Regulations 2020 which sought to broaden their remit to include the regulation of SACCOs that hold significant deposits from members. Section 4(a) of the regulations set 100 million Kenya shilling as the threshold for non-deposit-taking SACCOs to obtain licences. At the end of the licensing exercise, some 183 non-deposit-taking SACCOs came under SASRA's ambit.

members ought to be licensed and supervised (regulated) not because they are mobilizing deposits from the public and therefore require prudential regulation (as with deposit-taking SACCOs) but because they are deemed 'too large to fail'.

In total, there are roughly 359 financially secure SACCOs in Kenya and they are divided into three sub-categories. The first sub-category comprises 176 deposit-taking SACCOs who have opened their common bond and offer quasi-banking services to the public. As per SASRA's (2021) most recent report, a vast majority of the 176 deposit-taking SACCOs (164 out of 176) have assets above the 100 million Kenya shilling threshold I referred to earlier while many of the remaining 12 have members' deposits nearing this figure. Indeed, many of the 176 deposit-taking SACCOs have surpassed this threshold many times over as I will show. The second and third categories of financially secure SACCOs make up the 183 regulated SACCOs that have members' deposits of 100 million Kenya shillings and above but, unlike the first category, do not offer quasi-banking services to the public. These are referred to as non-deposit-taking SACCOs. The difference between the second and third categories is that SACCOs in the second category have relaxed or fully opened their common bond while those in the third category have not. In most cases, SACCOs in the third category have members with high incomes, unlike a majority of the SACCOs in the other two categories. I will proceed to discuss these three sub-categories in greater detail.

The first sub-category of financially secure SACCOs followed the advice from WOCCU and others to the letter; they opened their common bond, in some cases relaxed it significantly, and went on to offer quasi-banking services through their FOSA units. In total, these SACCOs comprise 176 licensed deposit-taking SACCOs[13], making up just about 5% of all licensed SACCOs in Kenya. It was easy to encounter these SACCOs because of their sheer size and prominence. Two of these, Cop SACCO and Uni SACCO, appear in my case studies. I also refer to a number of them, including City SACCO and Coffee SACCO, at different points in this thesis. I also spoke to a substantial number of people who belong to these large open-bond SACCOs, either as members like Aisha of Sheria SACCO, or as customers, such as Brian who uses FOSA services from Mwalimu SACCO. All these SACCOs offer FOSA services to the public.

[13] A list of the 176 regulated deposit-taking SACCOs can be found here: https://www.sasra.go.ke/download/list-of-licensed-and-authorized-sacco-societies-in-kenya-for-the-financial-year-ending-31st-december-2023/

By far the most financially secure of all SACCOs I encountered was Cop SACCO described in case study nine. Cop SACCO was founded in the mid-1970s as an occupation-based savings and credit co-operative with a national membership based in Nairobi. The membership grew from just a few hundred members to roughly 30,000 members by 2008 when it was required to formally re-register and be licensed as a SACCO. The manager of Cop SACCO, Siaya, who led the SACCO through this transition, mentioned that in 2005 the SACCO (then a co-operative) opened a 'banking section' that provided basic banking services to non-members, most of whom were left unbanked after the imposition of mandatory minimum bank balances as earlier described. He explained that after 2008, the SACCO's management committee took deliberate steps to increase its membership. The first step was lowering the mandatory monthly contribution to 1,000 Kenya shillings, down from 5% of a member's basic salary required previously. The second step followed a year later when the SACCO's membership, through his advice, voted to relax its common bond by opening membership to spouses of members. Then, having seen the possibility of recruiting more members and mobilizing more savings, the management committee, in a third step, again convinced the members of Cop SACCO to vote and allow staff of sister organizations and their spouses and civil servants to join their SACCO. By 2010, Cop SACCO had fully opened their common bond to any member of the public. This gradual relaxing to the full opening of the common bond has seen the membership of Cop SACCO rise dramatically from 30,000 in 2008 to well over 100,000 members in the present day. Siaya, the manager of Cop SACCO, indicated that the gradual relaxing of the common bond was deliberate to ease the common-bond members into the idea of a larger membership and to avoid a mass exodus of members who did not fully buy into the idea. He mentioned that many other SACCOs have adopted this strategy.

The increased membership saw Cop SACCO realize significant financial success in the first two years, leading them to launch their first FOSA branch in Nairobi in 2011. Currently, Cop SACCO boasts eight FOSA branches located in major towns and cities, and it has become a household name in the SACCO sub-sector. In the financial year ending December 2021, Cop SACCO reported having 23.5 billion Kenya shillings (208 million US dollars[14]) in members' deposits and 44 billion Kenya shillings (389 million US dollars) in total assets and an operating profit of 2.6 billion Kenya shillings (23 million US dollars), ranking among the top five SACCOs in Kenya by assets according to SASRA. Further,

[14] Translated using the CBK mean exchange rate for 31/12/2021 of 113 Kenya shilling/US dollar

Cop SACCO has become masterful at developing new products, such as mobile loans and mortgages among other products, making the SACCO attractive to its members.

Another financially secure SACCO I encountered was City SACCO. City SACCO was founded in the early 1970s by employees from a government department. The manager of City SACCO explained to me that, initially, the SACCO had aimed at providing affordable savings and credit facilities for co-workers in the department who at the time could not access affordable credit from commercial banks, given that many of them did not have physical collateral, a common requirement by banks at the time. The co-operative grew its membership slowly over the years to a couple of thousand members by 2008 when they were licensed to operate as a SACCO. The manager pointed out that by 2008 when he was leading the credit department of the SACCO, the SACCOs operations were unsophisticated with only a few loan products and one central office.

In 2010, City SACCO opened its membership to the public all at once. The manager who witnessed this shift explained that the move to open their open bond at once as opposed to gradually like Cop SACCO had been motivated by the fact that they had been facing intensified competition from other SACCOs and MFIs who all catered to small savers and borrowers. He added that the SACCO had found itself racing to catch up to other SACCOs who had been opening their common bonds since 2008. He pointed out that the SACCO's efforts in expanding its membership had been successful and the SACCO now boasts over 100,000 members. In the same year that City SACCO opened its common bond, it opened its first FOSA branch in the Nairobi city centre and has since grown its branch network to six branches. In 2021, when they marked their golden jubilee to celebrate 50 years in existence, City SACCO reported having 22.5 billion Kenya shillings (199 million US dollars) in members' deposits, and 34.6 billion Kenya shillings (306 million US dollars) in total assets[15], ranking among the top ten SACCOs in Kenya in terms of total asset base.

Uni SACCO, described in case study ten, is another financially secure SACCO I encountered. Teaching and non-teaching staff of an agricultural college located on the outskirts of Nairobi founded Uni SACCO in 1975. A FOSA manager at Uni SACCO, Sarah, explained that the co-operative had grown its membership as the institution had grown to become a large public university with a couple of thousand staff. As described in the case study, Uni SACCO faced financial difficulties when the

[15] The term 'total assets' refers to all moveable and immovable assets of the SACCO. This includes cash in the bank, debtors balances, land and buildings, and other physical assets.

university failed to transfer members' SACCO deductions to the SACCO because the university was facing challenges with getting capitation from the government. Such was the state of Uni SACCO until the government bailed out the university in 2019 to bring it back from the brink of insolvency. From 2019, the university began to gradually pay monies owed to the SACCO in the form of member contributions.

Sarah recalled that Uni SACCO had had significant liquidity issues in the few years before 2019. She explained that loan applications had been taking unusually long to process from the usual two to four days and that, for a period, the SACCO had scaled back lending such that the amount a member could borrow was capped. In 2018 and 2019, Uni SACCO failed to declare dividends because it was doing so poorly. The SACCO's woes were compounded when banks refused to extend credit to them to help them offset liquidity challenges after they understood the prevailing situation. Sarah pointed out that the management committee had used these hard lessons from the past to convince members of Uni SACCO to vote to open the common bond.

After opening their common bond in 2020, Uni SACCO's membership grew from roughly 2,000 to 6,600 members. Sarah explained that this increase is no mean feat, firstly considering that it is an institution-based SACCO with roots in a smaller town than Nairobi, the capital, where both Cop and City SACCOs are based, and, secondly, due to the fact that they opened their common bond in 2020, much later than Cop and City SACCOs. Like Cop SACCO before it, Uni SACCO relaxed their common bond gradually, first by reaching out to staff from other universities and colleges and later to the public. In the financial year ending December 2021, Uni SACCO reported having members' deposits of 1.4 billion Kenya shillings (12 million US dollars) and total assets of 1.95 billion Kenya shillings (17 million US dollars). SASRA places Uni SACCO among the top 70 deposit-taking SACCOs by asset base. Between 2020 and 2022, Uni SACCO has managed to open three FOSA branches, a significant feat but still less compared to the number of Cop and City SACCO's FOSA branches.

One point should be emphasized: SACCOs who opened their common bond much later tend to be less successful in recruiting new members and attracting more financial resources than those who made this leap much earlier. This is because there is only a limited pool of people who can afford to belong to a SACCO and the earliest in the market, like Cop and City SACCO, tend to get a 'first-mover advantage'. Similarly, SACCOs that opened their common bond and started providing FOSA

services earliest have been able to earn themselves significant long-term advantages over their followers. Such is the case with Cop and City SACCO compared to Uni SACCO.

It is also important to briefly highlight a few other ways that some of the more successful deposit-taking SACCOs have adopted a more commercial focus. These trends are important to highlight because they not only represent a significant departure from the conduct of earlier co-operatives but also because they have a direct bearing on the financial success of these SACCOs. One such trend is paying interest on FOSA account savings, which many, if not all, of the 176 deposit-taking SACCOs do. For example, City SACCO gives 4% interest annually on a pro-rata basis for savings in the FOSA account while Sheria SACCO where Aisha is a member pays a free-floating interest on monthly FOSA balances once at the end of the year. Notably, commercial banks in Kenya offer interest on fixed savings and typically do not offer interest on withdrawable savings, and where they do, this is significantly less than the interest offered by SACCOs. This makes SACCOs more appealing to savers. One such saver is Brian from case study three who uses FOSA savings facilities when he gets occasional windfalls from his side gigs producing advert jingles for corporate clients. Indeed, both Siaya of Cop SACCO and Sarah of Uni SACCO mentioned that paying interest on FOSA accounts has been an effective way to mobilize savings from their customers. The question that would naturally follow is how deposit-taking SACCOs make the money to pay this interest on FOSA accounts. Many SACCO managers I spoke to mentioned investing members' and customers' deposits in money market funds, treasury and corporate bonds, and real-estate projects which have significant returns, enough to cover the interest payments. This is over and above making money from interest charged on loans, which traditionally was these SACCOs' only source of income.

During my fieldwork, I encountered several SACCOs that have FOSA accounts for minors. Coffee SACCO calls it a 'coffee junior savers account', Cop SACCO calls it a 'junior account', Uni SACCO calls it a 'children savings account', and so forth. This was particularly interesting to me because commercial banks have traditionally been the ones providing these types of savings accounts in Kenya. A FOSA savings account is operated by the minor's parent(s) or legal guardian and has some benefits, such as low or no account maintenance fees. This is a shift from the old order when SACCOs used to cater to adults who were economically engaged, to the current situation where SACCOs have devised new strategies to mobilize deposits from customers. This is yet another example of how SACCOs have latched on to a more commercial model to ensure their financial security.

Recent years have also seen deposit-taking SACCOs significantly diversify their products. For example, 11 top SACCOs, including Cop and City SACCO, are shareholders of the Kenya Mortgage Refinance Company, a public-private facility through which the SACCOs offer low-interest, fixed-rate, and long-term mortgage loans to their members. Recently, a growing number of deposit-taking SACCOs started extending digital loans to their members. Examples include Stima SACCO, Metropolitan National SACCO, Harambee SACCO, Mwalimu National SACCO, and Boresha SACCO, among others. These large, deposit-taking SACCOs have significant financial capability which allows them to take on greater financial risk with digital lending than the less successful ones. This is in keeping with a trend in the financial services industry where various types of institutions have launched digital lending platforms to serve their customers and in some cases the mass market. As I show in the next chapter, the incentive to lend this way is high because of the high risk–reward proposition. However, digital loans provided by SACCOs are typically accessible to paid-up members of the SACCO. As such, non-member customers who access FOSA services do not access SACCO digital loans. Also, deposit-taking SACCOs have in the last five years or so started making use of financial innovations, such as mobile banking and the use of VISA-branded ATM cards (see figure 1).

Figure 1: A VISA-branded ATM card issued by a SACCO. Source: Informant

The second sub-category of financially secure SACCOs has been less bullish than deposit-taking SACCOs, as described above. SACCOs in this category have opened or at least relaxed their common bond but unlike the three SACCOs described above, they have not gone further to offer FOSA services to the public. For this reason, SASRA categorizes them as non-deposit-taking. These SACCOs do not feature in my case studies but they form part of the 183 non-deposit-taking SACCOs which meet the SASRA threshold of 100 million Kenya shilling in members' deposits[16]. Even though I did not speak to managers from this category of SACCOs, I understood from other SACCO managers that a SACCO needs a business case that justifies providing FOSA services to the public before being allowed to do so. This means that the SACCO must be able to afford to invest in the infrastructure and resources necessary to provide the banking services and must be able to attract a large number of customers to make a return on the investment. Obviously, attracting many customers in an already saturated market is not easy, as seen in Uni SACCO's case, and therefore many SACCOs in this category choose to be conservative in their growth plans.

An example is Mhasibu SACCO (Mhasibu meaning 'accountant' in Swahili) which members of the Institute of Certified Public Accountants of Kenya started in 1986 to cater exclusively to chartered accountants. The SACCO grew over the years and was successful which led many people, mostly professionals, to express interest in joining the SACCO. This interest caused the SACCO to rethink their common bond. In 2019, members of Mhasibu SACCO voted to open its common bond to people from all occupations, corporates, and groups as a response to the market. This saw its membership grow from roughly 18,000 in 2018 to over 20,000 by the end of 2021. Today, Mhasibu is successful with assets of over 7.5 billion Kenya shillings (66 million US dollars).

Another example is Mzima Springs SACCO which non-teaching staff of Strathmore School and College (now University) started in 1983. The teaching staff at Strathmore were excluded from joining the SACCO for several years after its founding. However, the contributions by non-teaching staff were small, which meant that the SACCO's growth was slow and its liquidity was at risk. The SACCO's struggles worsened when Strathmore's college section relocated and, as a result, some members pulled out of the SACCO. The collapse of the SACCO was forestalled when members resolved to relax their common bond to include members of the teaching staff. Later, the SACCO's common bond was

[16] A list of the 183 regulated non-deposit-taking SACCOs can be found here: https://www.sasra.go.ke/download/list-of-licensed-and-authorized-sacco-societies-in-kenya-for-the-financial-year-ending-31st-december-2023/

relaxed even further to include staff from 34 other institutions, one after the other. This move saw members climb from 659 in 2015 to 1,042 members in 2022 and the SACCO's assets more than double from 121 million Kenya shillings (1 million US dollars) in 2015 to 370 million Kenya shillings (3.3 million US dollars) in 2022.

It is, however, important to point out that some of the 183 non-deposit-taking SACCOs that have an open common bond had achieved considerable success long before they opened their SACCOs to non-members. Such was the case with Mhasibu SACCO. Mhasibu SACCO members are qualified accountants who typically earn above-average salaries and in some cases very high salaries and they were able to make significant monthly contributions to the SACCO. The key difference between Mzima Springs SACCO and Mhasibu SACCO is the fact that the common bond members of Mhasibu SACCO were far more financially secure and in greater numbers than those of Mzima Springs SACCO. As such, they had significant financial resources prior to opening their common bond. Whereas Mzima Springs had to open their common bond to survive, Mhasibu SACCO did it largely out of a market response to the opportunity to grow the SACCO's financial strength even more and affirm the SACCO's standing.

Of the eight SACCO managers I spoke to, five came from SACCOs which had opened their common bonds. All five managers oversaw the relaxing of the common bond in their SACCOs and I was interested in learning from them why they had made this leap. From our discussions, four common justifications for relaxing the common bond in Kenyan SACCOs emerged.

The first justification for relaxing the common bond was to advance financial inclusion. For a long time, SACCOs have been viewed as alternatives to banks, which appeals to the non-elite. This is due to their grassroots organization by poor peasant farmers and later workers who could not access banking services, especially credit. The earliest SACCOs I encountered who relaxed their common bond were City SACCO and Cop SACCO who relaxed their common bonds in 2009 and 2010 respectively. Other SACCOs I encountered relaxed their common bond after 2010 with the latest one being Uni SACCO which opened their common bond in 2020.

The second justification concerns the ability of SACCOs to compete and survive in an intensely competitive market. It is critical to consider that SACCOs are part of the market economy and just like other types of institutions, they are bound to respond to market forces, such as competition from other market actors. As described in chapter three, the Kenyan financial services industry was

characterized by stiff competition among different institutions in the late 2000s, including NBFIs and MFIs. At the time, commercial banks were well-capitalized and were experiencing steady growth while MFIs were also gaining popularity, especially among the low-income population. Further, the entrance of mobile money in 2007 significantly disrupted the financial services industry and caused institutions to jostle for profits using different strategies. It is precisely under this set of circumstances that SACCOs that served a select pool of common-bond members faced a danger of collapse and possible extinction. In this view, relaxing the common bond was thus an act of self-preservation for some SACCOs, like Uni SACCO, which were on the verge of collapse.

At the time, the SACCO sub-sector generally understood that SACCOs could only grow by increasing their membership. Several SACCO managers I spoke to mentioned that their management committees had put them under great pressure to boost returns for members by setting ambitious targets for membership numbers and other financial parameters. The rationale was that a bigger members' register would in turn lead to better financial capability of the co-operative in terms of capital (shares), deposits, and loans. Siaya of Cop SACCO further explained that SACCOs had taken their cue from public sector reforms that had started earlier in the 1990s when the government had introduced performance contracting for public officers in state-owned corporations. This was occasioned by the Parastatal Reform Strategy Paper of 1991 which was aimed at improving public sector service delivery. It could be inferred that in the era of performance contracting, racking up membership numbers in SACCOs was not only an attempt to make them financially viable but also served to help SACCO managers deliver on their ambitious performance obligations set by the management committees.

The third justification for relaxing the common bond offered by SACCO managers relates to the pursuit of economies of scale. In a recent report, SASRA (2021) stresses that 'despite being social enterprises in their nature and formation, SACCOs are principally economic businesses which will thrive and be sustainable to meet members' obligations when they enjoy economies of scale'. A majority of managers I spoke to who had overseen the relaxing of the common bond in their SACCOs mentioned that they had done so to curb high operating costs and create efficiencies in their SACCOs with the hope that this would translate to cheaper services and attractive dividends for their members. They further explained that cost savings had realized from leveraging economies of scale to free up earnings which could be used for other growth initiatives and increasing returns to members.

The fourth justification for relaxing the common bond offered by industry insiders relates to the need to make them more sustainable and forward-looking. According to various industry insiders I spoke to, a significant number of SACCOs relaxed the common bond to draw in younger members in an effort to make the SACCOs more sustainable. One informant described this as 'future-proofing'. One SACCO which relaxed their common bond to appeal to a younger demographic is City SACCO (pseudonym). The manager of City SACCO explained that in 2009 when they had opened their common bond, roughly 70% of City SACCO's membership had been civil servants of the 'aging generation'; that is persons who were either retired or approaching retirement. He explained that the move by City SACCO to relax their common bond had been, therefore, an attempt to draw in younger members and in so doing make the co-operative more forward-looking. I personally relate with his explanation because my father, Magale Senior, whom I refer to in chapter three, is a long-time member of City SACCO and is indeed a retired civil servant.

This trend in the aging membership of SACCOs is, however, not peculiar to Kenya. A 2015 report by the WOCCU (2015) notes that the median age of credit union members in most countries is mid-to-late 40s; in Canada, the median age is 53 years while in Australia, the UK, and the USA it is 47 years. For Kenya, however, the median age of SACCO members was 30 years in 2015 (ibid). This could be ascribed to efforts in relaxing the common bond which had begun around five years earlier. A 2019 demographic report by SASRA (2019) shows that 31% of SACCO members are young adults between the ages of 18 and 35.

The manager of City SACCO pointed out that in line with attracting a young adult membership, there is a great imperative to design products and services that resonate with their younger members, given that such products and services are strong determinants of young members' decision to join the SACCO. To this end, City SACCO's management plan is to convert its current emergency loan product to a digital loan. According to the manager, young members are particularly attracted to this offering. He was, however, cognizant of balancing the design of new products and services to avert the mass exit of older members who in many cases would have sizeable savings with the SACCO and whose exit may cause the SACCO to experience liquidity challenges or, in extreme cases, collapse.

Opening the common bond was accompanied by several changes. Particularly, the change of a SACCO's name is worth highlighting briefly. Earlier, co-operatives were typically named after the geographical location (often the district) from where the SACCO drew its membership and the

socioeconomic activity the members were engaged in. Rebranding exercises were meant to shed a SACCO's former 'exclusive' identity as a society of teachers, farmers, and so forth in favour of a more neutral and inclusive identity in the hope that the SACCO would attract new members who were not previously affiliated with the SACCO. For example, Masaku Traders SACCO became Universal Traders SACCO (UTS), Muramati SACCO became Unaitas SACCO, Nyandarua Teachers SACCO became Tower SACCO while Taita Taveta Teachers SACCO became Kwetu (meaning 'ours' in Swahili) SACCO, and so forth. Cumulatively, 60 deposit-taking SACCOs changed their name between 2010 and 2014, representing roughly one-third of those licensed by SASRA at the time (SASRA, 2013).

Conversely, some co-operatives chose not to change their name even after relaxing the common bond. For example, United Women SACCO, which relaxed its membership to male members, still trades under its original name. Likewise, Kitui Teachers SACCO bears the 'teachers' and 'Kitui district' tags even though they opened their common bond. Siaya told me that he had unsuccessfully tried to get members of Cop SACCO to vote for a name change. He noted that a name change is a contested subject among their members who feel that the SACCO is losing its identity and reputation which has been built over a long time. A section of SACCO managers I spoke to viewed a name change as a necessary implication of relaxing the common bond. They argued that relaxing the common bond without following up with a change of name, where necessary, is counterproductive. This is because the SACCO will still appear to have a closed bond or to have members of a dominant class, which is likely to turn away prospective members.

It is, however, important to clarify that rebranding SACCOs has had little to do with their financial security. For example, Cop SACCO, whose members refused to vote for a name change, have managed to grow its membership by over 70,000 members and are financially secure despite operating under its old name. Similarly, Uni SCCO still bears its 'university' tag but has managed to recruit a couple of thousand more members and achieve financial success, however not nearly as much success as Cop SACCO. Conversely, City SACCO, which changed its name in 2010 when it opened its common bond, has equally managed to grow its membership to over 100,000 members and is also financially secure. The same can be said of many other open-bond SACCOs.

The third sub-category of financially secure SACCOs have achieved financial success despite ignoring the advice of WOCCU and others to open their common bond and offer FOSA services to non-members. SACCOs in this sub-category have a closed common bond and do not offer FOSA services.

It is also important to clarify that only the 176 deposit-taking SACCOs, all of which have an open common bond, offer FOSA services. Closed-bond SACCOs, therefore, do not offer FOSA services because their by-laws forbid the provision of SACCO services to non-members. Indeed, section 4.3(h) of the model by-laws for SACCOs, provided by the Commissioner of Co-operatives, lists 'transacting business with non-members' among the activities that closed-bond SACCOs are prohibited from engaging in. This legal restriction implies that a SACCO has to, with necessity, open its common bond to offer FOSA services to non-members.

SACCOs of this third sub-category also make up part of the 183 regulated, non-deposit-taking SACCOs that meet the SASRA threshold of 100 million Kenya shillings in members' deposits. Two of these SACCOs appear in my case studies – Auditor SACCO, which I describe in case study eleven, and the Bankers SACCO of which Vivienne from case study five is a member. Such financially secure, closed-bond SACCOs typically have a relatively small membership of people who enjoy a considerable level of financial security and predictability and are able to make significant contributions to the SACCO. By account of this, these SACCOs have amassed significant financial resources.

Employees of a top accounting firm founded Auditor SACCO in 1999, exclusively for employees who include accountants, tax professionals and other business consultants. At the time of writing, the SACCO had roughly 527 members from present and former staff at the firm like me. When I joined the SACCO in 2012, it had 451 members (according to the annual reports which are shared with all members). This indicates that the SACCO, having kept a closed common bond, has only managed to grow its membership by 76 members over a period of ten years. This is of course taking into account that some members left the SACCO within the period; it is not unusual for members of employer-based SACCOs to leave the SACCO after they leave their employment, perhaps to join a SACCO at their new employer or another SACCO that has a broader or open common bond. In the financial year ending December 2021, Auditor SACCO reported having members' deposits of 771 million Kenya shillings (6.8 million US dollars) and total assets of 860 million Kenya shillings (7.6 million US dollars) and an operating profit of 24 million Kenya shillings (212,000 US dollars). Auditor SACCO's services have hardly changed over the years that I have been a member. They have a few credit products which are available through guarantee by other members and have not ventured into more sophisticated products, such as digital loans or mortgages, like Cop and City SACCO have done.

In case study eleven, I highlight the reasons Leah, the manager of Auditor SACCO, gave for the SACCO rejecting the invitation by SASRA and others to open its common bond. She had insisted that the SACCO's founding objective was for members to access cheaper credit secured by guarantee rather than by assets. For this reason, keeping the SACCO small enough to have an effective guarantee mechanism is a strong imperative for members. Leah further opined that the social-proofing of SACCOs, as she termed it, is the one thing that cannot be replicated using technology and that this limitation is commonly used to suggest that SACCOs are slower at adopting technology. Further, Leah observed that all members of Auditor SACCO have one or more bank accounts and as such there is absolutely no need for Auditor SACCO to provide FOSA services.

Leah's reasons for Auditor SACCO not opening its common bond are reasonable. Leah stopped short of mentioning that the reason why Auditor SACCO has the 'luxury' of maintaining the bond is that its members are high-income professionals who can afford to make substantial contributions. As Leah noted:

> 'As a SACCO, our objective is very clear. We want people who work at Big 4 (pseudonym) to pool their savings and use the same to access cheaper credit. Period. This has worked for us for over 20 years. I would not say that we are an exclusive club; we have a small membership by default because we only offer co-guaranteed loans and the monthly contributions are slightly higher than elsewhere.'

Another SACCO that has followed the same path as Auditor SACCO is Vivienne's Bankers SACCO. Vivienne indicated that Bankers SACCO has restrictive requirements around the minimum share capital and monthly contributions of each member, making membership quite small. For this reason, only banking professionals, a majority of whom are well-paid, and reputable members of Nairobi's corporate elite can afford to be members of the SACCO. The common characteristic between Auditor and Bankers SACCOs is that they have small memberships of highly paid professionals who can afford to make significant contributions to their SACCOs each month, making these SACCOs essentially financially secure. As a result, there is little incentive to open the SACCO to other members, let alone to those who may not enjoy the same level of financial security and predictability. Vivienne also indicated that bank staff already get subsidized loans which are at times cheaper than SACCO loans and therefore members use SACCOs to mostly build their savings and as a 'Plan B' for obtaining loans in the event that they leave employment at the bank (which means that the staff rates on loans will

cease to apply to them and they will be required to pay commercial rates for their loans). Bankers SACCO therefore has little incentive to offer any sophisticated credit products or cater to the public (which the bank already does).

Auditor SACCO's path to financial security is therefore much different from the one that Cop SACCO and others took. Unlike Auditor SACCO, which focused on providing a limited range of services exclusively to its small number of financially well-off members, Cop SACCO and others have primarily relied on increasing their membership numbers and providing quasi-banking services to non-members (customers) to achieve financial security. The central point is that SACCOs that have been successful in achieving financial security to a greater or lesser extent make up only a small proportion of the total number of SACCOs in Kenya at the present time. These are the 176 deposit-taking SACCOs and 183 regulated non-deposit-taking SACCOs, adding up to a total of 359 SACCOs. This makes up roughly 10% of the roughly 3500 licensed SACCOs in Kenya.

5.4 Financially vulnerable SACCOs

The second broad category of SACCOs are those that are financially vulnerable or at least financially constrained despite following the recommendation by WOCCU and others to open their common bond, or, in some cases, for failing to make this change. All these SACCOs do not meet SASRA's threshold of 100 million Kenya shillings in members' deposits and are therefore not regulated, perhaps an indication that they are not significant in the grand scheme of things. These financially vulnerable SACCOs make up over 3000 of the 3500 licensed SACCOs, representing about 90% of all SACCOs in Kenya. This figure includes an indefinite number of dormant and inactive SACCOs and those that are still active but are financially constrained. Inactive SACCOs refer to SACCOs that are no longer operational or that are otherwise collapsed. Dormant SACCOs refer to SACCOs that show signs of inactivity, such as failure to submit annual reports, failure to conduct annual general meetings or process member loans, and so forth. There are, however, no updated industry reports showing the precise number of inactive or dormant SACCOs in Kenya. These financially vulnerable SACCOs, which I describe in detail below, fall under one of two sub-categories, roughly evenly split in number.

The first sub-category, which accounts for roughly half of the 3,000 financially vulnerable SACCOs, is made up of SACCOs who followed the recommendations by WOCCU to significantly relax or fully open their common bond. However, these vulnerable, open-bond SACCOs did not go further to offer

FOSA services to the public. The reluctance of these open-bond SACCOs to offer FOSA services could be attributed to multiple reasons. The first is the fact that providing FOSA services requires significant financial resources to finance brick-and-mortar branches, personnel, and expensive infrastructure, such as core banking systems and ATMs, which such SACCOs cannot afford. The second reason is that providing FOSA services requires SACCOs to fulfill stringent licensing requirements and to come under prudential scrutiny of the regulator, SASRA, given that they will be involved in mobilizing deposits from the public. Thirdly, through the SACCO Societies (Deposit-Taking Business) Regulations 2010, SASRA imposes significant capital adequacy and liquidity ratios and requires them to abide by strict rules around financial reporting and how to invest members' and customers' deposits. The significant cost and regulatory burden deter such open-bond SACCOs from venturing into providing FOSA services and these SACCOs thus prefer to remain unregulated and out of view.

Whereas this sub-category of financially vulnerable SACCOs does not feature in my case studies, there are numerous examples of SACCOs that fit this description. One such example is Nyamira North Women SACCO, a rural SACCO which is made up of roughly 1,600 members from Nyamira sub-county and neighboring areas. The SACCO started in 2019 for smallholder women farmers who were engaged in vegetable farming in the area. Later, in 2020, the SACCO opened their common bond with the hope that this will accelerate their growth. Even though the SACCO is now open to everyone, men included, it still struggles to build up significant financial resources from members. At the end of 2020, the SACCO's members' deposits stood at just over 13 million Kenya shillings. This amount may have gone up slightly over the last two years but it would still be insignificant compared to the financially secure SACCOs described earlier. This is because most of the SACCO's members are farmers and tradesmen and tradeswomen who can only manage to make the minimum monthly contribution of 800 Kenya shilling. Owing to its limited financial resources, the SACCO simply does not have the capacity to provide FOSA services. This is in addition to the fact that the SACCO is already late to the FOSA market and can hardly get new members who may want to use their banking services.

The key point here is that the recommendation from WOCCU and others to open the common bond to achieve financial security has only worked for a small minority (less than 10%) of SACCOs in Kenya. The large majority of SACCOs have not found financial success, or at least have not succeeded to the same extent as the SACCOs described in the previous section, even though they have opened

their common bond. Indeed, it is possible for SACCOs to be perfectly financially secure without opening the common bond if it has members who can make significant monthly contributions to the SACCO. This finding refutes the assertion that opening the common bond was a sure path for SACCOs to achieve financial security.

The other half of the roughly 3,000 financially vulnerable SACCOs are those that have kept their common bond closed, which by default also means that they do not offer FOSA services to non-members. Of the eight SACCO managers I spoke to, three managers came from SACCOs that still have a closed common bond. Two of the three SACCOs, Auditor and Bankers SACCO, which I described earlier, have achieved financial security, courtesy of having members who are well-paid urban professionals. However, one of the three closed-bond SACCOs I encountered, Fertilizer SACCO which I describe in case study twelve, is in stark contrast to the other two and I took some time to understand and reflect on why this is so.

Fertilizer Limited is a company based on the outskirts of Nairobi and specializes in the manufacture of a variety of crop nutrition products. The company has roughly 2000 employees comprising factory workers, a few dozen supervisors and middle-level managers, and a small number of senior managers, most of whom are also owners of the company. A few managers of Fertilizer Limited founded Fertilizer SACCO in 1999 as a means for employees to access affordable, unsecured credit for their own personal development and to meet family needs such as school fees. The manager of Fertilizer SACCO, Patrick, told me that the SACCO currently has roughly 1,000 members, a large majority of whom are low-skilled factory workers and their supervisors who all earn low incomes. He added that these members can only afford to part with the minimum monthly contribution of 1,000 Kenya shillings (10 US dollars) set by the SACCO.

Patrick pointed out that a small minority of the SACCO's members (less than 100 members) are middle- to senior-level managers of the company. This category of members earns substantially higher salaries and is able to make significant contributions to the SACCO, well beyond the minimum contribution required. I gathered from Patrick that the SACCO is effectively being propped up by contributions from the managers at the company who represent a minority of the SACCO's membership. He suggested to me that if by chance the managers were to withdraw their contributions, Fertilizer SACCO would be unable to keep up with loan requests by other SACCO members and would possibly collapse. It was difficult to obtain financial records of Fertilizer Limited from Patrick

but it was evident that the SACCO was nowhere near the league of financially secure SACCOs like Auditor and Bankers SACCO.

Fertilizer SACCO represents a large number of small SACCOs in towns and big cities whose members have low to moderate incomes at best. In my view, Fertilizer SACCO has not kept its common bond closed out of choice but rather by default. In other words, the SACCO may not be completely disinterested in the idea of opening its common bond but finds itself in such difficult circumstances that it is incapable of confronting the issue. This is due to two main reasons as I see it. The first reason has to do with the fact that they would be making this leap to an open common bond much later than other SACCOs with no clear advantage over the already successful open-bond SACCOs like Cop and City SACCO. There is a general rule of thumb that the earlier the SACCO makes this leap, the more successful they are likely to become. This is because there is only a limited pool of people in Nairobi who can afford to make monthly contributions to a SACCO and the SACCOs who opened their common bonds earliest are more likely to have scooped up this pool. Secondly, Fertilizer SACCO's vulnerable financial situation makes it unappealing to new members. This is particularly true for people with higher levels of income than the majority of its current members and who can make significant contributions to the SACCO, enough for the SACCO to escape the overreliance on savings from a few managers. For these reasons, Fertilizer SACCO does not harbour any illusions that simply opening its common bond to everyone will in any way guarantee its financial security.

SASRA's advice for financially vulnerable SACCOs, such as Fertilizer SACCO and Nyamira North Women SACCO, is for them to merge with other SACCOs in the hope that they will survive and possibly even achieve financial security in the long run. SASRA argues that by consolidating their financial resources, these SACCOs are able to serve their members more effectively and make the new SACCO cheaper to run. What SASRA does not know or refuses to acknowledge is that it would be highly unlikely that a financially secure SACCO like Auditor SACCO or Bankers SACCO would even consider linking up with a financially constrained SACCO like Fertilizer SACCO because they hardly have any financial incentive to do so. Naturally, Fertilizer SACCO would find it easier to merge with a SACCO which is experiencing a relatively similar level of financial uncertainty where it could potentially be mutually beneficial for both. However, if Fertilizer SACCO elected to merge with another small SACCO in a similar financial predicament, like Nyamira North Women SACCO, they may not be successful because they will simply be adding more members with low incomes, who are

only able to make small contributions to the SACCO, and only a few better-paid employees which will not do much to help their financial situation.

The key point is that WOCCU and other bodies tend to oversimplify the idea of opening the common bond; for many SACCOs, opening the common bond or merging SACCOs is not as straightforward as it is presented to be. Many Kenyan SACCOs are unable to confront this issue because of their circumstances and for those that do, it becomes a matter of chance whether they will achieve financial success or not. Put differently, for the majority of SACCOs whose members are not particularly financially secure, opening their common bond is not more assuring of their financial viability than keeping it closed. For these vulnerable SACCOs to stand a chance, they need to recruit many more members who make small contributions. However, this is a difficult task for such SACCOs given that the market is nearly saturated and attracting members is nearly impossible. These financially vulnerable, closed-bond SACCOs are therefore resigned to jogging along into their uncertain future.

5.5 The question of financial inclusion

Having considered how SACCOs responded to the proposals to open their common bond and offer quasi-banking services to non-members, I now turn to reflect on how the actions of SACCOs in response to these proposals play into the financial inclusion discourse. The hope and hype of the proposals of SACCOs opening their common bond and providing FOSA services to non-members were fixated on the idea of a 'fortune at the bottom of the pyramid' which was based on Prahalad's (2005) argument. As described in chapter one, Prahalad's argument is that designing goods and services, in this case financial services, which are more tailored to the needs of the poor would be mutually beneficial to both the poor, who use the services, and the organizations' financial success. Prahalad's logic is backed up by numerous scholars and influential organizations who have carried the financial inclusion message over the last two decades.

CoopAfrica also put a positive spin on the proposal to open the common bond and provide quasi-banking services, which mirrored the financial inclusion rhetoric that had emerged a few years earlier. They argued that opening the common bond and providing quasi-banking services would 'provide a path out of poverty'. In a 2008 book titled *Cooperating out of Poverty* produced by CoopAfrica, Develtere, Pollet and Wanyama (2008) suggest that SACCOs can be effective in combatting poverty, inequality, and exclusion in Africa. They argue that SACCOs must adopt radical changes in their model to reach the poor by helping them build savings and make investments and creating employment and other

income-generating opportunities. The proposals from CoopAfrica were therefore not particularly new, and the timing was not mere coincidence. It is also no coincidence that the institutions that drove the 'financial inclusion for poverty reduction' mantra were the same institutions that backed and indeed funded many initiatives aimed at helping Kenyan SACCOs open their common bonds and provide quasi-banking services.

The argument that SACCOs opening the common bond and providing FOSA services is a sound financial inclusion strategy that will deliver immense benefits to the poor has been largely uncontested until this study. However, there has been some criticism about financial inclusion as a strategy to combat poverty. As mentioned in chapter one, this wave of criticism about financial inclusion started after Duvendack et al. (2011), Bateman and Chang (2012), and others presented evidence to show that microcredit has had little to no impact on poverty reduction and has in some cases heightened the vulnerability of the poor. Bateman and Chang (2012) and Soederberg (2013) argue that the powerful actors in global finance and international development have brought back microfinance in a new disguise, that of financial inclusion, which they further argue is deeply exploitative of the poor. Along similar lines, Mader (2016, 2018) argues that financial inclusion is a vague idea and cites the lack of robust evidence backing the assertions made in the literature about the socio-economic benefits of financial inclusion. However, unlike Mader who arrives at this conclusion based on an extensive review of reports and scholarly articles, my approach in this regard is based on empirical evidence from the people on the ground. I have interacted with and spoken to a significant number of insiders in the SACCO sub-sector, SACCO members, and FOSA customers of different types of SACCO services and have drawn conclusions based on my interviews with them.

Even though relaxing the common bond was meant to lift restrictions to SACCO membership and to be transformative for financial inclusion, it has become clear since 2008 that SACCOs are still generally inaccessible to the majority of the low-income population and that relaxing the common bond has not been effective in combatting poverty, as was proposed by CoopAfrica in 2008. The overall difficulty in belonging to a SACCO in the present day concerns one's ability to purchase the minimum set share capital and one's ability to make regular contributions or savings with the SACCO. By implication, new SACCO members who join SACCOs after the common bond was relaxed are people who can afford to make monthly contributions to the SACCO and are, in most cases, not people at the bottom of the pyramid. Many ordinary Kenyans are simply unable to meet this requirement and those that do, struggle with it. It is precisely for this reason that SASRA (2021) notes

in their 2021 annual report that roughly 25% of the 5.5 million SACCO members are inactive, meaning that they have not transacted with the SACCO in over six months.

To help visualize the above argument, I draw from the first five case studies of various borrowers I encountered (see chapter 4). The majority of the borrowers I encountered can be described as being at the 'bottom of the pyramid'. This includes wage-earners like Makosa the security guard (see case study one) and micro-entrepreneurs like Odongo the boda-boda rider (see case study two) who equally earn very little. Nairobi's informal settlements are full of people who fit neatly into this group. It was clear through my interactions with those at the bottom of the pyramid that they are in most cases not SACCO members. This is because their small and often erratic incomes do not allow them to buy the mandatory share capital and sustain making the minimum monthly contributions as required by SACCOs. If Odongo or Makosa become members of a SACCO, that SACCO would likely be just as financially vulnerable as Fertilizer SACCO, if not more so, given their low and unpredictable incomes.

Another category of people I interacted with occupy a higher socioeconomic standing than Makosa and Odongo in that they earn above-average salaries which allow them to cope much better financially. However, their SACCO membership largely depends on the predictability of their incomes. An example is Vivienne from case study five who is an affluent urban professional and enjoys a high level of expectation and predictability in her finances. People in Vivienne's socioeconomic class represent a small minority of people in Nairobi, and Kenya at large. Vivienne can comfortably make regular and significant monthly contributions to her SACCO. People in her class enjoy sizeable co-guaranteed SACCO loans to use for capital purchases and productive assets which place them in a unique position to improve their economic alternatives and streams of income. Another example is Aisha from case study four who is employed as a lawyer. She earns a regular salary, much higher than what Odongo and Makosa earn, enabling her to make regular monthly contributions to her SACCO even though not nearly as significant as Vivienne.

However, for some people whose work situation is more precarious, for example self-employed people and gig-workers like Brian described in case study three, keeping up with monthly SACCO contributions is not assured. Brian occasionally earns significant amounts from his gigs but his income is irregular and unpredictable, given that it could take three months or more before he gets another gig. This precludes him from being an active SACCO member given that his monthly contributions will likely be in arrears, which in turn affects how he is assessed for a loan. Non-member customers

like Brian do not enjoy all the rights and privileges of a SACCO member in the true sense. Brian is forced to contend with FOSA services from deposit-taking SACCOs. However, some benefits which are available to common-bond members, such as unsecured, co-guaranteed loans and dividends, are not available to him.

By the same token, the recommendation that SACCOs should offer FOSA services to the public as a way to combat poverty has not lived up to its billing. The evidence suggests that there has not been a mass uptake of FOSA services as WOCCU and some SACCO managers had initially expected. This is despite FOSA services having some advantages over conventional bank services, as highlighted earlier. The key issue is that one needs money to use FOSA services provided by deposit-taking SACCOs. Therefore, the proposal to open the common bond and provide FOSA services addresses the wrong issue. In my discussions with SACCO managers and while reviewing numerous annual reports of deposit-taking SACCOs, I noted that SACCOs only disclose the number of paid-up members as required by the SACCOs Act, leaving out the number of FOSA customers. The managers were reluctant to reveal the actual numbers of FOSA customers; some indicated that they did not know the precise number of active accounts while others simply said that this was a business secret.

The question that still lingers is how the vast majority (90%) of Kenyan SACCOs can ensure their financial viability and how these SACCOs can meet the needs of their members and, if possible, reach out to those at the bottom of the pyramid. The last 15 years have shown that the options of opening the bond or keeping it closed or providing quasi-banking services to the public have little to do with answering this question. It is possible that in another 15 years to come, people who can afford to join a SACCO will join the more successful SACCOs, like Cop and City SACCO, as the smaller financially vulnerable SACCOs, like Fertilizer and Nyamira North Women SACCO, collapse. It is also possible that in that time, the number of inactive SACCO members will rise significantly from the present 25% as more people struggle to keep up with the demands of membership.

To sum up, even though SASRA and influential international bodies like WOCCU and CoopAfrica popularized opening the common bond as the ideal model for 'the SACCO of the future' and as a triumph for financial inclusion, doing so has barely lived up to the promise. The idea that merely opening the SACCO to people outside the common bond or that providing them with cheaper banking services will significantly reduce poverty was overambitious. The issue of tackling poverty,

therefore, is more complex and has to be dealt with in some other way that pays attention to inequalities in the global economy as I discuss in the last chapter of this thesis.

5.6 Conclusion

The chapter has described the various categories of SACCOs in Kenya, emphasizing their financial viability – an immediate issue that many analysts tend to downplay. I have described the logic behind how a majority of SACCOs in Kenya find themselves financially constrained whether or not they have opened their common bond. Conversely, a minority of SACCOs have escaped constraints in some cases by opening their common bond and in other cases by keeping it closed. The chapter also describes the difficulty that a large number of smaller SACCOs have in opening their common bond and explains why these SACCOs see no obvious advantage in either keeping their common bond closed or opening it up. This goes against the proposition by WOCCU and others that opening the common bond is virtually the only way to guarantee a SACCO's financial success and to reach out to the poor.

The timing of the proposals by WOCCU and CoopAfrica to open the common bond and extend banking services to the public as a pathway to financial inclusion was not at all a coincidence. At the time, financial inclusion was the ideology in vogue and the international lobby on financial inclusion was convinced that extending financial services to people at the bottom of the pyramid would help to tackle poverty. Notably, the organizations that were at the forefront of the push for financial inclusion were the same ones who were involved in financing projects by WOCCU and CoopAfrica. This chapter has shown that, against these organizations' expectations, opening the common bond and providing FOSA services have not made SACCOs more accessible to the poor. This is because relaxing the common bond has not fundamentally altered membership in most SACCOs given the financial demands placed on members. This is in contrast to the assertion by the financial inclusion lobby that access to financial services will have unlimited potential to shore up the poor. This chapter shows that this is certainly not the case in relation to SACCOs in Kenya. The next chapter examines this assertion about mobile money and specifically the phenomenon of digital lending in Kenya.

CHAPTER SIX: SCATTERING SEEDS: THE EMERGENCE AND GROWTH OF DIGITAL LENDING

6.1 Introduction

The traditional form of lending requires borrowers to provide collateral in the form of productive assets and other sureties. However, the majority of Kenyans do not possess assets against which they can borrow and are therefore effectively locked out of the formal credit market. This led working-class people to form co-operatives to satisfy their credit needs. Recently, the prohibitive conditions for accessing formal credit have led to the emergence of digital lending in Kenya. This was preceded by the innovation of mobile money which dramatically disrupted the financial services sector and was heralded as a boon for financial inclusion when Kenyans rapidly adopted this service.

The mature mobile money infrastructure presented digital lenders with an opportunity to offer unsecured, short-term loans through mobile channels. Digital lending has taken many forms in the last decade. Firstly, digital lending has transcended institutions. Both financial and non-financial institutions offer digital loans of different kinds. Additionally, while some digital lenders remain conservative and lend to a closed group of customers, others lend to the mass market. Several digital lenders also offer in-kind loans through digital platforms in the form of goods or purchases on installment, commonly referred to as buy-now-pay-later loans.

This chapter concerns itself with the digital lending model, how it emerged, the market conditions that made this possible, and how it works. Developments in the digital lending industry over the last decade are discussed. The chapter also delves into the benefits of digital lending as well as its challenges. Part of the reason why digital lending grew rapidly in Kenya was the fact that the industry was unregulated for a long time. However, calls for regulation from various governmental authorities and the public precipitated several attempts at regulating the industry. This chapter highlights recent efforts in regulating the sector. Finally, the chapter discusses credit information sharing and how it supports digital lending in Kenya.

6.2 Digital lending and financial inclusion – a fallacy

Digital financial services have been fashioned for the last decade and a half as the magic formula to finally reach the elusive bottom of the pyramid. Indeed, some innovations, such as M-Pesa and digital loans, have reached the bottom of the pyramid in Kenya. However, for these low-income borrowers, digital loans have proved harmful in the long run. Low-income borrowers routinely use digital loans for household consumption smoothing. Digital loans are also the default option for financial emergencies. Many low-income borrowers in Kenya have become heavily dependent on digital loans as evidenced by loan stacking that is rampant among this category of borrowers. Due to their low and often erratic incomes, they face great difficulty in repaying their digital loans, and therefore over-indebtedness is common among them.

In this chapter, I demonstrate that moderate- to high-income borrowers also use digital loans. However, their interaction with digital credit is vastly different from low-income borrowers. Moderate to high-income borrowers use digital loans mostly as a convenient tool; digital loans are therefore insignificant to their financial and social life. Their higher level of expectation and relatively high, predictable incomes allow them to pay their digital loans relatively easily. These borrowers are also much less likely to be multi-borrowed. When considering the use of digital loans by this category of borrowers, I make the case that digital loans are useful to a narrow cross-section of borrowers – those who are often already financially included. Taking this view, I argue that digital loans have not advanced financial inclusion in Kenya.

Part of the reason why digital lending grew rapidly in Kenya was the fact that non-bank lenders were unregulated for a long time. The absence of regulation gave room for digital lenders to innovate further and grow quickly. However, borrowers' experiences with digital loans, which I highlight in this chapter in detail, have left much to be desired. The crusaders of the financial inclusion message and many industry insiders usually overlook or downplay the high cost of digital loans, adverse inclusion, and other predatory practices. Notably, some digital lenders are more problematic than others in this regard, a case in point being the venture-capital-backed digital lenders who are more aggressive in their lending strategies and less sympathetic about the consumer outcomes of their tactics than banks and SACCOs who also give digital loans. These challenges have led to recent steps in regulating the industry. However, whether regulation will provide significant protections for the poor or make digital loans less harmful is left to be determined.

6.3 Kenya's dualistic credit market and the unmet demand for formal short-term credit

As with many African countries, Kenya's credit market is dualistic given that formal and informal lenders co-exist side by side (Zins & Weill, 2016). Atieno (2001) suggests that this fragmentation exists because different lenders serve clients with distinct characteristics. Informal lenders include shopkeepers who offer store credit, other supply chain creditors, moneylenders, local member savings groups formally referred to as accumulating savings and credit associations or rotating savings and credit associations, and friends and relatives who offer someone credit through social networks.

Formal lenders in strict terms are financial institutions that are regulated by a prudential authority. In the case of Kenya, this comprises 39 commercial banks, 14 microfinance banks regulated by the CBK (see CBK, 2020), and 175 deposit-taking SACCOs regulated by SASRA (see SASRA, 2021). Also, semi-formal financial institutions are not prudentially regulated by a statutory body but are legally registered to offer specified financial services. These semi-formal institutions comprise over 25,000 active co-operative societies (International Co-operative Alliance, 2021), 8,033 non-deposit-taking SACCOs (WOCCU, 2019), and an indefinite number of credit-only institutions and digital lenders.

The question of why these formal and semi-formal financial institutions do not serve or underserve the poor has been well explored in literature. Beck, Demirgüç-Kunt, and Martinez Peria (2008), as well as Prahalad and Hammond (2002), among others, argue that this is because financial institutions regard the poor as being unprofitable customers. Prahalad and Hammond (2002) argue that this view fails to consider the growing importance of the informal economy among the ultra-poor, which they estimate accounts for 40 to 60% of all economic activity in developing countries. The argument about the poor being an unprofitable customer segment stems from the logic that financial service providers need to invest in expensive infrastructure, such as brick-and-mortar offices, automatic teller machines, and personnel, as they seek to serve the poor who often lack substantial incomes or savings. Kendall and Voorhies (2014) note that banks invest in such infrastructure almost exclusively in the wealthier, denser, and thus safer, areas. Further, dealing with small transactions is costly for financial institutions and therefore makes serving the poor a low priority (Beck & Demirgüç-Kunt, 2008). Poor households and individuals also tend to have a high credit risk on account of their low and erratic incomes (Beck et al., 2008). Specifically, the important constraints to accessing credit are that the poor have no collateral and cannot borrow against their future income because they tend not to have steady jobs or income streams (ibid).

The demand for small, short-term credit in Kenya has long been a need among Kenyan borrowers. The unmet demand for short-term credit forced borrowers, especially blue-collar workers and those with erratic incomes, to either go without formal credit or turn to informal lenders. Costa, Deb, and Kubzansky (2015) point out that there is a clear demand for unsecured, formally provided, reasonably priced credit for short-term purposes. However, given that formal lenders mostly offer significantly sized loans with a longer tenure, borrowers often look to informal credit providers to meet their need for short-term credit. Further, prohibitive conditions of accessing formal credit, such as the requirement for security, helped informal lenders establish themselves as an alternative source of credit in Kenya. Diagne (1999) argues that formal and informal credit are imperfect substitutes. He notes that whenever formal credit is available, it reduces but does not eliminate the need for informal borrowing, suggesting that the two forms of credit fulfill different functions in a household's intertemporal transfer of resources. (ibid).

Many accounts in the literature argue that informal financial service providers are critical in Africa. Atieno (2001) points out that a large part of financial transactions in Africa occurs outside the formal financial system. Zins and Weill (2016) find that informal credit is crucial on the African continent, given that 41% of individuals are reported to have borrowed from an informal source with the first source being 'family and friends' (37.5%) followed by credit from a store (7.9%). Similarly, CBK (2019), through the FinAccess Household Survey, finds that 59% of credit uptake has been from informal lenders with store credit being the most preferred source (29.7%), followed by family and friends (10.3%).

Many advocates of financial inclusion, however, tend to overlook these informal sources of credit and indeed other financial services which are clearly still significant in the Kenyan market, even today. It seems to me that these advocates of financial inclusion have the image of loan sharks and the crude business practices that they employ at the forefront of their minds. While this image is useful in capturing everyone's attention and making the case for formal financial services, it ignores the fact that informal credit sources still dominate the financial lives of Kenyans. Encouraging people to abandon informal financial services which they are familiar with and use frequently and ascend to bank accounts and digital financial services, which according to the FinAccess survey they either do not trust or perceive as expensive, is just another way in which the financial inclusion discourse is far removed from the reality on the ground.

In a study exploring the phenomenon of informal credit in Kenya, Atieno (2001) points out that formal lenders in Kenya focus on borrowers with certain characteristics – a stable income and/or physical collateral. This results in a credit gap that drives borrowers to the informal market to meet their credit needs. She argues that informal credit is particularly client-focused in that credit appraisal often involves group monitoring of a borrower's habits, personal knowledge by the lender, and the recommendation of others. Atieno (2001) and Diagne (1999) suggest that informal credit is based on flexible arrangements to adjust to changing economic circumstances, which results in a dependable working relationship between the lender and the borrowers. This makes informal credit attractive to small borrowers despite the usury interest rates imposed to compensate for the higher risk of default (ibid).

Some literary studies argue that informal financial services can be pernicious because these service providers are typically small with little room to scale up; lack structure; lack basic consumer protections, which renders them generally exploitative; and tend to be expensive, particularly as it relates to credit. For example, a study of informal savings groups in Kenya by Feather and Meme (2018) finds that in some cases, the interest rate on loans from table banking groups can be as high as 20%. The authors note that even though this interest is recirculated into the group's pool, the high interest rates make loan repayment obligations harder to meet, leading to default. In her book, *Money from Nothing*, James (2014) sums up many of the ills of informal lending in post-apartheid South Africa. She provides a compelling account of how local money lenders in South Africa, referred to as mashonisas, exploit poor, black wage workers by offering them loans at usury rates which lead to perpetual debt traps. She notes that mashonisas are themselves borrowers and that they borrow cheap and lend dear to those who do not qualify for formal credit, in her words 'making money from money'. She further describes the over-aggressive collection methods employed by lenders, including confiscating a borrower's debit card and identity document, and misusing garnishee orders to recover debts directly from a borrower's meagre wages. She, however, notes that despite mashonisas being shrewd businessmen, they are part of the community which means they have some degree of compassion and empathy for people in the townships where they operate.

The demand for short-term credit provided by informal lenders was a precursor to digital lending in Kenya. As Atieno (2001) predicts, 'the emergence of demand for short-term credit especially among small borrowers will most likely lead to the development of an informal mechanism to meet that demand; informal credit, therefore, seems to develop in response to an existing demand'. Prahalad

and Hammond (2002) also suggest that in designing products for the poor, it is incumbent on financial service providers to change their business models and leverage technology, given that the market for the poor is receptive to technological innovation.

John the serial entrepreneur described in case study seven, who was in the informal lending sector as a logbook lender before launching Kash loans, explained:

> '…this is not to say that low-income earners did not have existing coping mechanisms before digital lenders came into the picture; they did, only that it was informal. Financial technology was not a solution unto itself, it only made an existing process more efficient, faster, and possibly less costly.'

In recent times, financial technology has transformed the provision of financial services globally, including the provision of credit. Costa et al. (2015) point out that financial technology has created new opportunities to address many longstanding barriers in financial services. Likewise, Di Maggio and Yao (2018) point out that digital lenders face low barriers to entry and are likely to succeed where other financial institutions are profitable, likely due their significantly lower fixed costs or because they are less strictly regulated, allowing them to adopt laxer lending conditions and reach out to more borrowers.

6.4 The emergence and growth of digital lending in Kenya

As highlighted in chapter one, Kenya has been at the forefront of financial innovations, in particular mobile money and, recently, digital credit. These innovations have been heralded globally as being critical in the promotion of financial inclusion. Launched in 2012, M-Shwari was the first digital lending product in Kenya and was a result of a partnership with NCBA Bank and Safaricom. The M-Shwari loan was easily accessible to customers through their mobile devices, was instantly delivered, and offered privacy. With this move, commercial banks and MNOs tapped into the unsatisfied market for short-term credit which, as highlighted earlier, had been satisfied by informal lenders. Mobile money, therefore, set the stage for digital lending in Kenya. Hwang and Tellez (2016) observe that digital lending is particularly prevalent in sub-Saharan Africa, in part because of the high level of mobile money penetration in the region, which enables the delivery of mobile loans.

Two consequential technological developments in Kenya coincided with the growth of mobile money and digital lending. These developments underpinned the digital lending model and caused digital

lenders to lend more efficiently. The first development was the digitization of the Kenyan identification (ID) system in 2012 through the integrated population registration services. This was significant because it allowed digital lenders to utilize a verifiable unique ID for each borrower. The second development was the requirement under the Kenya Information and Communications Act 2015 to register all SIM cards (mobile phone numbers). This allowed digital lenders to link the borrower's ID to their mobile number(s). John explained to me that these developments went a long way to resolving issues of identity theft that had arisen in the first few years of M-Shwari's operation. He described to me how dodgy borrowers would take out digital loans using different mobile numbers which could hardly be traced back to them when enforcing repayment.

These developments described above were also significant in the recruitment of new digital lenders. To illustrate, Meyo explained to me the onerous process of opening a bank account, once the gateway to credit. He explained that until recently, know-your-customer procedures had been mostly manual. To open a bank account, a client had to present themselves physically to the financial institution and present physical copies of their ID document, a passport photo, and an introduction letter from an employer or another account holder, and sign numerous forms. For a time, Meyo's role was to dispatch these documents to the head office for the second layer of review and in the absence of any questions, the account-opening department would then open the account. The process would take a few days to a week and sometimes longer than this. The customer would then wait for a further week or two weeks to collect a physical bank card and/or a chequebook for ease of transacting. It is important to recall that operating a bank account was a prerequisite to obtaining credit; hence financial inclusion is primarily measured in terms of ownership of an account.

The innovation of M-Pesa and M-Shwari significantly democratized financial services in Kenya, allowing users more choice in the financial services they consumed. This new wave led to commercial banks looking into their business models to innovate to compete and maintain profitability in a now highly competitive market. In the years to follow, many other commercial banks mirrored NCBA to launch their digital lending platforms, restricting their services to customers on whom they had considerable information. KCB launched KCB M-Pesa, Equity Bank launched Eazzy loan, Co-operative Bank launched M-Coop Cash, Barclays Bank (now ABSA) launched Timiza loan, Housing Finance Bank launched HF Whizz, and so forth.

In a considerably short period, there was a massive uptake of digital loans among borrowers in Kenya. For example, Cook and McKay (2015) point out that one in five Kenyans (4.5 million people) were using Safaricom's M-Shwari digital credit product in 2015. This figure does not take into account the growth of M-Shwari in the ensuing period, nor the borrowers who take out loans from other digital lenders in the market. This illustrates that borrowers, especially those with low and erratic incomes, were in dire need of formally provided, unsecured, short-term credit. Globally, there is growing evidence that financial innovation has increased access to credit for small borrowers, in both advanced and emerging economies (Bazarbash & Beaton, 2020). Costa et al. (2015) note that in emerging economies like India, China, Brazil, India, Mexico, Indonesia, and Turkey, hundreds of millions of people have to gain access to formal credit for the first time, creating a market opportunity that is too big to ignore.

The lack of a regulatory framework to oversee digital lending in Kenya, after the test case of M-Shwari, created an easy path for non-bank digital lenders to enter the market. From 2014, just two years after the launch of M-Shwari, non-bank digital lenders started experimenting with digital lending, issuing loans to the mass market using private funds from international venture capitalists. These fintech companies extend digital loans on the strength of credit scores computed by proprietary algorithms using troves of information collected on borrowers. The first of these was an internationally based fintech company, Tala loans, which remains the largest non-bank digital lender in Kenya to date. The second private fintech company to launch in Kenya was Branch International which, like Tala loans before it, was also internationally based. Many other non-bank digital lenders, both local and international, set up shop in Kenya. One small digital lender gave me examples of loan sharks and logbook lenders who simply shifted their business to digital platforms and branded themselves as digital lenders. Himself a former logbook lender, John explained that digital borrowing was not only trendy at the time but also had better, quicker returns for such entrepreneurs. By offering credit directly to borrowers, digital lenders performed financial disintermediation, effectively cutting off banks that had traditionally acted as a 'middleman' (intermediary) between savers and borrowers.

Digital lending also broke barriers from an institutional perspective; for the first time, non-financial institutions such as MNOs and retailers who previously had no role in the provision of financial services, started offering loans in one form or another. To this point, Bazarbash and Beaton (2020) note that digital credit has evolved through non-financial institutions that have built capabilities for

accessing borrowers' digital footprints, which helps them assess credit risk and identify potential demand for credit from their customers. I describe this evolution in more detail later in this chapter.

6.4.1 Scattering seeds: the digital lending model

The defining characteristic of the various types of digital lenders described above is that the digital lending process they use, is in some or all parts automated. Bazarbash and Beaton (2020) describe digital credit as business models that use modern technology to digitize at least some aspects of the credit extension process. Hamp, Agwe, and Rispoli (2016) identify three dimensions that have been effectively digitized on digital platforms offering credit: the assessment of an applicant's repayment capacity and therefore the risk of default, disbursement of the loan, and repayment of the loan.

I spoke to Shirley (pseudonym) who works as a digital financial services consultant for a boutique consulting firm. She has vast professional experience in the financial services sector, having previously worked with several large banks and as an executive of one of the first microfinance institutions in Kenya. Shirley explained to me the difference between conventional bank loans and digital loans. She pointed out that because banks and other formal financial institutions extend sizeable loans compared to digital lenders, they are interested in the likelihood of default. For this reason, the bank typically looks at the proposed use of the loan, the profile of the borrower, and the borrower's history with the institution. In contrast, digital lenders issue as many small loans as possible, to as many people as possible and fashion crude tactics for maximizing repayments and their return, without regard for the wider implications to the borrower's welfare. She aptly describes the digital lending model as 'scattering seeds':

> 'The digital lending model is that of scattering seeds. You know the way you just scatter seeds in a '*shamba*' (farm) and hope that more seeds will land on fertile ground and that whatever you harvest will pay back the cost of your inputs. There are few people who are good payers, but because the interest rates are so high, one good payer can cover losses from the bad payers so that they have a net positive. They are all scrambling for good payers.'

Expanding on her comment, she described the scattering seeds strategy as digital lenders giving small loans to borrowers with whom they have no previous borrower-lender relationship, with the hope that they will convert them into good borrowers who will be loyal in the future. This view corroborates

the view of Di Maggio and Yao (2018) who note that digital lenders acquire market share by first lending to higher-risk borrowers and then to safer borrowers. Hwang and Tellez (2016) also hint at this when looking at different ways that digital credit is deployed. They note that digital lenders use alternative (non-historical) data when evaluating first-time borrowers with whom they have no previous relationship, and use the borrower's history of repayments for subsequent loan applications. Typically, the pricing strategy employed by digital lenders mirrors their scattering seeds strategy. Unsurprisingly, Di Maggio and Yao (2018) argue that the interest rate charged by a digital lender correlates with the loan default probability, in other words the lender's pricing model likely takes into account the risk of a digital loan defaulting.

Digital lenders collect a wide range of information on a borrower from a variety of sources and use proprietary algorithms to compute a credit score that they believe indicates a borrower's repayment capacity. Lenders use credit scores to set a credit limit for each customer which increases or reduces over time, depending on the borrower's repayment behaviour; this is referred to as the dynamic incentive model. Carlson (2017) describes the dynamic incentive model as a carrot-and-stick strategy where lenders threaten to exclude defaulting borrowers from access to additional credit and start borrowers at small initial loans but promise progressively larger loans on condition of repayment. Beck and Demirgüç-Kunt (2008) argue that increasing loan sizes as customers continue to borrow and repay, helps reduce default rates. Likewise, Carlson (2017) gives evidence that the dynamic incentive model produces a strategic repayment motive, where borrowers repay loans to get access to larger loans in the future.

Jeanne, the chief executive officer of Pioneer Nanoloans (see case study six), explained to me that digital lenders perform three automated know-your-customer checks when onboarding a new customer. First, they reference a borrower's ID number against the government's integrated population registration services system. Second, they verify a borrower's telephone number with an MNO (mostly Safaricom) which confirms if the borrower is the registered user. As I described earlier, these two preliminary tests ensure that the ID and mobile number are valid and belong to the same individual, which helps to prevent identity theft. Finally, the lender queries the borrower's credit score with one or more CRBs to gauge the borrower's ability to repay their loan after which they are automatically assigned a credit limit. These three checks are automated and take less than five minutes to perform and do not involve any human intervention. When a user is onboarded on a digital lending platform, they can access a loan immediately.

The vast majority of my informants who were SACCO members also borrowed from digital platforms. When I asked these borrowers to compare their experience in obtaining loans from their SACCOs with their experience on digital platforms, they expressed that with digital lending platforms, one can get a loan immediately after being onboarded on the platform without parting with any money. They explained that with SACCOs, they are first required to buy a minimum number of shares to be a member and then make regular contributions for some time, usually a minimum of six months, before accessing a loan which must be co-guaranteed by other members. They also indicated several other features of digital loans that make them preferable to SACCO loans, as I describe below.

Borrowers pointed out several attributes of digital loans that make them an attractive value proposition and more favoured than traditional loans. The most alluring qualities of digital loans are their accessibility, their rapid delivery, greater privacy, and the fact that they are unsecured. Many digital borrowers indicated that easy access to mobile loans is the most attractive feature of digital loans, which also makes them their go-to product for financial emergencies and other consumption needs. The 2019 Kenyan Census report (Kenya National Bureau of Statistics, 2019) reveals that nearly 21 million Kenyans own mobile devices. Although this figure represents all individuals aged three years and above who own phones, we can deduce that a significant proportion of the Kenyan adult population of 25 million (Kenya National Bureau of Statistics, 2019) own mobile devices. The inference is that a large proportion of Kenyans have access to financial services delivered through mobile phones, including digital credit. Borrowers apply for digital loans conveniently through their mobile devices using a mobile application for smartphones or through an unstructured supplementary service data (USSD) code for both feature phones and smartphones. It was clear that digital borrowers whom I spoke to had little to no difficulty in installing and using mobile loan applications as well as accessing digital loans through the USSD code channel.

Digital loans are accessible around the clock, unlike traditional credit providers who operate during strict working hours. Further, digital loans are processed remotely without requiring the customer to visit a bank branch or agent in person, an attribute digital borrowers find attractive. Digital credit, therefore, closes geographical distances that formerly acted as a barrier to accessing credit, as Mwangi and Sichei (2011) argue. Prahalad (2002) also points this out and asserts that the poor who are economically excluded are often physically isolated and, as such, better distribution systems are essential to deploying goods and services to them.

Rapid delivery is another hallmark of digital lending. Burlando, Kuhn, and Prina (2020) suggest that this attribute of digital loans makes them particularly appealing to borrowers who can act on time-sensitive opportunities to a much greater degree than in the past. The ease and speed with which borrowers have access to digital loans are attractive to households who tend to use these funds to meet their pressing consumption needs. Two factors primarily enable rapid delivery of digital loans. First is the mobile money infrastructure which is the delivery and repayment channel for digital loans. The second factor is credit information sharing through CRBs, which enables automated credit querying and instantaneous lending decisions as highlighted earlier. While rapid delivery of loans has been found to increase the ability of borrowers to deal with emergencies (Bharadwaj et al., 2019), contrary evidence from literature shows that rapid delivery of digital loans negatively influences loan repayment behaviour. For example, Burlando et al. (2020), while studying borrowers' credit repayment behaviour for digital loans, argue that induced delay of delivery time significantly reduces the default rate for digital loans (up to 20%).

The other attractive attribute of digital loans is the fact that they are unsecured. The requirement to secure loans with physical assets has long been a problem with the provision of credit to poorly collateralized individuals. As argued earlier in this chapter, the requirement to secure loans with assets led to the growth of informal credit in Kenya which still stands as the main source of credit. I also argue that the soaring demand for unsecured, short-term credit saw digital lenders tap into this market and rival both formal and informal lenders. From my discussions with digital lenders, it was apparent that digital loans are unsecured because of two main reasons. First, digital loans are of low value, typically a maximum of 100 US dollars, which could not be reasonably secured by productive assets such as land and machinery. This is consistent with Menkhoff, Neuberger, and Rungruxsirivorn (2012) who suggest collateral for loans may be substituted by reducing loan size and loan tenure and increasing the interest rate. The inference is that the requirement for collateral is expected to increase with loan size. Likewise, Steijvers and Voordeckers (2009) argue that since large loans increase the lender's leverage, they tend to be riskier than smaller loans. As such, small loans need not be collateralized.

The second reason why digital loans are unsecured concerns the fact that the loans have a short tenure, typically 30 to 90 days. This is distinguished from secured traditional loans which have a significantly longer tenure and thus would need to be secured to hedge against the risk of default. This agrees with Ortiz-Molina and Penas (2008) and Menkhoff et al. (2012) who posit that collateral and loan tenure

are substitute mechanisms for mitigating information asymmetry problems. Shorter loan durations reduce the moral hazard problem by lowering the opportunity and incentive for the borrower to switch from low-risk to high-risk projects, which increases the likelihood of default (ibid).

Digital credit offers greater privacy than traditional loans. With digital lending, the process of application for a loan, credit appraisal, delivery, and repayment is automated and does not require any human interface. This is opposed to other forms of informal lending where one needs to make a physical visit to a lending institution or an informal lender, sometimes after trying to obtain the loan from several other such lenders. In the case of credit from informal sources, default normally dents the borrower's reputation and this in turn hampers their future ability to borrow. Digital borrowers consulted for this study explained that privacy offered by digital loans is particularly appealing since no other party is aware of their borrowing and repayment history. Some described this privacy as a 'secret' between themselves and the digital lender. Others note that with digital loans, they can avoid being debt-shamed when they are late in repaying loans, which in most circumstances is not intentional. This is consistent with Cook and McKay (2015) who argue that M-Shwari's most important feature is the privacy of their funds.

However, digital lenders indicated to me that the privacy offered by digital loans is the main cause of strategic default; strategic default is where the borrower intentionally defaults on a loan unless there are consequences to their non-repayment. Thus, although fully aware of the responsibilities when taking out digital loans, some borrowers feel less obligated to the digital lender, given that they took out the loan 'quietly and secretively'. This is unlike other formal lenders who would repossess assets and list the borrower adversely in CRBs or informal lenders who could impose societal sanctions or debt-shame the borrower.

John spoke to me at length about how he handles debt collection. He explained to me that he groups loan defaulters into two categories, namely 'can't pay, will pay' and 'can't pay, won't pay'. 'Can't pay, will pay' defaulters default on loans but fail to repay the loan because they either forgot or have genuinely fallen on hard times. Borrowers in this group answer demand calls from the lender or debt collector and are willing to adhere to a repayment plan. In contrast, 'can't pay, won't pay' defaulters are strategic defaulters who upon default do not answer demand calls from the lender or are simply unreachable, or refuse to repay the loan outright.

Jeanne explained that because the loans are of small value and the cost of debt collection cannot exceed the value of the loan, lenders and debt collectors can only go about collection by making demand calls to the borrower. According to her, many 'can't pay, won't pay' or strategic defaulters are aware of this limitation. She added that if the loan goes unrepaid for more than 90 days, the borrower will be issued with a notice of listing with a CRB as per the CRB regulations, before being formally listed with the CRB if they still do not repay their loan.

6.4.2 Credit information sharing and credit scoring

Credit scoring and credit information sharing (or simply information sharing) are at the core of the digital lending model. This is because digital loans are unsecured and digital lenders make use of credit scores computed from information gathered on borrowers to perform swift loan appraisals and extend quick loans, the primary value proposition of digital lenders. Björkegren and Grissen (2018) posit that the borrower's foremost barrier to accessing credit, especially with digital credit, is being scored. Lack of documentation and credit history, particularly where CRBs are non-existent, constrains credit for small borrowers; in such circumstances, lenders often rely on collateral to reduce their credit risk exposure (Bazarbash & Beaton, 2020).

In the context of information sharing, credit information encompasses all historical information on borrowings, loan repayments, and credit transactions of individuals. A CRB holds an individual's detailed credit information, including information on their identity, credit accounts and loans, bankruptcies and late repayments, and recent inquiries of their credit record. CRBs use credit information to compute credit scores which allow lenders to underwrite and monitor loans without meeting the borrower, as was the case before the advent of information sharing.

In Kenya, CRBs collect information from formal financial institutions, including licensed financial institutions such as commercial banks, microfinance institutions, and SACCOs, and unlicensed financial institutions such as credit-only institutions and digital lenders. In other sophisticated markets, CRBs also collect information from 'third party sources', such as utility companies, letting agencies and other merchants to improve the precision of their credit scores (Miller, 2000). Kalberg and Udell (2003) and Berger, Espinosa-Vega, Frame and Miller (2005) suggest that to be effective, CRBs ought to gather information on all borrowers from as many credit sources as are available.

In the 1980s and 1990s, the Kenyan banking sector was significantly weighed down by non-performing loans (Kwambai & Wandera, 2013). This triggered a push by stakeholders to share credit

information among providers of credit and use this information to make better-informed lending decisions. This push resulted in an amendment to the Banking Act 2006 and subsequently the formalization of the Credit Reference Bureau Regulations 2008 that made it mandatory for commercial banks to share information on non-performing loans through CRBs. A stakeholder project named the Kenya Credit Information Sharing Initiative was initiated in 2009 to prepare providers of credit to participate in the information-sharing mechanism. In 2010, the CBK licensed the first private CRB, TransUnion CRB, followed by Metropol CRB in 2011 and CreditInfo CRB in 2015.

At the inception of CRBs, the CBK mandated financial institutions to share negative credit information with CRBs. However, De Janvry, McIntosh, and Sadoulet (2010) point out that negative credit information essentially creates a 'blacklist' that acts as a screening tool for lenders and gives borrowers an incentive to repay their loans. Following the institution of the 2013 CRB regulations, commercial banks and MFIs were mandated to share both negative and positive information, also referred to as full-file credit information. According to Meyo, who was a banker for more than ten years, negative data was shared initially because the objective at the time was to curb loan defaults. He further explained that the mandate to share both positive and negative data aims at recording information on good borrowers to expand access to credit. This agrees with Walsh (2003) who postulates that when lenders have only half of the picture (negative credit information), the industry runs the risk of using a blacklist as the only deciding factor with the potential of impeding access to credit. Sharing positive credit information allows the borrower to build 'reputation collateral' which can signal a borrower's creditworthiness. McIntosh and Wydick (2005) stress that sharing positive credit information helps to mitigate over-indebtedness among borrowers, lower default rates, and bring down borrowing costs where the credit markets are competitive.

The inception of credit information sharing and the emergence of CRBs brought about credit scoring for borrowers. Digital lenders feed these credit scores into proprietary algorithms to assess a borrower's creditworthiness. Jeanne from case study six explained that a person's creditworthiness combines elements of their capacity to borrow and the likelihood of them repaying their loan. Specific to digital lending, M-Shwari's incipient credit-scoring algorithm consisted of a set of telecommunication variables from Safaricom's data related to mobile money transfers, airtime use, repayment history of Safaricom's airtime advance product named 'Okoa Jahazi', and length of time

the borrower had been a subscriber; the algorithm assigned each variable differing weights and scores based on its perceived predictive power (Cook & McKay, 2015).

It is worth noting that at the inception of M-Shwari in 2012, CRBs had just begun operations and, as such, hardly any credit information on borrowers was available. M-Shwari therefore had to rely on alternative sources of data to assess their borrowers' creditworthiness. However, in the last ten years, CRBs have accumulated data on some 14 million borrowers, according to John from case study seven. John explained that, initially, lenders would submit credit information separately to each of the three CRBs, mostly in monthly batches using a prescribed template. However, recent advancements in technology have seen this change to a real-time system where information is transmitted simultaneously to all three CRBs, which is a boon for digital lenders who require the best information on customers to make lending decisions.

In a growing trend, digital lenders also utilize unconventional sources of data, such as an applicant's airtime recharges, mobile phone usage, and location (GPS) data, among other sources, to complement traditional credit scores. This alternative data, referring to information other than a borrower's credit information, is essentially non-historical, unlike credit information held by CRBs. Alternative information is mined from the borrower's device upon onboarding and include call and SMS volume data, social media data, mobile money data, merchant transactions, and so on. Berg, Burg, Gombović, and Puri (2020) argue that alternative data could help to overcome information asymmetries between lenders and borrowers when standard CRB information is not available. The use of alternative data in predicting credit risk is particularly relevant in developing countries, where most households do not have credit scores, due both to underdeveloped CRBs and to the fact that many people do not have a history of financial transactions that can be verified by a lender (Björkegren & Grissen, 2018).

A small but growing number of studies have explored the incorporation of alternative data in credit scoring. For example, Djeundje, Crook, Calabrese, and Hamid (2021) studied various features of email usage and psychometric data among borrowers from commercial banks in Mexico and Nigeria and conclude that these elements give greater predictive accuracy than a model that uses demographic data only. Óskarsdóttir, Bravo, Sarraute, Vanthienen, and Baesens (2019) investigated call and call network data for credit applications in a Belgian bank and conclude that these elements enhance traditional credit information in predicting loan default. Likewise, Bennouna and Tkiouat (2019) studied age, sex, marital status, and education levels of 1,500 borrowers from microfinance institutions in Morocco and conclude that these variables in credit scoring can better predict the default on loans. In the same way,

Berg et al. (2020) investigated default rates at a German retailer using ten digital footprint variables as proxies for the economic status, character, and reputation of a borrower and conclude that alternative data on a borrower not only complements (rather than substitutes) CRB data but that the use of alternative data in credit scoring also reduces loan delinquency.

Aisha from case study four showed me information that two different lending applications, PesaFlash and OPesa, had accessed from her phone. This information included the reading of messages, location data, her daily schedule, her phone contacts, and call log. Figure 2 and figure 3 below show screenshots that Aisha shared with me.

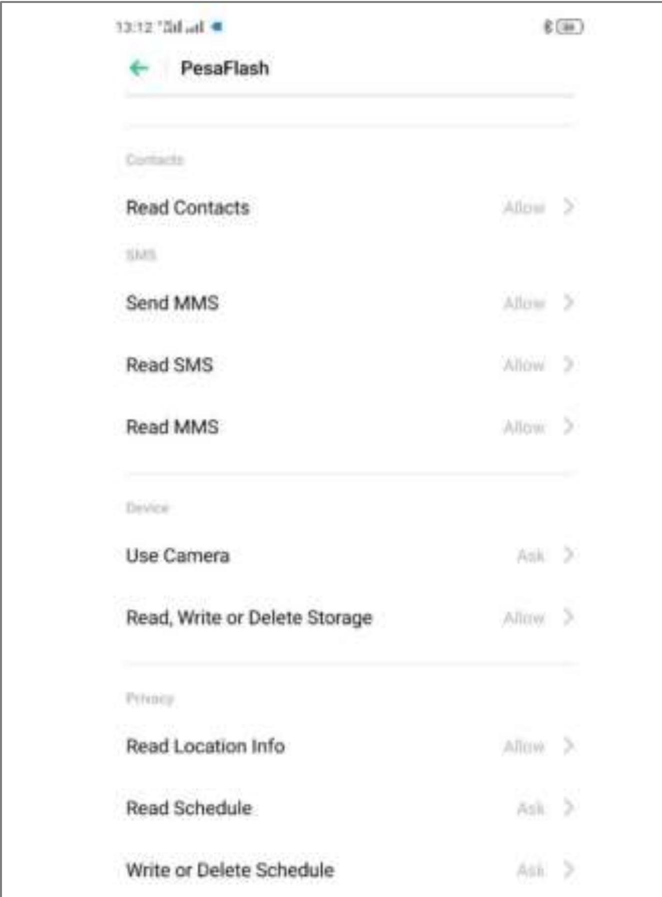

Figure 2: Screenshot showing information accessed by a digital lender. Source: Informant

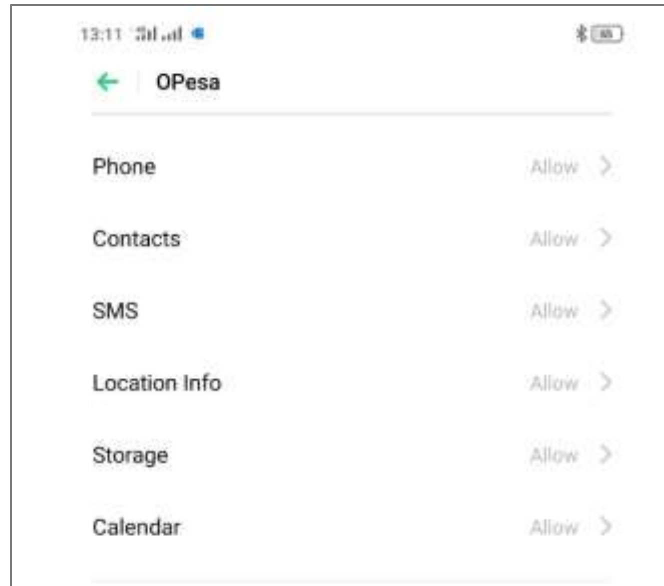

Figure 3: Screenshot showing information accessed by a digital lender. Source: Informant

Jeanne claimed that Pioneer Nanoloans uses roughly 200 data points on a single customer from different sources to assess their capacity to borrow. She explained that individuals who have been excluded from the credit market and therefore have never taken out a loan from a formal institution (known as 'no file' borrowers) are invisible to the credit information-sharing mechanism. For this reason, digital lenders pick up digital dust that a borrower leaves behind in an effort to include such a borrower in the financial system.

Before 2010, credit appraisals by formal lenders were subjective in that it was somewhat dependent on the personal impression the borrower made on the lender. Shirley, who previously had been employed in the credit risk department at a local bank, described one such technique, the 5Cs model, which had been commonly used by lenders in Kenya before the inception of CRBs. The model was based on five characteristics of a credit applicant, namely character, capacity, capital, collateral, and conditions. Character related to a borrower's loan repayment history. However, this was before credit information sharing commenced in 2010. Capacity referred to the borrower's capacity to repay a loan, which was essentially an assessment of the applicant's income vis-à-vis their debt obligations. Capital related to financial resources that the borrower had, for example savings and financial investments. Collateral referred to productive assets that a borrower could put up to secure a loan while conditions related to the use of the loan as specified by the borrower. The credit officer in this case manually assigned weighted values to each of these attributes based on his professional assessment, which

Shirley admitted, would have been subjective at times. The total weighted score of the applicant was used to estimate the applicant's creditworthiness. Traditional credit appraisal techniques were highly subjective, given that the score assigned to a borrower depended on the impression a borrower had made and on the scorer's individual biases.

According to many industry insiders, information sharing has helped lenders transition to less subjective credit appraisal techniques than the ones previously applied and, therefore, has been beneficial for financial inclusion. Information sharing means that credit appraisal by digital lenders and some formal lenders is impersonal given that it is done remotely and speedily by an algorithm. Kshetri (2021) and Costa et al. (2015) argue that whereas the use of alternative data in predicting default is still experimental, it holds significant potential for expanding credit access, especially to 'thin file' or 'no file' borrowers in the developing world.

However, as I describe in my conversations with Jeanne, algorithms used in credit appraisals are not only well-guarded business secrets but are also highly dynamic, which makes the credit appraisal process obscure; the algorithm tweaks frequently, depending on the lender's analysis of credit applications and repayment patterns and of market trends. O'Neil (2016) in her book *Weapons of Math Destruction* also points out the opacity and the discriminatory power of credit-scoring algorithms, noting that human biases are embedded in algorithm decision rules. She suggests that the use of algorithms continue to privilege wealthier customers to the detriment of the financially excluded whom some industry insiders claim to help. This inconclusive debate about the use of credit-scoring algorithms highlights the challenges with the digital lending model, which I highlight from the perspective of borrowers in the next section.

6.4.3 The landscape of the digital lending industry in Kenya

The digital lending industry in Kenya has witnessed tremendous growth following the advent of M-Shwari in 2012. By 2018, 49 digital lending platforms were operating in the Kenyan market (FSD, 2019b). Several industry insiders I spoke to place the current number of digital lending platforms in the country at more than one hundred. Others estimate the number to be over fifty. As digital lending is an unregulated industry, it is difficult to pinpoint the exact number of digital lenders in the Kenyan market. A common feature of all these digital lenders is that they utilize Safaricom's mobile money network, M-Pesa, to either disburse loans or facilitate repayments or both. The reason for this is that Safaricom has the largest subscriber base in Kenya with the largest number of registered mobile money

users. Statistics from the telecommunications sector regulator, the Communications Authority of Kenya, show that M-Pesa has 34.5 million users (Communications Authority of Kenya, 2021). This is significantly higher than other mobile money platforms in the country – Airtel Money by Airtel and T-Kash by Telkom – which have a combined subscriber base of under 400,000 (ibid). The obvious incentive for digital lenders to partner with Safaricom, therefore, is the significant customer reach that M-Pesa can afford them. Digital lenders, however, differ in their institutional characteristics, the range of customers they serve, and the nature of the digital products they offer. This section takes a closer look at three broad categories of digital lenders that operate in Kenya.

The first category is digital lenders who lend to the mass market. The first group within this category comprises two commercial banks and dozens of non-bank digital lenders who have partnered with M-Pesa to offer digital loans. In this case, lenders use M-Pesa to facilitate the disbursement and repayment of the loans. As highlighted earlier, the maiden digital lending platform, M-Shwari, resulted from a partnership between NCBA Bank and M-Pesa. M-Shwari grew to become the biggest digital lending platform in Kenya (Putman et al., 2021). This is mostly because it had the first-mover advantage, being the first digital lending platform, and also because it is considerably cheaper than other platforms (FSD, 2019b). The second bank to partner with M-Pesa was KCB in 2015 with their digital lending platform, KCB M-Pesa. Initially, the KCB M-Pesa loan was only available to customers (account holders) of KCB Bank on whom they had credit information. A few years later, however, following successful proof of the model, the KCB-M-Pesa loan was opened to the mass market. This meant that the KCB M-Pesa loan was available to anyone with an M-Pesa account.

Jeanne, who had been closely involved in setting up and running several digital lending platforms, explained that the two bank–MNO partnerships, KCB M-Pesa and M-Shwari, have two unique features which distinguish them from all other digital lending platforms. First, the two platforms run on the Safaricom mobile network and do not require an internet connection or mobile application to operate as all other digital lending platforms do. This feature makes it doubly accessible and thus appealing to borrowers. Secondly, each platform offers two types of savings facilities. She also explained that both platforms offer added value through their longer-term savings facilities (referred to as 'lock savings' for M-Shwari and 'fixed savings' for KCB M-Pesa) and temporary savings facilities. With the temporary savings facility, customers can withdraw money at any time, similar to them having a bank account, while with the longer-term savings facility, savings are 'fixed' or 'locked' and can only be accessed after a specified period, between one and six months, while earning some interest over

the duration. Most co-operative managers and some digital lenders I spoke to expressed that savings facilities are meant to help users save more in a bid to help them build financial discipline and resilience and therefore only borrow when they need to. This view is reinforced by Mukherjee, Bergquist, Burke, and Miguel (2021) who argue that platforms offering multifaceted financial services can unlock significant benefits for households. In their study of farmer microcredit programmes in Western Kenya, the authors note that accessing a savings facility in addition to harvest-time loans increased both investment and household consumption for the study group.

The second group within the category of mass-market digital lenders is the non-bank digital lenders who utilize private funds from venture capitalists and investors to extend digital loans to the masses. As mentioned, the first of these platforms was Tala loans which launched in 2014, just two years after M-Shwari. Dozens of private fintech lenders, both local and international, operate in the Kenyan market. International non-bank digital lenders command a larger market share than local non-bank digital lenders. Some digital lenders told me that this is because international lenders typically have a bigger resource base and can offer bigger loans to riskier customers. Others explained that because of the large resource pool, internationally based digital lenders can deploy extensive marketing campaigns which are key in recruiting new customers. Non-bank digital lenders, commonly known as fintech lenders, offer loans through two main channels. The first and most used channel is smartphones via mobile applications (apps). This requires the borrower to be connected to the internet to apply for a loan. The second channel is feature phones via a USSD code.

In my discussions with various digital lenders, it appeared that there is a quiet rivalry between bank-based and non-bank digital lenders. On the one hand, non-bank digital lenders noted that CBK favours bank-based digital lenders. They cited examples where the CBK governor had publicly castigated various practices by non-bank digital lenders, going as far as suggesting that these lenders may be lending from proceeds of money laundering and related crimes and calling for the lenders' urgent regulation. Several non-bank digital lenders I spoke to suggested that in making these pronouncements, the CBK governor had been playing favourites as opposed to evening the playing field.

On the other hand, informants working in bank-based digital lending units pointed out that private fintech lenders are problematic on several fronts. To start with, non-bank digital lenders, unlike other financial institutions, make use of private investor funds to extend loans. For this reason, they are not

subject to any prudential regulations imposed on other institutions, such as banks and SACCOs who take deposits from their customers and intermediate them into loans to other customers and therefore tend to lend more responsibly. In many ways, the fact that these lenders are unregulated is seen as contributing to their aggressive lending behaviour for quick shareholder returns. Secondly, non-bank digital lenders are particularly known to collect a vast range of alternative data on borrowers, much more than bank-based digital lenders, which they use to complement credit scores from CRBs in assessing the borrower's creditworthiness. As described in detail later in this chapter, this strategy has been the subject of significant criticism, both in literature and praxis. Thirdly, regulators note that some non-bank digital lenders are nondescript and are hardly identifiable. Regulators continue to point out that some non-bank digital lending outfits are 'fly-by-night' operations with no physical offices or customer call centers while others are former loan sharks who have simply made their business digital but continue to charge usury rates and apply crude collection tactics. As discussed later in this chapter, the compounding of these issues, which are mostly attributable to private fintech lenders, precipitated the recent efforts in regulating the digital lending industry.

The second category of digital lenders are those who lend to customers with whom they have an established customer relationship. This comprises commercial banks, MFIs, and SACCOs who give digital loans exclusively to their loyal customers (account holders) whose detailed credit history and other personal information they have access to. Digital lending deployments from SACCOs and MFIs are recent but are becoming increasingly prevalent. Examples of such platforms are M-Tawi by Kenya Police SACCO, M-Boosta by Harambee SACCO, CariCash loan by Caritas Microfinance Bank, and Pesa Chap-Chap by Faulu Micro Finance Bank. Relationship-centric lenders use customer deposits and profit reserves to extend loans, unlike private fintech lenders who are forbidden under the Banking Act from taking deposits from the public and therefore can only lend from private funds. As such, these organizations are regulated and are subject to strict prudential guidelines to protect their members' and customers' savings. Commercial and microfinance banks are regulated by the CBK while SACCOs are regulated by SASRA.

Several informants who work for bank-based digital lenders advanced several motivations for relationship-centric lenders to focus on their fairly small, closed customer base. The first of these reasons concerns the issue of capitalization. Many MFIs, co-operatives as well as smaller banks are not sufficiently capitalized to serve the mass market. They therefore focus on lending to their small customer pool which they perceive as less risky. The second reason, which is an extension of the first,

is the fact that these institutions have a conservative approach to risk, given that the digital lending industry is unregulated and, as such, costly shocks in the industry may threaten their overall financial stability.

The third category of digital lenders are those who use digital channels to give in-kind loans. Digital lending in Kenya has transcended institutional boundaries in the last ten years. The extension of credit had for a long time been the sole province of financial institutions such as commercial banks, MFIs, SACCOs and credit-only institutions. However, recently, a variety of non-financial institutions that previously had no role in the provision of credit have set up platforms where they give in-kind loans. Credit offered by these institutions is in the form of product items and is offered on what is commonly referred to as buy-now-pay-later platforms. Meyo noted that even though the more conspicuous form of digital lending is cash through mobile wallets (accounts), digital lending in Kenya equally happens across different value chains. He illustrated Twiga Foods, a food distributor that gives credit to their food retailers in the form of a product (fresh vegetables) through their 'Soko Loan' platform. In their case, a food retailer applies through a mobile application for a certain range of product that is capped to a determined credit limit (order size). Twiga Foods delivers the product and retailers make repayments through the M-Pesa platform once they sell the product. In-kind digital loans are in effect ring-fenced, meaning borrowers cede rights to the lender to direct the funds to the specified use of the loan.

One prominent buy-now-pay-later deployment is Lipa Later (meaning pay later in Swahili) which has exclusive partnerships with over 500 retailers across markets allowing shoppers to pay for a wide range of products in installments. Another example is a partnership between Kenya Power and Lighting Company and Safaricom, named 'Okoa Stima', which gives prepaid electricity tokens to registered users on credit. An informant gave another example of a buy-now-pay-later deployment, known as M-Kopa Solar, which offers home solar pay-as-you-go solutions for households that are off the power grid. The solar equipment is fitted with a Safaricom SIM card which enables the vendor to turn off the solar equipment remotely if the account is in default and turn it on when repayment is made via the M-Pesa platform.

Evidently, digital lending has taken many forms over the last decade. This evolution in the typology of digital lending serves to demonstrate the agility of financial and non-financial institutions in churning out products for different borrowers and the soaring demand for these digital loans. Having

considered how digital lending emerged in Kenya, how it has grown since its inception, the digital lending model, and the broad typology of the digital lending industry, the study, in the next section, turns to the benefits of various aspects of digital lending to digital lenders and borrowers in Kenya.

6.5 Borrowers' experiences with digital credit

Since its inception a decade ago, digital lending has been heralded as a way to unlock credit for the poor and to advance financial inclusion more broadly. In this time, literature has hardly highlighted borrowers' experiences with digital lending. As a result, the chief proponents of financial inclusion, the higher-up international financial institutions and practitioners in the digital lending industry, have carried the day and have dominated the narrative. This section presents borrowers' interactions with digital credit and argues that what may have been a well-thought-out idea initially, is grossly detached from realities on the ground.

Below, I discuss four main themes that consider the perspectives on digital lending of the people on the ground, how they navigate different aspects of lending and borrowing, and what they consider is beneficial or problematic about it.

6.5.1 Use of digital loans

I described earlier in this chapter that digital lending was fashioned as a market response to a gap in the provision of small, short term and unsecured credit, especially for the poor who could not obtain formal credit and thus turned to informal credit sources. I also described that credit from formal lenders is not well suited for borrowers' immediate and pressing financial emergencies and consumption needs. Indeed, many digital borrowers own accounts with other financial institutions but turn to digital loans because they find access to formal credit prohibiting. The inference here is that digital loans are useful to borrowers to smooth their consumption needs. A deeper analysis of the five case studies of borrowers set out in chapter four suggests that borrowers take out digital loans for different reasons which range from loans to meet basic needs that are pressing and immediate to loans taken out for convenience. Notably, the rapid delivery of digital loans makes them ideal for both these purposes.

The first category of borrowers is the low-income borrowers. It is important to emphasize that a majority of digital borrowers in Nairobi, as indeed in the rest of the country, fall into this category. Borrowers in this category are financially vulnerable on account of their small and often erratic

incomes from wage employment, like Makosa the security guard from case study one. Micro-entrepreneurs like Odongo the boda-boda rider from case study two also fall within this category. Nairobi's informal and low-income settlements are full of people who do menial piece jobs to earn a small income. Concerning the use of digital loans as a start-up or working capital loan, my analysis suggests that digital loans are generally too small to expand micro businesses in any significant way. It is also important to stress that the credit limits for low-income borrowers are invariably small compared to credit limits for people who occupy an elevated social and economic class.

My analysis suggests that low-wage earners are heavily dependent on digital loans, which heightens their vulnerability. This is consistent with Cook and McKay (2015) and Wamalwa et al. (2019) who warn that it is unsustainably expensive for households to use digital loans to regularly finance their daily expenses. This is evident in the fact that these borrowers are often multi-borrowed, with some borrowers taking out as many as five digital loans at once. This trend in loan stacking makes it increasingly difficult for wage-earners to keep up with loan repayments.

The second broad category of borrowers is the moderate-income borrower. People in this group occupy a more elevated position in society than the low-income borrowers discussed above. While some of the people in this category are permanently employed like Aisha from case study four, many work on contract like Brian from case study three. The moderate-income class is an interesting group of borrowers given that more people in Nairobi are taking jobs that have a precarious pay system, such as gig jobs and closed-ended contracts. Because of the unpredictability of their jobs, people in this category moonlight in different jobs, the so-called side hustle, to supplement their main source of income. Their moderate incomes allow people in this category to meet their basic expenses relatively well, but they often need to borrow to bridge liquidity shortfalls during their pay period or when they are not working. Aisha and Brian typically take out digital loans to supplement their main sources of income, especially for the last week of the month as Brian intimated to me. For this class, a digital loan switches its purpose from a convenience tool to a loan to meet consumption needs.

The third category is the high-income borrowers like Vivienne from case study five who make up the uber-wealthy class in Nairobi. This category comprises mostly educated, highly paid professionals and successful businesspeople who are financially secure and enjoy a higher level of stability than the other classes. It is important to underscore that these individuals make up a tiny minority of borrowers in Nairobi. For high-income borrowers, digital loans are insignificant to their financial and social life. Unlike the other categories of borrowers, high-income borrowers use digital loans purely for

convenience purposes. Their regular and high incomes afford them the ability to meet their consumption needs with ease and predictability. These borrowers are much less likely to be multi-borrowed than borrowers in the other categories. For this reason, and because they enjoy regular and high incomes, these borrowers have no difficulty whatsoever in repaying their loans.

Notably, an overwhelming majority of SACCO members consulted for this study make use of both SACCO loans and digital loans for different purposes, as outlined in the above discussion. This suggests that SACCO and digital loans, while used for starkly different purposes, constitute critical components of the credit mix of many Kenyan borrowers. I therefore argue that digital loans are not completely useless; they are useful to a particular category of borrower in particular circumstances.

Financial inclusion is primarily meant to address the poor who are often excluded from formal financial services. It therefore has nothing to do with convenience borrowing by the elite who enjoy a greater level of predictability and expectation. Evidence from the people on the ground suggests that digital loans are only useful to the high-income earners and to a lesser extent to people with moderate incomes. Against the prescriptions of the financial inclusion lobby, evidence from the ground suggests that digital loans are harmful to the poor.

6.5.2 Pricing of digital loans

The cost of financial services has long been a sticking point in the push for financial inclusion. Several studies argue that digital lending has indeed led to lowered costs to the lender given that some costs associated with other financial institutions, such as operating brick-and-mortar branches and staff costs, are not incurred. For example, Bharadwaj and Suri (2020) and Francis et al. (2017a) argue that digital credit deployments, such as M-Shwari, have led to reduced transaction costs for both the lenders and borrowers. This study finds that while digital credit deployments have brought down some costs for lenders, the same cannot be said for borrowers. Whereas innovations around digital lending have led to reduced costs related to customer acquisition and due-diligence processes, these reduced costs have not been passed on as lower costs to end-users of financial services. Philippon (2016) points out that while the financial industry has witnessed significant innovations, financial services remain expensive and financial innovations have not delivered significant benefits to consumers.

The findings of this study indicate that digital loans are more expensive than other formal sources of credit in Kenya, with some digital loans being more expensive than others. Burlando et al. (2020) point

out that while digital lending broadens market access and minimizes frictions, it usually features high interest rates, stiff penalties for delinquency, and high default rates. For example, M-Shwari charges a 'facilitation fee' of 7.5% per month which translates to an annual percentage rate of around 138% (Cook & McKay, 2015). FSD (2019a) shows that many products charge an annual percentage rate upwards of 300% while others charge rates that are almost inscrutable.

The high borrowing cost of digital loans is partly attributed to the risky nature of digital lending relative to other types of lending. Digital lenders in Kenya charge high interest on digital loans as a standard measure to prepare against the risk of default. This is consistent with Bateman (2018) and Di Maggio and Yao (2018) who posit that interest rates on digital loans are fashioned in such a way that in the event that the loans are not repaid, the high interest rates are designed to ensure that there is sufficient capital in reserve to cover such losses and turn a profit. Likewise, Kwambai and Wandera (2013) and Wamalwa et al. (2019) argue that high loan delinquency rates lead to high interest rates on loans to compensate for the probability of default. Besides the steep interest charged on digital loans, digital lenders also levy stiff penalties upon default of loans and additional fees when a digital loan is 'rolled over' to the following month. As I detail later, informants explained that the interest rates and penalties are so punitive that one may end up paying more in penalties and interest than for the initial loan.

Many borrowers I encountered have little awareness about the terms of digital loans, particularly their cost. In my discussions with borrowers, it was evident that an overwhelming majority of borrowers did not know how much interest they were being charged on their digital loans. However, it appeared that this was not on account of them being unable to compute interest charges. Almost all digital borrowers could easily compute interest charges while a few borrowers suggested that if lenders presented interest in absolute terms rather than in percentages, this would enhance their understanding of borrowing costs. This is consistent with Cook and McKay, (2015) and Wamalwa et al. (2019) who note that low-income earners who take out digital loans have a low understanding of borrowing costs, how to qualify for a loan or increase loan limits, and the consequences of default.

Lack of knowledge of borrowing costs and other terms attached to digital loans is partly a result of the lack of transparency on the part of digital lenders. There was a consensus among digital borrowers that their inability to recall borrowing costs had to do with how digital lenders present loan terms. In 2016, the Competition Authority of Kenya issued an order to financial service providers to fully disclose all applicable charges for transactions (including digital loans) delivered through mobile

phones before completing the said transactions. My analysis shows that while bank-based digital lenders and large non-bank lenders adhere to this regulation, a vast majority of smaller digital lenders do this in a rather obscure way which prevents borrowers from judging the true cost of the loans. This finding is consistent with findings from a survey by Putman et al. (2021) who note that a vast majority of digital borrowers learn of the fees only when they receive a text receipt after the transaction has been completed, as opposed to before the transaction is finalized. The survey showed that fewer borrowers could accurately recall the fees charged on their previous digital loan as compared to those who could recall fees charged for a mobile money (M-Pesa) transfer. To elaborate on the opacity of digital lenders as it pertains to borrowing costs, Vivienne compared the manner digital lenders present interest on digital loans versus how banks and co-operatives present interest on their (non-digital) loans. She noted that in the case of a bank where she works or a SACCO of which she is a member, a borrower is furnished with a loan repayment schedule, most times in printed form, which outlines the principal and interest payments for the duration of the loan.

The very design of digital lending products causes this lack of information on terms of products among users; the ease of access via mobile devices and the delivery speed of digital loans urge the borrower to take out the loan quickly without reading through the terms of the loan. Cook and McKay (2015), for example, note that to open an M-Shwari account, customers must agree to a set of terms and conditions that is nine pages long and is provided via a website link; most customers accept the conditions without accessing the link. Putman et al. (2021) similarly suggest that the lack of consumer recall of seeing fees pre-transaction could be due to consumers focusing on executing the transaction and being less concerned about the fees. This is consistent with the findings of this study which reveal that all borrowers consulted do not read the terms and conditions of the loans, both when they are onboarded to the digital lending platforms and when they take out the digital loans.

Notably, some digital borrowers admitted that their lack of awareness of borrowing costs could also be attributed to indifference on their part, especially when they borrow to meet financial emergencies. For Odongo, who once took out a digital loan to meet his urgent medical expenses when he had an accident with his motorcycle, and Makosa, who take out loans primarily to feed his family, getting the loan is top of their minds and the cost is not (usually) a consideration at the time. The inference is that the opportunity cost of not borrowing to meet such expenses may be too high and thus the overall price feels affordable to the borrowers, especially in nominal terms. This agrees with Wamalwa et al. (2019) who similarly find that Kenyan households use digital loans for consumption smoothing

purposes because the loans are easier to access, despite the high cost and short repayment period. Likewise, Diagne (1999) argues that for poor households seeking short-term loans to meet their urgent needs, such as buying food or medical emergencies, getting access to credit is much more important than its cost for these households.

Related to the usurious interest charged on loans, are the steep hidden charges and penalties levied on digital loans making it harder for borrowers to repay their loans. Makosa from case study one is a case in point – he had defaulted on four different digital loans after which he was listed adversely at the CRBs. During one encounter, Makosa was eager to show me one example of where he took out a loan of 2500 Kenya shilling. He received a sum of 2,150 Kenya shilling, which was the loan applied for less initial interest. However, he was unable to repay the loan in 14 days as required because of another financial emergency and, as such, his loan was rolled over to the next 14-day period several times. Over six months, he had accrued penalty interest of 11,150 Kenya shillings, more than four times his initial loan, which made it increasingly difficult to repay. Figure 4 below shows a screenshot from Makosa's phone for the loan he described.

Figure 4: Mobile phone screenshot showing penalties charged on a digital loan. Source: Informant

Under section 44A of the Kenya Banking Act, institutions covered by the Act – banks and deposit-taking MFIs – are required to follow the 'Duplum rule'. The rule stipulates that with respect to non-performing loans, lenders should not charge interest exceeding the original principal amount of the loan. Notably, unregulated digital lenders are free from the encumbrances of the Duplum rule, which allows them to charge interest on non-performing loans in perpetuity.

6.5.3 Over-indebtedness and adverse inclusion

The analysis of my discussions with borrowers suggests that digital lending has contributed to growing over-indebtedness among borrowers in Kenya. This is due to both the cost of digital loans, as discussed earlier, and their general small value and short tenure making loans only useful for consumption purposes, as described earlier.

Over-indebtedness is most evident from the fact that most digital borrowers are multi-borrowed, meaning that they have taken out digital loans from multiple platforms at once. For example, Makosa and Odongo from case studies one and two respectively have four digital loans each from different lenders. Makosa has defaulted on all four loans while Odongo is in danger of defaulting, given his struggles to relay his four loans in time despite having devised a clever way to juggle the loans. Similarly, Aisha and Brian, who enjoy higher incomes than Makosa and Odongo, frequently take out loans from two different lenders each and although they are not in imminent danger of default yet, their frequent use of loans to supplement their incomes makes them increasingly financially vulnerable. This is consistent with Wamalwa et al. (2019) who argue that digital loans reduce disposable income and increase the probability of selling household assets to repay loans.

Many digital borrowers I encountered spoke of borrowing an additional loan from one platform to repay a loan from another lender that had fallen due. Loan stacking, as some industry practitioners refer to it, is made possible by the sheer number of digital lenders who have made access to digital loans easy and convenient. It is also made possible by the short tenure of the loan that make it more difficult for lenders to catch on to a defaulting customer in time. John from case study seven explained that before a customer is blacklisted with CRBs, he or she is given between 30 and 60 days to repay their loan, failing which they are given 30-day statutory notice of adverse listing with the CRB via email and/or SMS. He suggested that the 90-day window before a defaulter is blacklisted allows them to take out multiple digital loans, given that most digital loans have a tenor of one month or shorter. Many digital lenders acknowledge that they are aware that digital borrowers borrow from multiple

sources and see this as a problem that they have little control over but one that could potentially lead to over-indebtedness. This finding agrees with Putman et al. (2021) who find that up to 44% of digital borrowers have multiple loans at the same time, with wide variation in overlap across providers. This trend suggests a dependence on digital loans, which is indicative of over-indebtedness.

In a recent study on the digital lending industry in Kenya, Wamalwa et al. (2019) find that a larger proportion of digital borrowers in Kenya default compared to conventional credit borrowers – those who borrow from other formal financial institutions. This, they argue, is attributable to the poor screening of borrowers and weak underwriting of digital loans compared to the practice with conventional loans. Likewise, Di Maggio and Yao (2018) argue that digital lenders are more prone to adverse selection; recipients of digital loans are significantly more likely to default than individuals with the same characteristics borrowing from traditional financial institutions. However, these lenders are adamant that loan defaults are not a consequence of a poor initial credit appraisal in that they advance credit beyond the borrower's capacity to borrow; they attribute this to a 'sudden' change in the borrower's repayment behaviour, a reason they modify their algorithm from time to time. When I asked digital lenders what they do to avoid future default and over-indebtedness, some lenders indicated that they reduce the borrower's credit limit to a level that they estimate the borrower can comfortably manage while other, typically smaller, lenders blacklist the borrower upon default altogether.

Some industry insiders, particularly those outside the digital lending industry, argue that lending to borrowers who are not economically engaged, for example students, is problematic in that one ought to borrow only when one has the financial means to repay a loan. One such borrower I encountered was Aisha who was on an intern's stipend and had to take out digital loans to supplement her stipend with no clear means of repaying the loan. Whereas Aisha then finished her internship and was lucky to secure a job almost immediately, this is not the fate of many borrowers who borrow with the hope that they will be able to pay in the immediate future, which is in the next thirty days or so.

Bateman et al. (2019) argue against this trend of extending easy-to-obtain loans to the poor in the name of financial inclusion, saying that it only serves to enrich powerful financial institutions at the expense of the poor, a trend he terms the investor-led fintech model. In opposition, several digital lenders I spoke to insist that the notion of adverse inclusion is a false construct. They argue that preserving certain financial services (including digital credit) to any group of borrowers is

fundamentally exclusionary. Rather, they suggest that a more constructive approach would be to make a reasonable judgment about what the borrower can comfortably repay or afford. They suggest that lenders need to take a chance on borrowers, which will allow borrowers to grow their credit profile over time depending on their repayment behaviour.

6.5.4 Expanded choice and marketing of digital credit

Digital lending has intensified competition in the credit market over the last ten years. This is evidenced by the number of financial and non-financial institutions of different types that have ventured into digital lending in just the last five years. Both John and Jeanne pointed out that there are over 100 digital lenders in the Kenyan market, including commercial banks, microfinance institutions, SACCOs, non-bank digital lenders and non-financial institutions. New financial intermediaries have innovated new digital lending products. As highlighted in the previous section, financial institutions have a large catalogue of digital lending products available to the mass market and to their loyal customers. Further, non-financial institutions, such as retailers and non-bank digital lenders, have developed buy-now-pay-later and in-kind lending products. The significance of this expanded range of digital lending products is that different users use them for different purposes according to their needs, as I highlight later in this chapter.

Expanded choice of digital credit services and digital credit providers is one factor that many borrowers find beneficial to them. Many older borrowers noted that there has been a shift in the last decade or so from when borrowers had to choose from a limited number of credit providers and few services which did not necessarily suit their needs to the present situation where there are hundreds of lenders and products on offer. Meyo from case study thirteen, who consults on issues of financial inclusion, suggested to me that in the context of financial inclusion, expanded access does not mean much if there are very few players in the market, like in the case of M-Pesa. He argued that for products to become more affordable and of the highest possible quality, the market requires a mix of service providers who compete for customers. In his view, the proliferation of digital lenders is positive for financial inclusion to the extent that a borrower can choose which digital lender to use and which digital lending product suits his or her needs.

Expanded intermediaries in the digital lending space and intensified competition in the digital lending industry have, however, led to aggressive marketing strategies by different players, which many borrowers find troubling. These aggressive marketing tactics by digital lenders feed into the insatiable

demand for credit. From my discussions with digital borrowers, I gathered that digital lenders send unsolicited messages to thousands of borrowers at once, called an SMS blast, to nudge them to take out digital loans. In my conversations with various industry insiders, it was unclear how digital lenders choose whom to target with their SMS blast. Some lenders told me they get the information from merchants, some told me they have a database of potential customers, while some were unwilling to share this information. I gathered that many were unwilling to share this information as it would likely be an infringement of the recently passed Kenya Data Privacy Act 2019.

Aisha from case study four showed me SMSs she had received from a lender, at times several times a day, to coerce her to take up a digital loan. She shared with me a screenshot from her mobile phone (see figure 5 below) which shows five SMSs she had received from a digital lender, one on Tuesday, one on Wednesday, and three on Thursday, the day of the interview.

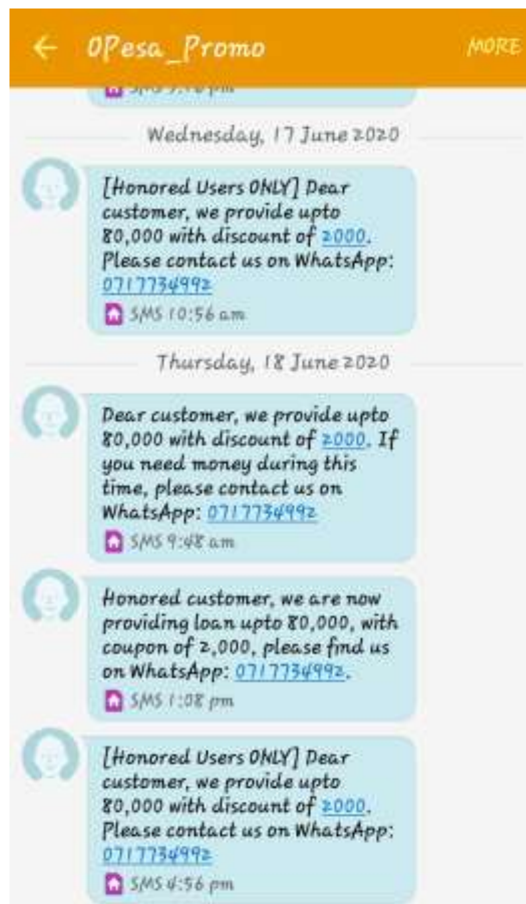

Figure 5: Mobile phone screenshot showing SMS blast from a digital lender. Source: Informant

Odongo was also quick to show me one such unsolicited SMS from a digital lender in which the digital loan was fashioned as a soft business loan. He shared the screenshot shown in figure 6 below.

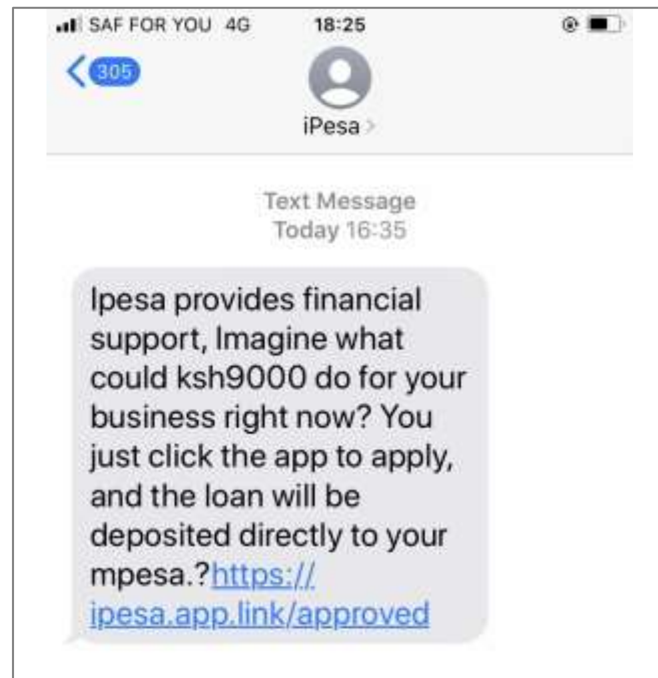

Figure 6: Mobile phone screenshot showing promotional SMS from a digital lender. Source: Informant

Furthermore, my analysis of marketing material from digital lenders indicates that many digital lenders use 'storytelling' and psychological marketing techniques to attract borrowers. For example, most digital lenders use customer testimonials, mostly from micro-entrepreneurs, which make unverifiable claims about how the loan has changed their lives. Meyo described to me some popular marketing campaigns by digital lenders:

> 'Digital lenders use psychological techniques to get to their customers. For instance, they would have a *'mama mboga'* (vegetable vendor) on a billboard smiling and saying how a loan from this and that lender has changed their life. The truth is that a loan of 1000 shillings cannot change your life. Or better still, when BCK (pseudonym) sends you a message saying *'usitense!'* (do not panic!), be cool, there is a solution here! So, they do a lot of priming, they manufacture desire.'

Whereas the use of marketing tactics described above is common in other markets and for different products and services, to many borrowers it is a particularly dangerous way to market digital loans. Aisha suggested that marketing money differs from marketing a typical product or service. She

suggested that this tactic is meant to tap into poor customers' sensitivities, is essentially predatory, and is an area that warrants urgent regulation.

The next section deals with the issue of regulation and traces the circumstances that led to calls for regulation of the sector and the various steps that have been taken in regulating the digital lending industry.

6.6 The question of regulation

The conduct of digital lenders has drawn sharp criticism in the last few years. These concerns surround their aggressive marketing, debt collection and pricing strategies, and the misuse of private information. Earlier, I outlined the pricing and marketing strategies of digital lenders. With regard to debt collection strategies, digital borrowers point out that some digital lenders employ collection strategies that are overly aggressive and that border on illegality.

One such strategy is threatening to expose the borrower's unrepaid debt to their close contacts, which industry insiders refer to as 'debt shaming'. For example, digital lender Sino (pseudonym) requires a borrower to enlist referees, without their prior knowledge, whom the lender contacts to follow up on repayment whenever the borrower fails to repay the loan in time. This tactic by Sino has been heavily criticized in the press, by industry insiders, and by the CBK. As highlighted earlier, many borrowers do not understand the full implication of loan terms such as requirements and enlisting referees.

John, who also is an office-bearer in the DLAK, mentioned that Sino and a few other players were soiling the otherwise good reputation of digital lenders. He also mentioned that Sino is not a member of DLAK, which in itself shows their rogue ways. He elaborated:

> 'Sino loans is Chinese-owned, and their lending model seems to be modeled around the concept of social credit, which is common in China where your credit reputation follows you in your circles. They have brought this debt-shaming model to a vastly different market, and this has irked many upstanding players in the industry.'

As I spoke to more digital borrowers, I quickly gathered that the practice of enlisting referees and debt shaming is not unique to Sino. Aisha explained that debt is, or at least is supposed to be, private. She explained that the privacy of digital loans is a key reason why she prefers them. She recalled an unfortunate occurrence when a digital lender had reached out to her through an SMS regarding her

senior colleague's unrepaid digital loan, an episode that had caused her a lot of embarrassment. As a lawyer, she explained that this tactic is a clear breach of privacy which attracts a fine of up to 5 million Kenya shillings (approximately 50,000 US dollars) under the recently enacted Data Protection Act 2019. She shared the screenshot shown in figure 7 below:

Figure 7: Mobile phone screenshot of an SMS sent to a phone contact of the borrower by a digital lender demanding repayment for a digital loan. Source: Informant

Likewise, Makosa shared with me an SMS (see screenshot in figure 8 below) where he was personally threatened with debt shaming from yet another digital lender.

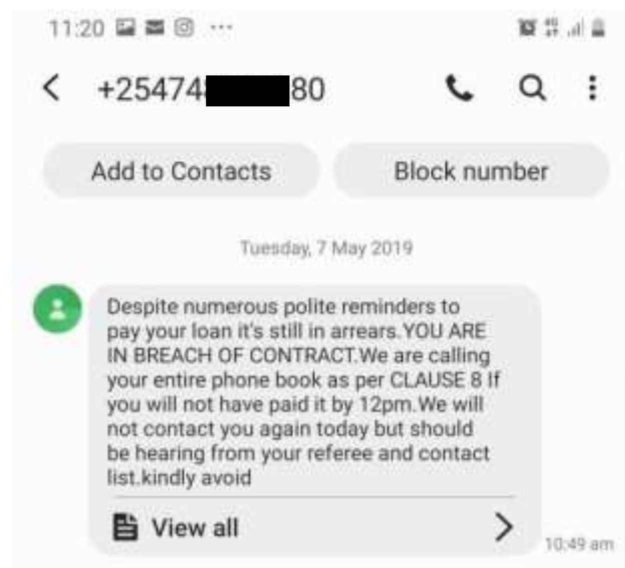

Figure 8: Mobile phone screenshot showing an SMS sent to a borrower by a debt collector demanding repayment for a digital loan. Source: Informant

My discussions with various industry insiders reveal that these worrying trends stem from the fact that the digital lending industry had been unregulated for a long time. They suggest that the lack of regulation left room for the development of unethical practices by digital lenders who now take advantage of vulnerable borrowers who seemingly have a high appetite and need for digital credit. Jeanne reiterated that with the advent of digital lending, many unethical loan sharks took their business to digital platforms but have remained true to their old tactics of crude debt collection and usury. Industry insiders also note that some non-bank digital lenders are fly-by-night operations with no physical offices but only call centers, which makes it difficult, if not impossible, for lenders to respond to customer complaints or scrutiny from authorities.

On one occasion in 2018, I took out a logbook loan of 150,000 Kenya shilling from an established credit-only institution to fund the last portion of my fees for my postgraduate studies. This involved using my vehicle as collateral for the loan. From the onset, there were some signs that the loan would be expensive, but I proceeded because I was convinced that my career circumstances hinged on me finishing my studies in time. For example, I encountered several hidden costs just before the loan was issued. First, the logbook lender required me to pay for a professional valuation of the car and for the installation of a tracking device from their specified 'partners'. The lender also required me to pay credit insurance for the loan and bear the cost of charging and removing the charge on the vehicle[17]. Perhaps the most disturbing aspect of the logbook loan was the usury interest rate on the loan and an unexpected interest penalty for repaying the loan six months before the specified maturity period. In total, I paid almost double the amount borrowed over only six months. Overall, my experience from taking a logbook loan left me scarred; not only was it traumatizing but it is easily the worst financial decision I have ever made. My experience demonstrates how loan sharks in Nairobi operate and mirrors their conduct as digital lenders.

A particular thorny issue for borrowers, which has been the subject of much discussion, is the misuse of private information by digital lenders, particularly the non-bank digital lenders. Kenya's Data Protection Act came into effect in 2019. The purpose of the Act is to protect the privacy rights of data subjects in Kenya and the Act applies to all data controllers and processors. The Act prohibits

[17] Charging an asset means registering the loan's security with the Registrar of Securities as per the Movable Property Security Rights Act, Cap 13. Removing the charge on an asset means reinstating the security to the owner after the loan is fully repaid or when the security is exercised by the lender.

sharing and tracking of confidential information without the subject's prior consent. The Data Privacy Act 2019 provides for the setting up of the Office of the Data Protection Commissioner (ODPC). The ODPC issued the Data Protection (Complaints Handling and Enforcement Procedures) Regulations 2021 which spell out stringent regulations on the use of personal data. This includes strict fines for digital lenders who breach users' data. These regulations took effect in February 2022 and the ODPC commenced with the formal registration of all organizations that handle personal data, the so-called data processors and controllers which include digital lenders.

Since the operationalization of the Data Protection Act, a significant number of digital lenders have already had brushes with the new law. An official communication from the ODPC dated 5 October 2022[18] notes that the ODPC had received numerous complaints relating to the misuse of personal data. The communication notes that over half of the complaints related to digital lenders, in particular non-bank digital lenders. Concerning this issue, the ODPC commenced an audit of 40 non-bank digital lenders who had misused personal data.

The conduct of digital lenders highlighted above put them in the spotlight and have precipitated several efforts in regulating the digital lending industry over the last five years. Like mobile money before it, digital credit is an innovation that raises novel regulatory issues that do not fit neatly into pre-existing regulatory practices. Currently, consumers of digital loans have few protections in Kenya (McKee et al., 2015). Given the prevalence of digital financial services, the diversity of actors involved in the industry, and the challenges highlighted earlier, the question of regulating digital lending merits greater attention.

Regulation is, however, a delicate art. If not done circumspectly, regulation can stifle innovation and erect a significant barrier to entry for new players by imposing a heavy cost to compliance. This view is shared by Philippon (2016) who cautions that since the goal of financial regulation is to foster stability of the industry and financial inclusion, regulations should not discourage financial innovation and the entry of new service providers. The Cambridge Centre for Alternative Finance (2021), however, points out that the Kenyan financial sector regulators generally support and encourage innovation, especially innovation that advances financial inclusion. This is evidenced by the CBK's test-and-learn approach with regard to M-Pesa. This approach later paved the way for elaborate

[18] Link: https://www.odpc.go.ke/press-release/

regulations in the form of the National Payments Systems Act 2011 and the National Payments Systems Regulations 2014 which provide a formal framework for the regulation of payment systems and payment service providers. As such, there have been various efforts to regulate the digital lending industry in Kenya in the last five years.

The first attempt at regulating digital lending focused on capping interest rates charged on credit products, including on digital loans. This stopgap effort in regulating digital lenders came through the introduction of Section 33B of the Banking Act through the Banking (Amendment) Act, 2016. This legislation capped interest rates at 4% above the Kenya Banks' Reference Rate for all products offered by institutions regulated by the CBK, which comprise commercial and microfinance banks only. Whereas the legislation covered the bank-based digital lenders such as M-Shwari and KCB-M-Pesa who have the largest market share of the digital lending industry, it did not cover non-bank digital lenders and other credit-only institutions which are outside the purview of the CBK.

The interest rate ceiling was premised on the logic that caps on loan prices will protect borrowers from excessive interest rates, thereby increasing credit affordability and access to finance. The interest rate capping subsequently proved to be counterintuitive in two main ways. First, the interest rate cap discouraged the supply of funds to the financial system, which led to the growth of the unregulated portion of the digital lending industry. Banks cut back on giving credit to individuals and micro, small, and medium enterprises (MSMEs), citing their inability to make risk-based lending decisions. Further, given the return on government paper was roughly 12% at the time, banks saw it more prudent to lend to the government, which has zero risk, and to low-risk customers (i.e. those with security and the formally employed) than to individuals or MSMEs who banks perceived to pose a higher credit risk.

The second way interest rate capping proved to be counterintuitive was by causing less transparency in the financial sector. Bank-based digital lenders found a way around this legislation and continued to impose additional and sometimes hidden charges. For example, banks offering digital loans renamed the interest charge to 'facility fees' for KCB M-Pesa loans, 'appraisal fees' for Eazzy loan by Equity Bank and M-Coop Cash by Co-operative Bank, and 'processing fees' for HF Whizz loan by Housing Finance Bank. The effect of the legislation therefore ran counter to its initial aim which was to reduce the cost of loans for individuals and MSMEs. In realization of the counterintuitive effect of

the legislation, section 33B was repealed three years later in November 2019, a move that saw regulated entities offering digital loans revert to charging interest based on their own assessment of credit risk.

Another attempt at regulating the digital lending industry came in the form of the Financial Markets Conduct Bill 2018, sponsored by the National Treasury. The overarching aim of the law was to protect users of financial services from fraudulent conduct of financial service providers. The Bill proposed the establishment of four new entities including a new regulator, namely the Financial Markets Conduct Authority, the Financial Sector Ombudsman, the Conduct Compensation Fund Board, and a Financial Services Tribunal. The proposed law specified several different functions that these four entities would perform in oversight and regulation of the activities of financial service providers, which included digital lenders. Additionally, the Bill sought to regulate the marketing and promotion of financial services and set out specific offences and fines for non-compliance.

The CBK, however, voiced concerns about numerous proposals in the Financial Markets Conduct Bill. The CBK felt that the Bill stripped down their powers which would ultimately limit their independence as a regulator. The Bill also made redundant some important provisions in the Banking Act. Although the Bill went through public participation as required by law, it was not introduced to parliament following spirited objections by the CBK. This was a case of two important government bodies, the National Treasury and the CBK, not reading from the same script regarding the thorny question of regulating digital lenders.

In 2020, non-bank digital lenders formed the DLAK to address cross-cutting issues in the market, such as consumer protection and high interest rates, and other fees. DLAK was also formed to give digital lenders a collective voice and possibly some bargaining power amidst calls for regulation by the CBK, the National Treasury, and the public. The formation of DLAK was largely perceived as an act of self-preservation, a public relations manoeuvre, and a desperate attempt to get a share of the press.

DLAK formulated a set of sandbox regulations in the form of a code of conduct that set a minimum standard for consumer protection. This code of conduct was meant as a sign of good faith to the public and the CBK whom the DLAK perceived as adversarial. This ambitious push for self-regulation was, however, confronted with several issues. First, the association only brought together a relatively small number of digital lenders who together constituted the majority market share of the digital lending industry among non-bank digital lenders. Of the over 100 digital lenders operating in Kenya,

DLAK only managed to attract about 20 members. However, this included some of the biggest private fintech lenders in the country – Tala, Branch, and Zenka. As such, a rather large number of digital lenders were not under the DLAK banner, which left lots of room for bad industry practices to continue.

The second challenge was that applying the DLAK code of conduct was voluntary and therefore not legally binding to non-bank digital lenders. The provisions of the code of conduct were also not robust in addressing the issues in the industry and therefore left too much room for interpretation. The code of conduct was seen as a futile attempt at self-regulation.

According to several digital lenders, a secondary objective of DLAK was to help players in the industry deal with the issue of identity theft and strategic default. To this end, there were proposals from DLAK members to launch a data-sharing platform where they would maintain a database of suspected fraudulent borrowers. The lender would check against this database to identify fraudulent customers and borrowers during the onboarding and credit appraisal processes. However, this proposal was met with mistrust among DLAK members; bigger lenders feared that smaller lenders would use this to reverse-engineer their algorithm, identify who the best customers are, and herd these customers away to themselves.

In late 2021, the CBK (Amendment) Act of 2021, which sought to regulate digital lending, came into force. This was preceded by extensive stakeholder deliberations led by the Parliamentary Finance Committee. The Act provided CBK with the power to license and oversee the governance and operations of digital lenders. The Act further provided for consumer protection and credit information sharing, and set out strict obligations of digital lenders with regard to anti-money-laundering practices and combatting the financing of terrorism. This legislation made the CBK the sole entity charged with enforcing the above provisions.

With the new law in place, the CBK, through an official communication[19], gave digital lenders a grace period of six months, until 17 September 2022, to satisfy the CBK of their data submission capability using application programming interfaces after which they would be required to obtain licences from

[19] Link: https://www.centralbank.go.ke/uploads/press_releases/245453051_Press%20Release%20-%20Application%20for%20Licensing%20by%20DCPs.pdf

the CBK. At the end of the six-month grace period, the CBK through a press release on 19 September 2022[20], communicated that they had received 288 applications for licences by digital lenders and that only ten of these applicants had fully satisfied the regulator and obtained the licences. They also communicated that they were working to have all the remaining 278 applicants comply with the set requirements and that any other entity that had not made an application should desist from conducting digital lending business.

The regulation of the digital lending industry was a live issue during my fieldwork. The CBK (Amendment) Act was still at the Bill stage and the finance committee of Parliament was conducting public participation on the Bill. It was therefore an issue that I discussed with my digital borrowers at length. Against expectations, a considerable number of digital lenders told me that they were supportive of CBK's call for regulation of digital lenders. They cited two reasons for this; first to root out rogue elements in the industry who muddy the reputation of the industry as a whole. Secondly, they expressed that any investor would like to invest where their money will be safe, implying that regulation would make the lending business safer for private lenders. My reading of the situation, however, was that the issue of regulation had been drawn out long enough and that digital lenders had realized the futility of fighting imminent regulation. As such, lobbying the CBK and parliamentary finance committee for 'soft' regulations that would not drive them out of business would serve digital lenders better.

Meyo pointed out that the CBK was at a crossroads on the issue of regulating digital lenders. He explained that the CBK had two options; they could either issue regulations incrementally or wait for issues in the industry to percolate before issuing regulations. However, given that many private sector players are known to skirt regulations in their pursuit for profit, Meyo felt that the CBK would always be playing catch-up with the nimble digital lenders. In his view, this motivated the CBK to choose the latter strategy and delay regulation until such as point as the issues in the market became clearer.

Various industry insiders explained that the CBK's decision to put the development of the digital lending industry ahead of regulation has allowed for unencumbered innovation and quicker growth of the industry. During my discussions, a common example that different informants gave was the case

[20] Link: https://www.centralbank.go.ke/uploads/press_releases/1281922685_Press%20Release%20-%20Licensing%20of%20Digital%20Credit%20Providers.pdf

of M-Pesa which grew to be a runaway success. Many industry insiders suggested that regulators ought to take time to understand the product on offer, its benefits, and the risks that could emerge.

As part of his work as a consultant, Meyo has taken part in formulating reforms in the financial services sector. He lauds the regulatory stance of the CBK that promotes quick growth and pushes the boundaries of financial innovation. He contrasts Kenya's regulatory environment with that of South Africa which he perceives as being too rigid. His opinion is that South Africa's regulatory stance has served to preserve the dominance of incumbent institutions, who are mostly banks, and has curtailed the entry of new players, such as digital lenders. As Meyo described:

> 'You need to let the animal roam around to understand what you are dealing with. Does it have horns, does it have claws or is it harmless? You cannot regulate what you don't know.'

The recent efforts in regulating the digital lending industry in Kenya have demonstrated that tightening regulations is not only difficult but can also be counterintuitive. Philippon (2016) points out that regulation is not only technically challenging but also requires cooperation among many stakeholders and requires an objective posture to ensure a level playing field among industry players. Whereas borrowers and a large portion of practitioners widely celebrated the enactment of the CBK Amendment Act 2021, what the Act portends for the digital lending industry in Kenya remains an open question. It is reasonable to expect that the Act will bring some semblance of order and fair business practices. However, it is not uncommon for private sector players to skirt regulations and for the regulators to be late in catching on to their new tactics. Observers therefore remain cautiously optimistic about what regulation portends for the digital lending industry.

6.7 Conclusion

Digital lending emerged as a response to the unfulfilled demand for formally provided, unsecured, short-term credit. Mobile money built the rails on which hundreds of institutions set up digital lending platforms. Several key industry developments in Kenya coincided to present digital lenders with favourable conditions to automate due diligence and credit appraisal procedures. The absence of regulations around digital lending spurred the rapid growth of the digital lending industry. For the pro-financial inclusion lobby, digital loans were a means to finally reach small borrowers who are typically not well collateralized and were thus excluded from the formal credit market. Digital loans

were seen to have the ability to deliver undiluted benefits to the poor who also included small entrepreneurs.

However, the optimistic rhetoric surrounding the provision of credit to people at the bottom of the pyramid has not lasted. Digital lending has played out differently from initial expectations and even unexpectedly in some instances. In addition to its high cost relative to traditional credit products, the conduct of digital lenders in terms of handling private information, their collection strategies, and obscure credit appraisal procedures has come under mounting criticism. Digital lending is widely perceived as a volume-driven, high-risk business where digital lenders are willing to lose money while 'cherry-picking' good customers with the hope of a net positive return.

I argue here that low-income consumers use digital loans for consumption purposes, making them dependent and financially vulnerable. Moderate-income borrowers use digital loans partly for convenience purposes and partly for consumption purposes and experience less detrimental effects from their use of digital loans. High-income borrowers typically use digital loans as a convenience tool. In this view, digital loans are particularly harmful to low-income borrowers who are the primary subjects of financial inclusion. Additionally, there is a growing realization that using digital loans to meet short-term consumer needs as opposed to using it for income-generating activities is problematic, given that this behaviour often leads to loan stacking and borrowers being trapped in a cycle of debt. Equally, there is an awareness that the low ticket-size and short tenure of digital loans make them unsuitable as business loans, despite the pro-financial inclusion lobby's claim to the opposite.

Digital credit, therefore, remains a critical feature in the financial lives of Kenyans, especially those living on the margins. The Kenya FinAccess Household Survey reveals that digital lending platforms are the second most common source of credit after informal sources (CBK, 2021). In response to this demand, many financial and non-financial institutions are continually innovating and deploying digital lending products of different kinds. The latest effort to regulate the burgeoning digital lending industry aims at rooting out predatory practices and purging unscrupulous lenders without compromising the ability of borrowers to meet their consumption needs through digital loans. Whereas borrowers and practitioners have welcomed this development, the effect of regulation on digital lending in Kenya remains to be seen.

CHAPTER SEVEN: RESPONSES, PERSPECTIVES, AND COUNTER-NARRATIVES FROM INDUSTRY INSIDERS

7.1 Introduction

Up to this point, I have described in detail the co-operative and digital lending models, the evolution of the two models, and the sectors in which they are situated. I have argued that these developments take place in the broader context of financialization. I have also described the evolution of the financial inclusion discourse which entails debates about the impact of financial inclusion and criticisms of strategies employed to ostensibly achieve financial inclusion.

The close involvement of powerful international actors has been an enduring feature of this push for financial inclusion. The World Bank in particular has been the preeminent voice on financial inclusion and has been instrumental in shaping its discourse. The purpose of this chapter is to reflect on the financial inclusion discourse and highlight the responses and present the perspectives of the people on the ground to this discourse. I use this as the entry point into unbundling the question of whether industry insiders have wholly adopted the financial inclusion message.

This chapter argues that industry insiders have indeed become wiser over time about financial inclusion strategies and are offering some criticism from within. Despite the initial triumphs of digital financial inclusion, questions abound about the socio-economic cost of the digital microcredit model, the danger that it portends for financial inclusion, and if these harmful effects can be sufficiently mitigated through regulation or other means. Many industry insiders acknowledge that the use of digital loans for consumption purposes leads to loan stacking which in turn makes borrowers more financially vulnerable. This chapter highlights the main criticisms offered by the people on the ground about the financial inclusion discourse and aspects of financial inclusion strategies that they perceive to work. It is argued here that leading narratives about financial inclusion, as proposed by higher-up financial institutions and their affiliates, gloss over a more complicated situation when one considers the evidence from the people on the ground.

7.2 Who are the industry insiders?

The previous section describes how the influential financial inclusion discourse cascaded down from the higher levels of the global financial architecture, far removed from the circumstances of the poor people whose lives, the global financial actors insist, will improve through financial inclusion. I have hypothesized that one cannot simply suppose that the financial inclusion discourse has been abstractly modeled by practitioners in the financial industry in developing countries such as Kenya, in effect brainwashing them. Some critics of the discourse of financial inclusion appear to believe that this is the case – that the financial industry as a whole displays an unwavering consistent outlook across the globe. The aim of this study was therefore to find out how the financial inclusion discourse, as promoted by the World Bank and others, has been received by industry insiders who implement these financial inclusion strategies.

In reaching this aim, I spoke to a variety of professionals in the financial services industry, whom I simply refer to here as industry insiders. I spoke to insiders in the co-operative sector, including SACCO managers who had historical memory of developments in the sector before and after financial inclusion came into vogue in the mid-2000s. I also spoke to a few lower-level and mid-level professionals working in various SACCOs, mostly as customer-facing staff in FOSA branches. Most of these staff came into the SACCOs less than two decades ago when financial inclusion efforts, such as relaxing the common bond, were already underway.

As I mention in chapter three, I spoke to two recent retirees who worked in the co-operative sector for more than three decades each. The first was my father who worked in the Co-operative Commissioner's office for over thirty-five years. The other is my father's friend and former colleague, Omollo, who had a two-decade stint at the Commissioner's office and later headed the credit division of a large SACCO before retiring slightly over a year ago. These two informants were useful in tracing the history of the co-operative sector and how co-operatives used to operate. This historical account was useful in analyzing how the financial inclusion discourse changed the sector.

I also spoke to a variety of professionals in the digital lending industry. My informants from the industry had diverse backgrounds ranging from finance and banking, software development, and product design, to a few who have been serial tech entrepreneurs and are well-known in Nairobi's tech scene. These informants were drawn from both bank-based and non-bank (private fintech) digital

lending outfits. I also spoke to two managers from SACCOs who have digital lending platforms. In this respect, there was an overlap in my conversations with these two informants.

Notably, my informants from the digital lending industry were much younger than those in the SACCO sector. This, however, is unsurprising given that skills required in the tech industry, such as computer coding, data analysis, algorithm engineering, and the like, are more resident in younger professionals. Overall, my estimation of the mean age of all my informants was roughly 40 years.

Industry insiders also include Meyo and Shirley, both of whom had long careers in the banking sector but transitioned into consulting on issues of financial inclusion more than five years ago. As I mention in the case study, Meyo is a personal finance coach and comes into direct contact with people who attend his financial academy and other speaking events. Besides working at a bank as a top executive, Shirley has also headed an MFI and currently works for a boutique consulting firm in Nairobi. These two informants were interesting because they have knowledge of how financial institutions operate and how products are developed and they have some level of direct contact with users of financial services.

7.3 Dissemination of the financial inclusion discourse

In trying to understand how my informants received and reacted to the financial inclusion discourse, I was first interested in how they came to learn about the discourse. This section therefore highlights the ways that the financial inclusion message has been disseminated to industry insiders over the last two decades.

In the introduction to this thesis, I mention influential expert reports issued by powerful institutions, which have been instrumental in shaping the financial inclusion discourse. These documents include a 2006 report by CGAP titled *Access for All: Building Inclusive Financial Systems,* the *Financial Inclusion Action Plan* produced by the Global Partnership for Financial Inclusion in 2010 and revised many times over the years, most recently in 2020, and the *2014 Global Financial Development Report* by the World Bank, which was dedicated to the subject of financial inclusion. This list represents a small fraction of these types of expert reports by international financial institutions which are often discussed at high-level gatherings such as the World Economic Forum.

One such high-level event, which I mention in chapter one, was the 2008 Mobile Money Summit held in Cairo, Egypt. This event has been followed up by many similar events that typically bring together various professionals in the financial services industry, including central bankers, financial services institutions, MNOs, development organizations, and solution vendors, among others. These global meetings have been fertile ground for the dissemination of the financial inclusion discourse over the last two decades.

I gathered from my informants that they also picked up the financial inclusion discourse from locally organized industry workshops and seminars. These industry workshops are organized by industry associations such as the Kenya Bankers Association, sector regulators such as the CBK and SASRA, as well as a number of NGOs and global consulting firms. It is useful to note that the CBK and SASRA are both members of the Alliance for Financial Inclusion[21] with the CBK governor sitting on its board. The Alliance for Financial Inclusion has been a leading voice on matters of financial inclusion and has produced many reports in this regard through its expert working groups. The CBK and SASRA have thus been instrumental in disseminating the financial inclusion discourse from the international financial institutions to the Kenyan financial services industry, particularly banks, MFIs, and SACCOs, whom they supervise.

I wish to emphasize the role that various internationally funded NGOs and consulting firms have played as interlocutors of the financial inclusion discourse on behalf of international financial institutions. These organizations have a more prominent presence in Kenya than anywhere else in Africa and have been useful in interpreting the financial inclusion message to industry insiders through workshops, blogs, and reports. These organizations have been trying to ingratiate themselves with various industry players, in particular regulators, by sponsoring industry events and financial-inclusion-related initiatives. This manoeuvre has seemingly earned them special access to the financial services industry.

A prominent example in this regard is the FSD network which is funded by various donors who have been at the forefront of promoting financial inclusion, such as the Bill and Melinda Gates Foundation

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[21] The Alliance for Financial Inclusion, founded in 2008, is an organization whose members are central banks and other financial regulatory institutions from 75 developing countries.

and others. The NGO, FSD Kenya, has for the last eight years organized annual lectures on financial-inclusion-related themes which bring together various industry insiders to discuss topical issues on financial inclusion. The NGO also commissions numerous surveys and studies around financial inclusion, including the recent FinAccess Surveys in collaboration with the CBK and the Kenya National Bureau of Statistics. Like CGAP, the FSD has a popular blog named the 'Financial Diaries' where the NGO makes available datasets and reports from surveys and a variety of other publications.

In a recent trend, some consulting firms have been unveiling short in-service and executive education programmes targeted at industry professionals. For example, the Digital Frontiers Institute has a Certified Digital Finance Practitioner course, a Digital Financial Inclusion Supervision course, and several other certifications delivered in partnership with CGAP and the Toronto Centre. Similarly, MicroSave Consulting, a boutique consulting firm, has a training arm called the Helix Institute which offers various general and bespoke training courses on digital financial services. The Helix Institute was founded roughly a decade ago in partnership with the Bill and Melinda Gates Foundation, the International Finance Corporation, FSD Africa, and the United Nations Capital Development Fund. Once again, we see the same prominent players involved in this effort.

Financial inclusion surveys have been keeping the financial inclusion discourse relevant in the last decade and a half. Two main financial inclusion surveys touch on Kenya. The first one is the Kenya FinAccess Household Survey by the CBK and the Kenya National Bureau of Statistics. This survey is supported by FSD Kenya and has been done biennially since 2006. The second is the Global Financial Index surveys by the World Bank which have been done triennially since 2011. The reports from these surveys are widely used by industry insiders. My informants pointed out that the reports contain useful information on financial inclusion gaps and usage trends for different financial services. In my discussions with various industry managers, they referred to these two survey reports, reflecting the reports' significance in shaping and sustaining the financial inclusion discourse.

In my interactions with different industry insiders, it was clear that the financial inclusion discourse is first disseminated to higher-level managers and then later filtered down to lower-level employees. Middle- to senior-level managers often represent their organizations at industry workshops. Similarly, managers are often the ones who attend short executive education programmes provided by consulting firms, usually funded by the organizations they work for. I gathered that lower-level

employees learn about the financial inclusion discourse from corporate town halls and strategy documents, and to a lesser extent through the media.

7.4 Shifting views on financial inclusion

Industry insiders in Kenya were seemingly enchanted by the financial inclusion discourse when it emerged in the mid-2000s. This initial excitement was borne out of the belief among industry insiders that the financial institutions working together would finally be able to reach the people at the bottom of the pyramid who had for long been a neglected market segment. The excitement around financial inclusion grew, in Kenya and elsewhere, when M-Pesa was launched in 2007. The rapid success of M-Pesa put Kenya on the map and gave renewed impetus to the push for financial inclusion to reach out to the neglected market segments through financial innovations that rode on the maturing mobile money network. The first of these innovations were mobile banking platforms which started springing up in 2010. Digital lending platforms followed soon, starting with M-Shwari in 2012. Industry insiders seemed to overlook the fact that M-Pesa's rapid success specifically related to money transfers. The idea that an array of other services could simply be successfully added to this platform in the name of financial inclusion is perhaps oversimplified.

It must be kept in mind that when the financial inclusion discourse came into vogue in the mid-2000s, the microfinance model was still surging in Kenya. At the time, there was little evidence that the microfinance model could be problematic and that the consequences of using this model to reach out to the poor may be more complicated than the discourse made them out to be. In fact, it was in 2006 that Mohammed Yunus, the founder of the microfinance model and the Grameen Bank was awarded the Nobel Peace Prize for his work in 'creating economic and social development from below'. Industry insiders were therefore still flushed with the perceived genius of microfinance. The criticism of the microfinance model was not to come until the early 2010s through scholars such as Duvendack et al. (2011) and Bateman and Chang (2012) and the World Bank report authored by Beck (2015) which suggested that microcredit yielded moderate but not transformative effects to the poor.

The financial inclusion message also permeated co-operatives which around the same time had started operating as SACCOs. The scramble for the customers at the bottom of the pyramid led them to start relaxing their common bonds and providing banking services to non-members. The trends sketched out above and which I elaborate on further here demonstrate how industry insiders were impressed

by the financial discourse, and thought, perhaps naively, that financial inclusion will deliver undiluted benefits to the poor.

From my discussions with industry insiders, it seems to me that their understanding of their customers significantly changed as they received the financial inclusion discourse. The lower end of SACCOs, which was previously viewed as unprofitable to serve, was now viewed by industry insiders from the SACCO sector and the digital lending industry as the new profit frontier. They had bought into the thesis put forward by Prahalad that indeed there was 'a fortune to be made at the bottom of the pyramid' and that serving the poor will also benefit them significantly. In my discussions, both industry insiders and borrowers acknowledged that the discourse on financial inclusion was no doubt powerful and had caused them to significantly change the way they operate. These trends highlighted above demonstrate the drive by co-operatives and digital lenders, in their pursuit of financial inclusion and financial return, to make loans of different kinds available to a wider pool of borrowers.

Over time, tangible evidence about the various financial inclusion strategies began to emerge and painted a picture that was in stark contrast to the one painted at the 2008 mobile money summit in Cairo and other fora where the financial inclusion message was peddled. Indeed, many industry insiders revealed that they had come to learn about the adverse effects of their strategies from their interactions with their customers. They explained that what they had thought were well-thought-out, well-researched strategies were not producing the results they had initially thought they would.

Similarly, the FinAccess Household Survey conducted by the CBK and its partners, which stands out as the most authoritative source of information on financial inclusion in Kenya, produced important insights on consumer outcomes of financial inclusion interventions. The results of the 2021 FinAccess Survey indicate that while financial inclusion, measured as account ownership with a formal financial institution or a mobile money account, has been on the rise over time, peaking at 83.7% in 2021, the financial health of consumers has been deteriorating. The survey reveals that only 17% of the respondents were financially healthy, which in the report is defined as the ability to adequately and comfortably meet one's day-to-day needs, cope with financial shocks, save, and invest. This statistic shows a declining trend when compared to the 2019 FinAccess survey when 22% of the respondents were said to be financially healthy.

Growing evidence from the customers on the ground has inspired industry insiders' fresh perspectives on the financial inclusion strategies they deploy, and on financial inclusion discourse more generally. This emerging evidence has seen the enthusiasm about financial inclusion among industry insiders, as witnessed at the 2008 Cairo summit, begin to wane over time. As it turns out, many industry insiders have questions about the sustainability of the digital lending model in the context of financial inclusion. As John from case study seven explained:

> 'The idea of financial inclusion in itself is not objectionable; there is nothing wrong with extending a service to a poor person. The challenge for us as a business is that can you do it profitably? We are coming to learn that you cannot serve the poor profitably in a sustainable way unless you go completely rogue by imposing high interest rates, aggressive collection, and all manner of tactics. This is a view shared by many members of my association.'

The progressive realization of the wider implications of extending SACCO and digital loans to the poor and of the risk that the use of these loans poses to their financial health has led industry insiders to question the reasoning behind financial inclusion as a poverty alleviation tool. However, this developing realization is not evenly distributed among industry insiders. Informants in both the SACCO sector and in the digital lending industry hold different views about their strategies and the discourse. Their views vary by virtue of their position in their organization and depending on the size and financial muscle of their organization. The following two sections explain in greater detail this variation in perspectives among my informants.

7.5 Perspectives of insiders in the digital lending industry

Proponents of financial inclusion have always emphasized scaling up digital financial services as the most ideal way to reach the financially excluded. This is because financial technology enables financial intermediaries to reach their customers much faster, at scale, and cheaper – issues that have always been perceived as the main reasons for not reaching out to the lower end of the market. Charmed by the financial inclusion discourse, industry insiders went on to innovate new products and significantly change their business models in the hope that they will reach the financially excluded while simultaneously boosting their bottom line. They also saw using emerging technology, most prominently mobile money, as a way to reduce the back-end costs of providing an array of financial services to the poor. At the time, there were no grounds to criticize the financial inclusion discourse.

Lessons from the failures of microfinance, which is largely perceived as the precursor to financial inclusion, were yet to surface.

In time, industry insiders' infatuation with the idea that they can serve the poor using emerging financial technologies and be profitable while doing so began to fade away. To demonstrate this change of heart by industry insiders, I refer to two conversations with John. The first conversation happened during my fieldwork in 2020 and the other one happened two and half years later when we met at a conference[22]. In my initial discussion with John, he appeared to have bought into the financial inclusion message and to genuinely believe that it would open new horizons for both the poor and the tech entrepreneurs trying to serve them. John had dismissed as 'ridiculous' the claims by critics of financial inclusion such as Bateman et al. (2018) and others that digital loans were harmful. As he stated:

> 'Poverty is the biggest factor of exclusion. Someone has to take a chance on the people at the bottom and try to convert them into good customers (those who pay their debts) and build their capacity to borrow and repay over time. This is what we are trying to do as digital lenders.'

With time, many industry insiders have become increasingly disenchanted with the financial inclusion discourse after realizing they cannot make money from the poor, at least not in the long run. In a recent encounter with John at a conference, two years after my fieldwork, he pointed out that digital lending has turned out not to be a sustainable business model. He pointed out that as a 'card-carrying capitalist', he now knows that he cannot make money from the bottom in any sustainable way. John made this stunning public admission at a conference among his fellow tech entrepreneurs. This was perhaps my clearest indication that industry insiders had come to be disillusioned by the financial inclusion discourse. In his admission, John contradicted Coimbatore Krishna Prahalad's (2005) view that there is a fortune to be made at the bottom of the pyramid if one tailors one's services to the poor. Prahalad insisted that this would result in a win-win situation for both borrowers and service providers of different kinds.

In a conversation with John, he explained that one needs a lot of initial capital to make money in digital lending. He explained that at the heart of a successful digital lending platform is a robust credit-

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[22] The Human Economy Research Programme Conference held from 10 to 14 October 2022 at Future Africa Campus, University of Pretoria, South Africa, with the theme: Persistent Barriers, New Frontiers: Fintech Futures in Africa.

scoring algorithm. His remark made me recall my conversation with Jeanne of Pioneer Nanoloans who bragged about having the best algorithm in the market. She explained that digital lenders accumulate troves of data on their customers over time which they use to analyze customer trends, tweak their credit-scoring algorithm, and target customers more surgically. With this information, they also learn a great deal about customer borrowing and repayment behaviour. I also gathered that banks and large non-bank digital lenders like Pioneer Nanoloans have invested in customer relationship management systems which they use to collect customer feedback and roll out periodic customer surveys.

John explained that investing in data, technology and personnel requires significant financial resources which a vast majority of relatively smaller digital lenders are unable to afford. Smaller lenders like John find themselves unable to compete with much larger, well-capitalized lenders like Pioneer Nanoloans or Safaricom's M-Shwari who have access to a wider pool of data, can construct sophisticated and highly dynamic algorithms, and invest in risk-learning. At the conference, John recalled a time when he had been developing a digital lending application and had an investor pull out nine months into the development phase because his developing team had delayed taking the product to the market. John pointed out that in the digital lending industry, there is always a 'rush to market' and private investors with strong profit motives are keen on making quick returns. To me, this explains digital lenders' aggressive lending behaviour for quicker, higher returns on the capital invested. It also explains their marketing techniques, crude collection mechanisms, high interest on loans, and exorbitant late fees. Bateman and Teixeira (2021) describe this as the investor-led fintech model which they argue will ultimately fail the poor given that any gains of financial inclusion will be skewed towards investors.

As explained in case study seven, John has now ventured into providing insurance for boda-boda riders through a product co-designed with a fuel station chain. With this insurance fintech, the fuel company pays the premiums on the client's behalf when they refuel their motorcycle up to a specified amount every month. In John's view, the lower end of the market is indeed the new frontier but he opined that one way to manage risk for this segment is to create a product that serves a niche segment rather than one that targets the mass market. Most importantly, he argued that the only way to reach those at bottom of the pyramid is not to ask them to part with money, which they clearly do not have. He suggested that the future of fintech and a way to make it less harmful is to co-design products with retailers and service providers who serve this customer segment. John's new business model mirrors

the digital lending product for medical emergencies that Shirley was recently involved in piloting in collaboration with an insurance company and a private hospital chain.

The other industry insider who has become growingly cynical about the financial inclusion discourse is Lydia from case study eight. For Lydia, reaching out to the poor in a sustainable way is incompatible with making money. Her new venture, Biashara Loans, offers a working capital loan to small businesses who may in turn offer loans to their loyal customers whom they know well and have an established relationship with. To her, this is more sustainable than giving digital loans to poor borrowers since the loans are used more productively and are, in her view, a less harmful way to reach the bottom billion.

My conversations with Lydia and John paint a picture of fintech enthusiasts and tech entrepreneurs in search of a new sustainable fintech model which could be beneficial to them as entrepreneurs and deliver some benefits for the people at the bottom of the pyramid. This suggests a change in the attitude of industry insiders about the financial inclusion discourse. This disillusionment about the financial inclusion discourse seems to be more pronounced among smaller lenders like John and Lydia as opposed to larger lenders. It appeared to me that larger digital lenders like Jeanne are slower at getting disenchanted by the discourse given that they seem to have better mechanisms and substantial financial resources to cope with the credit risk posed by low-income borrowers. As she remarked:

> 'You must remember where we've come from. Ten years ago, you could not obtain a loan if you did not have some form of security. You also had to wait for a week or so to access a loan and give long explanations to the bank manager about why you needed the loan and how you will repay it. This is now a thing of the past. We have a clear value proposition and that is why mobile loans are now part of every Kenyan's life and will continue to be.'

Part of the disillusionment about financial inclusion among industry insiders is that they now have a clearer picture of the consumer outcomes of the digital lending model, as I describe in chapter six. It is important to highlight that, unlike most digital lenders, SACCOs seem to have devised a more sensible and sustainable way to go about digital lending. Notably, there are striking differences in the way that SACCOs and mainstream digital lenders go about extending digital loans. Firstly, SACCOs seem to have a conservative approach to digital lending. Unlike most digital lenders who appeal to the mass market, large open-bond SACCOs who have ventured into digital lending give loans to a much smaller pool of members who, as I mention inin section 5.5 ,are often people with moderate to high

incomes. As explained by the manager of City SACCO, restricting digital loans to members serves to keep the default rates low and make the loans affordable. Kwambai and Wandera (2013) suggest that this is because high loan delinquency rates inevitably lead to high interest rates to compensate for loan defaults.

SACCOs are also more risk-averse because they use members' savings and their small profit reserves to extend digital loans. For this reason, SACCOs operate under strict prudential guidelines aimed at safeguarding members' savings. This is different from unregulated non-bank digital lenders who are often backed by cash-flush investors and venture capitalists who can afford to lose money in risk-learning while trying to create their credit-scoring algorithm.

Furthermore, digital loans by SACCOs are considerably cheaper than digital loans from other lenders. For example, M-Boosta digital loan from Harambee SACCO attracts an interest of 5% per month, while M-Pawa digital loan from Stima SACCO attracts an average interest rate of 5.5%. This is compared to M-Shwari's 7.5% per month, and other digital loans that are significantly more expensive than this. In my assessment, SACCOs are more realistic about the possible impact of digital lending and go about it in a more responsible way given that they lend to people with moderate to high incomes who mostly use the loans for convenience purposes as opposed to lending to low-income earners to whom these loans prove harmful.

The above discussion highlights the struggle that industry insiders have encountered in trying to reach users at the bottom of the pyramid in ways that are not harmful. The financial inclusion discourse, which was acclaimed as being laden with possibilities, has not yielded significant benefits to users.

To further describe how digital loans work in practice and how this practice differs from the prescriptions of the financial inclusion discourse, I highlight below two key themes that emerged from my discussions with insiders.

7.5.1 Good versus bad debt

During my fieldwork, I encountered a lively debate in the digital lending industry about the usage trends of digital loans. The debate concerns the use of digital loans for consumption rather than income-earning or 'productive' activities. Many professionals I spoke to from both digital lending platforms and co-operatives brought up a distinction between 'good debt' and 'bad debt'. They went

on to explain that good debt is debt used to increase one's earning capacity, for example student loans, business loans, or buying appreciating assets such as mortgages. Conversely, bad debt is debt used for reasons other than the uses of good debt, for example day-to-day consumption, leisure, and such other uses.

The FinAccess household survey notes that more than two-thirds of Kenyans are unable to meet their daily expenses in each income cycle, which leads them to take out digital loans to meet this shortfall (CBK, 2019). This is borne out by the responses of my informants. When I asked borrowers how they used digital loans, a majority of them cited purchases for the household, such as food, utilities, and emergency medical expenses. A few digital borrowers I spoke to, most of whom work in the informal sector, mentioned using digital loans to keep their small businesses running even though they did not consider it a business loan. One such respondent was Odongo who operates a boda-boda taxi and uses digital loans to refuel and repair his motorcycle. In this view, digital loans take the form of bad debt given that they are predominantly used for consumption purposes. It was clear that a majority of borrowers did not have this nuanced understanding of debt or cared little for it. However, they demonstrated a generally good understanding of the need to use loans more responsibly and repay them in time.

Similarly, professionals working in the digital lending industry that I consulted acknowledge that most of the loans they offer are used for day-to-day consumption needs and financial emergencies. Many of these informants acknowledge that the low-ticket value and short tenure of the loans make them only suitable for consumption purposes rather than as working capital or for other income-generating activities. According to Meyo and Shirley who work as financial inclusion consultants, the design of digital loans in relation to the ticket size and short tenure was intentional and was born out of a clear market need as evidenced by their rampant use.

In contrast, co-operative loans are mostly used for high-value purchases and investments. SACCO members I consulted spoke about using the SACCO loan for paying for school and college fees, financing their weddings or paying bride-price, and buying assets such as vehicles, machinery, plots of land, and home construction, among others. Among these informants was Vivienne from case study five who used a SACCO loan to fund her Executive Master of Business Administration degree. In this sense, SACCO loans mostly take the form of good debt since they are used for more 'productive' purposes.

Such significant expenses could not possibly be funded by digital loans since most digital lenders offer loans of below 1,000 US dollars. For example, M-Shwari gives loans up to a limit of 50,000 Kenya shillings (roughly 500 US dollars), two of the largest non-bank digital lenders, Tala and Zenka, both offer loans up to a limit of 30,000 Kenya shillings (roughly 300 US dollars) while Branch offers a maximum of 70,000 Kenya shillings (roughly 700 US dollars). Invariably, the average borrower would qualify for loan amounts much less than these maximum limits.

Many digital lenders I spoke to perceive two main dangers of using digital loans for consumption purposes. The first danger is that using digital loans for consumption could lead to consumerism and create dependence on the loans among borrowers, especially when borrowed from multiple sources. The second danger relates to debt distress. Cook and McKay (2015) and Wamalwa et al. (2019) caution that it is unsustainably expensive for households to use digital loans to frequently finance their regular expenses. Even though digital loans have proved important in responding to financial emergencies, the ease of access, short tenure, and high cost may exacerbate debt distress, especially when they are used for non-productive purposes (Wamalwa et al., 2019). This runs counter to claims by Bharadwaj et al. (2019) in their study of the impact of digital loans, using M-Shwari as a case study, where they argue that digital loans increase the financial resilience of households.

One way that debt distress is evident among low-income borrowers is the fact that many digital borrowers take additional loans to repay other digital loans falling due. Many borrowers I spoke to mentioned repaying a loan to avoid the loan being rolled over, accruing penalties and additional interest, and being blacklisted by CRBs. The second way that over-indebtedness is evident among digital borrowers in Kenya is the growing trend in late or non-repayment of digital loans. This finding is corroborated by a survey by Putman et al. (2021) which finds that 77% of digital borrowers in Kenya reported having been unable to repay a loan at least once, pointing to a worrying trend of over-indebtedness.

More perniciously, defaulting on a digital loan is extremely punitive which makes lending to this class almost predatory. When digital loans are not repaid in the specified time, many digital lenders start accruing penalties and interest immediately. Some digital lenders, for example M-Shwari, KCB M-Pesa, and a few others roll over unpaid loans to the next 30-day period and apply a rollover fee and interest for the next 30-day term. Many borrowers, like Makosa, express that a pile-up of these charges makes the original loan much harder to repay. Upon default, these individuals eventually find

themselves locked out of the formal credit market when they are adversely listed in CRBs. I also gathered from my informants that upon default, digital borrowers fashion various strategies to avoid debt collection. This includes avoiding calls from the debt collector, changing SIM cards, and making up stories, for example saying that the borrower in question is deceased and so forth.

The literature advance several arguments on why digital loans are prone to 'misapplication', the so-called bad uses. Some scholars make a rather unsophisticated deduction, stating that the use of digital loans for short-term use points to a lack of financial literacy among borrowers. For example, Mazer and Fiorillo (2015) and McKee et al. (2015) point out that because borrowers do not fully understand the terms of digital loans, they use the loans to finance unproductive, time-sensitive investments and consumption opportunities.

Some industry insiders insisted that the problem with the misapplication of digital loans is fundamentally a 'user problem' and that many borrowers do not understand digital loans as short-term credit facilities, but rather tend to use them too regularly and fail to repay the loans on time. Shirley, who was involved in the development of Fuliza, Safaricom's M-Pesa overdraft facility, convincingly argued that Fuliza users are generally unfamiliar with the concept of an overdraft facility. She insisted that Fuliza ceases its purpose and becomes increasingly expensive when borrowers stretch out the repayment period, given that it accrues interest daily. As she further explained:

> 'Kenyans have completely overlooked the intended idea of Fuliza and have ended up using it like M-Shwari. Fuliza should be a day's loan, i.e. a facility to get you money to spend immediately, which you already have but is in the form of cash or in your account. But if you take a whole month to repay Fuliza, it ceases its purpose.'

In agreement, John opined that Fuliza and typical digital loans such as M-Shwari are starkly different products and should be understood as such. He explained that product differentiation happens in all industries and is a response to a need in the market. He said that Fuliza is no exception and that like any other product, digital loans may have unintended consequences; what is needed and lacking is consumer education.

Unlike Jeanne from case study six who rejected any association between digital loans and over-indebtedness, John was more willing to acknowledge this link. He pointed out that digital loans could lead to over-indebtedness when used for consumption purposes or when one borrows from multiple

sources. John suggested that borrowing from multiple sources is a clear sign that one is living beyond one's means. He mentioned that he had witnessed many such cases where his customers borrowed and later defaulted on the loans. He noted that when he chases repayment, the cause of default points to over-borrowing which is common in borrowers who take out multiple digital loans. As he explained:

> 'The majority of our customers are multi-borrowed. The problem with this is that if your disposable income hasn't changed, then you can't pay all your loans all at once, meaning you get trapped in a cycle where you take (out) a digital loan to repay another.'

Part of the debate on digital loans surrounds whether lenders should direct the usage of digital loans. There is a general lack of consensus among different practitioners in the credit industry as to whether digital loans should be ring-fenced for specific uses as a better approach to financial inclusion or whether the users should elect the use of the loan. In many ways, this debate mirrored the discussions I had with co-operative managers, as discussed in the previous chapter, about abandoning ring-fenced co-operative loans. Many lenders offered dissenting views on the issue of ring-fencing digital loans; they insisted that it is naive to assume that all or indeed most borrowers do not have the financial knowledge or discipline to use digital loans responsibly.

Shirley is a strong advocate for ring-fenced digital loans. She explained that she had been involved as a consultant for a project for a local bank in collaboration with a local insurance company and a private hospital chain. The project is in the pilot stage and involves extending ring-fenced digital loans where the loan is remitted directly to the service provider, in this case the hospital. Shirley described to me the challenge of giving loans in cash:

> 'Digital lenders are not tying their solution (digital loans) to a specific need. Giving out quick loans as cash brings about over-indebtedness. Cash is flexible, it can be adapted to whatever use case. The problem, therefore, is in the product design. If credit is the solution, what is the problem?'

The practice of ring-fenced loans is not a new concept. As mentioned in chapter five, SACCO loans were initially ring-fenced. Siaya from Cop SACCO explained that SACCOs were not well capitalized at the time and that ring-fencing was a way to prevent mass default on loans which could put the SACCOs in financial trouble. Sarah from Uni SACCO also opined that ring-fencing was a way to

instill financial discipline such that members could only access credit when they really needed to, for example when paying school fees, court bail, or a medical bill. To this extent, SACCOs required a borrower to produce third-party evidence to support their loan application. However, as SACCOs became better capitalized, they abandoned the practice of ring-fencing. In Uni SACCO, this was accompanied by protestations from its members who insisted that third-party evidence was too administrative.

After SACCOs abandoned ring-fencing loans through third-party evidence, most SACCOs transitioned to a more subtle but less effective way of ring-fencing SACCO loans: requiring borrowers to indicate the use of the loan on the loan application form. I spoke to Vicar (pseudonym), who has worked in Church SACCO for roughly six years first as a FOSA customer care representative and presently as a credit officer in Church SACCO's main branch. He has significant client-facing experience and from our conversation, he appeared highly knowledgeable about Church SACCO's products and those of other SACCOs. Vicar explained that the requirement to explain the use of the loan was ineffective given that many borrowers would make ambiguous narrations such as 'personal use', 'family needs', or 'emergency' which made it impossible for SACCO officials to tell what the loan would be used for. Vicar further noted that the SACCO did not follow up with the member to find out how they had used the loan. As such, the requirement was pointless. Furthermore, Sarah noted that these narrations were not used to deny or approve a loan application as this depended solely on the amount of savings and whether the loan was properly guaranteed. She observed that the narration was 'purely administrative and served no purpose' and therefore this requirement was scrapped altogether. I noted that this was the trend across many SACCOs.

To some industry insiders, like Shirley, the issue of over-indebtedness lies in the misapplication of digital loans. This, she claims, owes itself to the fact that most digital loans are given in cash which can be directed toward different uses. While it is unclear what the impact of ring-fencing of digital loans would be, it is clear that some industry insiders are aware of the harmful aspects of digital lending. Some industry insiders like Shirley see ring-fencing as a more ethical, less harmful approach to digital lending. My consideration of Shirley's suggestion, however, is that while ring-fenced digital loans could potentially help borrowers overcome the lure of taking out easy loans for non-productive uses, it is grounded on the flawed assumption that many borrowers do not know how to use digital loans.

To sum up, industry insiders disagree on the root cause of over-indebtedness among digital borrowers. Some cite faults in the product design, others blame it on low-information borrowers while others blame this on predatory lending practices by some errant lenders. Likewise, practitioners provide different remedies to the challenge of over-indebtedness; some advocate for more financial literacy, others propose non-cash, ring-fenced digital loans while some suggest tighter regulation. What these industry insiders agree on is that over-indebtedness is an issue of growing concern among digital borrowers.

7.5.2 The entrepreneurship myth

By far the most dominant narrative of the financial inclusion discourse for the last two decades has been that financial inclusion is a definitive poverty alleviation strategy. As (Jenkins, 2008) prominently noted in the 2008 mobile money summit in Cairo report:

> 'Access to financial services would provide new fuel for private sector activity and economic growth, helping empower people to forge their own paths out of poverty.'

In the last two decades, influential financial institutions and their acolytes, as well as some scholars have promoted this idea in numerous reports. Other narratives about financial inclusion include the creation of a cashless ecology which eventually led to the formation of the United Nations-affiliated Better Than Cash Alliance. Evidently, these leading narratives on financial inclusion have not aged well in the last two decades. However, the power of these bold proclamations about financial inclusion cannot be underestimated.

Embedded in this claim is the idea that financial inclusion will lead to microenterprises springing up, which will help alleviate poverty and lessen global inequality. It follows from this narrative that, at inception, digital loans were passed off as working capital loans for micro and small businesses. For a long period, analysts tended to downplay the fact that digital loans are too small to sustain any business with the hope that businesses will substantially scale up. In recent times, industry insiders have come to agree that digital loans are predominantly used to complement the borrower's income and are essentially used for day-to-day consumption and emergencies.

Few digital lenders insist that the use of digital loans for consumption purposes was an intended consequence; they claim that digital loans were primarily designed to offer start-up and working capital

to micro and small enterprises. As described in case study thirteen, Meyo considers the popularization of taking out digital loans to start or boost small businesses as 'false advertising'. He explained that this form of popularizing digital loans was common with the foremost digital loan deployments. He noted that digital lenders now fashion marketing strategies that appeal to the vulnerabilities of low-income borrowers who constitute the bulk of the market. As he explained:

> 'Back then, the message was about entrepreneurship, but if you watch their adverts these days, the message has shifted to that of emergencies – someone's car is running out of fuel, or someone is on a date and the card declines. The entrepreneurship message could not work for long because it just wasn't the reality, no one related to those initial adverts. We cannot all be entrepreneurs, but we all get financial emergencies.'

From my review of television adverts for M-Shwari available on online sources, I corroborate Meyo's observation about these changed marketing tactics. The earliest M-Shwari advert presented a rags-to-riches story. The advert featured a mechanic who was trying to save up for a toolkit worth 5,000 Kenya shillings with the hope that it will help him start his own business. The mechanic then saved some money and took out an M-Shwari loan to make the purchase. In a number of years, the mechanic had become a successful garage owner and had abandoned his dirty and oily overall for a white dress shirt and tie and even had employees working for him. Another M-Shwari advert features a narrated testimonial from a furniture maker named John who used the M-Shwari loan to expand his business after using an M-Shwari loan to buy carpentry supplies.

In more recent adverts, Safaricom and other digital lenders present digital loans as a product for financial emergencies. For example, one M-Shwari advert shows a man who is on a date but does not have enough money to settle the bill; he quickly avoids any possible embarrassment when he remembers that he can take out the M-Shwari loan to pay for the dinner. Another recent advert shows a motorist who is almost running out of fuel and takes out an M-Shwari loan to refuel his car.

To me, this change of marketing tactics employed by digital lenders demonstrates a realization that fashioning digital loans as business loans for micro-entrepreneurs was not realistic. This was because the small value and short repayment period of digital loans made their use as working capital rather ambitious, even for micro and small businesses. Diagne (1999) also shares this view, arguing that short-term loans are usually too small to help poor households start a viable micro-enterprise. In this

view, there was a need to move away from the idealized notions of inclusion and entrepreneurship to marketing strategies that reflect the actual use of the loan.

As detailed in the case study, Meyo explained that many entrepreneurs he has interacted with in Nairobi's low- and middle-income areas qualify for very small digital loans of between 1,000 (10 US dollars) and 3,000 Kenya shillings (30 US dollars), which in his considered view cannot sustainably scale up any business. In fact, he suggested that these small loans and their short tenure make them only useful for consumption purposes. Further, in my discussions with micro-entrepreneurs like Odongo who use digital loans, it was clear that they do not consider digital loans as business loans as touted by some digital lenders and the financial inclusion lobby. My discussions with micro and micro-entrepreneurs revealed that because of the small loan ticket sizes they qualify for and their small incomes, they typically do not disentangle personal finances from the finances of their enterprises.

John linked the failure of financial inclusion to deliver benefits to micro-entrepreneurs to predatory lending behaviour by lenders of different kinds targeted at low-information borrowers. He gave an example of a rogue lender in Nairobi who gives motorcycles on loan to boda-boda riders. The loans are not only expensive but also unbeknownst to the borrowers, the motorcycle loans are priced in US dollars and the lender manipulates the exchange rates such that the outstanding loan hardly reduces. Given that boda-boda riders are low-income earners, this loan manifests itself as being harmful and most of the riders' motorcycles are repossessed. As John said:

> 'If you consider that the boda-boda takes home less than five dollars a day, you do not need anyone to tell you that the boda-boda can never repay that loan… tomorrow's bubble will not affect today's profit, that is how these rogue lenders think.'

Based on the evidence from the people on the ground, I posit that there is no compelling reason to argue that financial inclusion, more so credit, will address poverty for people at the bottom of the pyramid through entrepreneurship. Low-income borrowers like Odongo the boda-boda rider who takes the line argued by proponents of financial inclusion and try to 'forge their own path out of poverty' by starting micro-enterprises, rarely succeed. In contrast, they are more likely to find themselves over-indebted and disillusioned. My analysis reaches the conclusion that digital loans will not lift the economically disadvantaged out of poverty or launch them into entrepreneurial careers. Instead, digital loans are having the opposite effect of heightening the poor's vulnerability. To this

extent, my arguments part company with those of many proponents of this financial inclusion narrative.

7.6 Perspectives of insiders in the SACCO sector

Another objective of speaking to industry insiders was to understand the impact of the financial inclusion discourse by learning how their jobs have changed over time and specifically what they are doing differently from before to get more people financially included. I was also interested in learning how SACCOs, banks, and digital lenders have changed since the financial inclusion discourse came into prominence. I have highlighted most of these changes in chapters five and six. However, two trends should be emphasized – the growing scope of the services of these lenders and the increasing size of their organizations.

For co-operatives in Kenya, the first step towards 'banking the unbanked' was taking deposits from the public. This was occasioned by commercial banks imposing minimum account balances, a practice that left many small depositors unbanked in the early 2000s. Co-operatives taking over-the-counter deposits necessitated regulators to tighten sector regulations, which led to the emergence of SACCOs. The formalization of the SACCO model and the subsequent relaxing of the common bond led SACCOs to expand the scope of SACCO products and services. This came through deposit-taking SACCOs introducing banking services through their FOSA sections. Although typically small, FOSA sections have all the makings of a banking operation, offering secured loans, savings and current accounts, and other services, and they are accessible to both members and non-members, otherwise referred to as customers.

SACCOs' appetite for risk and their expertise in packaging financial products for their members and customers have grown over the last two decades. These developments paint a picture of how SACCOs have radically transformed in response to the financial inclusion discourse. From my discussions with co-operative managers, I have established that at the time when SACCOs emerged, the school fees loan was the anchor product in most SACCOs. Co-operative managers indicate that increased savings and deposits led them to start diversifying their services and products to include emergency loans, home development loans, asset-financing loans, and, most recently, home mortgages through the Kenya Mortgage Refinance Company scheme and unsecured digital loans, a product which is beyond their traditional domain of operation.

Co-operatives have also considerably increased their membership since they started relaxing the common bond in the late 2000s to shed the SACCOs' 'exclusive' outlook. Many co-operative practitioners I spoke to explained that there had been a sector-wide realization that the way to make SACCOs more financially viable was through building financial resources and leveraging economies of scale by increasing their membership. Most SACCO managers described to me how they had come under great pressure from their management committees to increase their membership over the last decade. For example, Cop SACCO has seen its membership rise from 7,000 to over 61,000 members after they relaxed their common bond in 2010. Similarly, City SACCO increased its members register from a few hundred teachers to over 100,000 members after relaxing membership to individuals outside the teaching profession.

It is useful to note that open-bond SACCOs also have non-member customers who operate FOSA accounts but do not own shares in the SACCO. Managers were eager to make this distinction, perhaps in a bid to explain to me that their SACCOs are not exclusive clubs as was the case before. However, given the 'walk-in' nature of the FOSA operations, the number of non-member customers that most SACCOs serve was not definitive to my informants, given that they needed to take account of dormant accounts as well as the opening and closure of accounts to arrive at a correct tally. Further, SACCO managers explained that increasing the membership was not only directed at natural persons but also extended to corporate members. They noted that this was seen as a faster way of building substantial pools of capital as opposed to building capital from individual members.

The transformation of co-operatives from small, localized institutions to formidable financial institutions over the last two decades is largely attributed to their enthusiastic response to the financial inclusion discourse. However, despite these clear gains in reaching out to new members, I argue that even SACCOs who have a relaxed common bond are still not 'inclusive' given that the conditions of membership – purchase of minimum share capital and periodic savings – are still prohibitive to people at the bottom of the pyramid. SACCOs in Kenya therefore remain the preserve of people with moderate to high incomes, who are often not the subjects of financial inclusion strategies.

Members and industry insiders are beginning to feel the impact of the changes in SACCOs described above and this has led to discussions about this drift towards making SACCOs more commercial. The first way industry insiders have realized the impact of their strategies was through direct interaction

with their customers. Notably, as SACCOs relaxed their common bonds and their membership became larger and more commercial, they started to gradually lose touch with their members.

During my interactions with SACCO insiders, I gathered that lower-level employees in SACCOs and banks appear to be more in touch with their customers than middle- to senior-level managers. Most of these lower-level SACCO employees were customer-facing staff working in the FOSA sections who had direct contact with the customers and seemed to be more in touch with the SACCO members and their circumstances compared to other professionals who occupied higher positions in the SACCOs. Lower-level employees, however, narrated the difficulties of a large membership getting loans, the rising default rates, and the general commercialization of the SACCO sector. One such low-level employee was Vicar (pseudonym) who works as a credit officer in Church SACCO and is well versed in industry trends and the financial inclusion discourse. Vicar seemed cynical about the changes that his SACCO has made in the name of financial inclusion. As he remarked:

> 'Financial inclusion is not a bank account or being a member of a SACCO. We have more members and FOSA customers but many of them have inactive accounts meaning they do not transact regularly. That is why the conversation has now shifted from access to financial health… there is even a new term – inclusive finance. It (financial inclusion) is a moving target.'

Sarah from case study ten is a middle-level employee at Uni SACCO. As a FOSA branch manager, she is acquainted with the SACCO members and customers. Sarah explained to me the struggles that borrowers go through to obtain loans, noting that SACCOs are no longer the go-to place for affordable credit:

> 'Getting a loan has also become harder because the guarantee mechanism is very different from what it was ten years ago. The burden of finding guarantors has forced us to build the administrative capacity to take logbooks and title deeds as security for loans. But remember, you need to get the asset professionally valued, which increases the cost of getting the loan. It's not all rosy.'

In contrast, I gathered that senior-level managers in the SACCOs have minimal to no contact with SACCO members and that they mostly interact with high-level management reports about business performance. It appeared to me that these managers are still passionate about their efforts in promoting financial inclusion. Perhaps the most enthusiastic of my informants was Siaya, who was proud of the journey of Cop SACCO and Kenya's SACCO movement in general. As he noted:

> ‘The impact is there for everyone to see. Kenya is way ahead of other African countries and this is because of these efforts, it’s not by luck. People come here (to Kenya) for benchmarking, and I am invited to speak outside Kenya, about our SACCO sector. SACCOs have become the default way to organizing one’s financial life…. we are peers with banks in this market.’

Whereas middle- to senior-level managers appeared to have less knowledge of their customers than lower-level employees, they are not completely oblivious to the outcomes of their financial inclusion strategies. I suggest this because most of the senior managers I spoke to started their careers in these lower-level positions, many of them within the last two decades when financial inclusion became popular. Furthermore, these managers do not operate in a vacuum but rather interact with friends, acquaintances, and family members who use their services, as well as staff from other SACCOs. I perceive that industry insiders who occupy higher positions in their organizations, in both SACCOs and banks, have some knowledge of the challenges of their financial inclusion strategies from their interactions with different people outside their work setting. However, their knowledge of their customers is clearly not as detailed or in touch as that of lower-level, customer-facing employees.

7.7 Conclusion

Financial inclusion has been a key discussion point among development practitioners in the last two decades. International financial institutions have been responsible for popularizing this discourse, supported by NGOs, think tanks, and consulting firms who have been intermediaries of this discourse to the financial services industry in Kenya, as elsewhere in the Global South. Co-operatives, banks, and other digital lenders in Kenya have responded to the financial inclusion discourse. While SACCOs relaxed their common bonds and diversified their products and services, digital lenders have oriented themselves to lending to the mass market and have been constantly innovating to reach new frontiers. Without a doubt, the power of the financial inclusion discourse has permeated financial institutions and caused them to change course and refocus their efforts toward extending their services to the lower end of the market.

In the same vein, industry insiders responsible for overseeing these financial inclusion strategies hold some reservations about the strategies in question and the financial inclusion discourse more broadly. The most discussed subject about extending credit to the poor, particularly digital loans, has been growing over-indebtedness. While there are competing views about why this over-indebtedness arises and different prescriptions to correct this shortcoming, industry insiders generally acknowledge the

problem. Further, the financial inclusion lobby has in the last two decades pushed the narrative that financial inclusion will spur entrepreneurship and that this will be a way to shore up the vulnerable in society. Most analysts seem to ignore the immediate fact that digital loans are too small to start or scale up most businesses and that SACCOs who indeed could offer working capital loans are still inaccessible to the poor, even after their efforts in relaxing their common bonds.

In conclusion, proponents of financial inclusion clearly overestimate what digital loans are, what they can do, and to whom they are useful. While some claims about digital loans are unrealistic, some of them are misguided and not borne out by the evidence on the ground. This chapter, however, argues that industry insiders are under no illusions about their financial inclusion strategies' success with lifting people out of poverty. In fact, many of them hold views that diverge from those held by powerful proponents of financial inclusion, which in my estimation are far removed from reality.

CHAPTER EIGHT: WHICH WAY?

'Things could be very different. History has shown that the takers don't always trump the makers.'

Rana Foroohar – Makers and Takers

8.1 Introduction

The last few chapters show that financial inclusion efforts in Kenya over the last two decades have not yielded much success. This brings me to the issue of money. The monetary system – how money is created, circulated and controlled – is a deeper issue that underlies the push for financial inclusion. At present, the monetary system is profoundly unequal; the wealthy borrow money and hoard it and even when this money is circulated, it flows in elite circles through buying and selling of financial assets. This leads to a scarcity of money for average borrowers to earn, which leads them to borrow more to meet their needs, thus creating a perpetual cycle of creating 'debt-money'. This debt, however, is sold to poor people as a way to 'access' finance and possibly a path out of poverty. This chapter argues that financial exclusion is a problem of access to money rather than access to credit which the poor have to pay back with interest, in most cases exorbitant interest.

Over the last decade or so, however, the emergence of digital payments, mobile wallets and cryptocurrencies has not only been viewed as a boon for financial inclusion but has also led to the reimagining of money as a basic social construct. This has sparked fresh debate concerning who should issue money and concerning the functions of money, in particular if the basic functions of money can co-exist or if they should be separated out. These debates are largely beyond the scope of this thesis. However, I highlight some experiments which have been put forward to transcend the current "debt-money" system which I perceive as an obstacle to true financial inclusion. I argue in conclusion that it is imperative to devise new alternatives ways to undertake real monetary reform and create a viable pathway to true financial inclusion.

8.2 Money as an object of contest

Money is relatively constant and predictable. However, Bendell and Slater (2017) point out that, on average, people barely understand the essence of money, how it is created, and how it influences their day-to-day experiences. As highlighted above, there are growing contestations about money. At the

heart of the debate is how money is created and controlled, and how the monetary system can be reformed. In this chapter I briefly highlight the main issues to engage with when thinking about a more viable path to financial inclusion.

The first contentious area, which this thesis does not deal with, is the chronological debate around the origin and creation of money. It suffices to point out that money is created by issuing more debt, what money theorists refer to as 'debt-money'. In what Greco (2009) describes as an 'unholy alliance', the state confers to central banks the legal monopoly to create "debt-money" and to charge interest on it and in exchange for this monopoly power, the state gets to spend freely beyond what they collect in taxes. Central banks lend to retail borrowers at a mark-up. This cycle means that the amount of debt is always greater than the money supply; as such, 'debt-money' creates a future need for even more money (Eisenstein, 2011). The key issue here is that consumer credit fuels the global monetary system.

The other area of contest is who should issue and control money. For a long time, it has been a foregone conclusion that the state should issue and control money. The school of thought that promotes the role of the state in issuing and controlling money is commonly referred to as Chartalism. Chartalists promote the idea that 'money is a creature of the state', to mean that the state has the power to dictate what money is, and how it should be issued and controlled. Their fundamental logic is that money is a substitute for counter-party risk and given that the state can never be insolvent, one does not need to trust the counterparty.

Recent economic events, more particularly in the last two decades, have led to new thinking around this critical question. New thinkers argue that money does not have intrinsic value, but rather its value is in the eye of the beholder, the people. Vasantkumar (2022) argues that the question of who should issue money comes down to the fundamental issue of trust; that is who the people trust with the responsibility of issuing and controlling money; in some cases, the people trust the state to issue and control money while in others they do not. He illustrates the case of Zimbabwe where the state had suffered a lack of legitimacy stemming from deep political and economic woes which led ordinary Zimbabweans to oppose the rather forceful reinstatement of the Zimbabwean dollar in 2019, a currency that they associated with 'national economic trauma'. The same can be said of Venezuela which issued a new currency, the Petro, in 2018 to supplement the Bolivar as a way of cushioning the country from a series of US and European Union sanctions that had come into effect a year earlier

following political struggles and social decline. Bianchi (2018) and Rendon (2021) point out that due to the mistrust in the authoritarian government, the Petro ended up a failed project.

The experiences of Zimbabwe and Venezuela illustrate the challenge with the state's role in issuing money and oppose the Chartalist view that money is whatever the state says it is. Critics suggest that the people's trust in the state can indeed be withdrawn, and that people can dump state-issued money for privately issued alternatives. This is most true in uncertain times, such as periods of political and social collapse. Further, critics argue that it is not true that states do not go bankrupt; recent sovereign debt crises in Sri Lanka, Greece, Argentina, Ghana and others bear this out. The question of what money is and who should issue and control it is thus a contestation between people, the state, and markets. This is a complex question that will continue to be the subject of future debate.

Literature have raised questions about whether fiat money works for the people, particularly the poor majority who are poorly collateralized and lack stable formal employment, which place them at a disadvantage in the allocation of credit. Economists argue that money has three basic functions; money is a medium of exchange, a store of value and a unit of account. Generally, economists argue that money's prime function is being a medium of exchange (Graeber, 2012). This function of money implies that money should circulate and change hands in the activity of buying and selling. However, Thomas Greco (2009) in his book *The End of Money and the Future of Civilization,* posits that this is hardly the case; the 'debt-money' system concentrates power and wealth in the hands of a few who use this money for speculative purposes, such as investing it in financial assets or hoarding it to benefit from exchange rate movements. This behaviour starves the rest of the economy (poor borrowers and smaller organizations) of money which forces them to borrow more, a process Bendell and Greco (2013) describe as 'unsustainable, unfair and unintelligent'.

This trend of hoarding money (using it as a store of value), as opposed to using its for its main function of facilitating commerce, has piqued a discussion about whether the three functions of money can be separated. Complex questions arise here. Can one form of money be used as a store of value, another as a medium of exchange and another as a unit of account? Also, can this be a sustainable way to deal with the flaws of fiat money? These are loaded questions that are the subject of ongoing research. These discussions show a growing discussion about moving beyond the orthodox view of money and call for reforming the monetary system which seems to be the problem underlying true financial inclusion. My thesis agrees with Bendell and Greco (2013) who stress that 'unless we transform the

way money is issued, rather than repackaging it, then we are not addressing the underlying problem.' The next sections discuss some experiments that could lead to a reformation of the current monetary system.

8.3 Beyond fiat: new stories of money

My discussion on the credit industry in Kenya suggests that people know their economic circumstances but do not quite understand the overall monetary system in which financial institutions exist and operate. However, whereas ordinary Kenyans do not espouse great knowledge of the global monetary system, they are not blind to the concerns about the ability of the monetary system to fulfill their financial needs. People are not always passive in using money, they have an inner resilience and ability to 'innovate, subvert and change' as Maurer (2012) puts it. The formal financial sector is therefore not invulnerable; ordinary people have the ability to organize against it. Some questions arise here. Have ordinary people devised new ways of effecting social justice in relation to credit? What will the benefits of this credit activism look like? How can co-operatives and digital lenders in Kenya offer credit in ways that are non-problematic in the global economic context in which they exist? These are loaded questions. Below, I deal with these questions by highlighting new ways that money is being reimagined in Kenya and beyond.

One of the ways that people are organizing to move beyond fiat money is through community currencies which work alongside fiat currency and in some cases are used independently. Community currencies were devised to overcome the challenges of fiat money scarcity for average borrowers, prohibitive access to credit, and credit rationing. These currencies are typically issued by a group of local businesses and are thus used to facilitate exchange within a defined geographical setting. Community currencies are typically pegged on the sovereign currency for purposes of determining the price of goods and services and come in the form of vouchers that resemble banknotes, for example the Orania Ora, while more recent versions take the form of digital tokens, for example the WIR Franc. There is no shortage of examples of community currency projects throughout the world. Some of these community currency projects have been somewhat successful while others have faded away over time.

The idea of community currencies found its way to Kenya through a non-profit organization, Grassroots Economics. The organization has launched several community currencies in various local

communities over the past twelve years and has had several iterations of the community currency over that time. The first was EcoPesa, launched in 2010 in Kongowea, Mombasa. Community members would earn Eco-Pesa after cleaning the environment and use it for purchases at designated shops. To enable cash-out to Kenyan shillings (to enable small merchants to restock and so forth), the organization mobilized donor funds to back the project. However, because Eco-Pesa was backed by a donor, the project had a life span and the currency naturally faded away when Eco-Pesa was redeemed for all donor funds available.

Grassroots Economics' community currency project entered a new phase with the introduction of Bangla-Pesa in 2013. Bangla is short for Bangladesh, an informal settlement in Mombasa where the project was situated, and Pesa translated from Swahili means money. Bangla-Pesa was fashioned as a credit voucher pegged on the Kenyan shilling and redeemable at any of the participating businesses. Bangla-Pesa spawned other community currency projects in other low-income neighborhoods, such as Gatina-Pesa, Lindi-Pesa, and Kangemi-Pesa in Nairobi and Ngombeni-Pesa in Mombasa.

In 2018, Grassroots Economics transitioned from the paper-based Bangla-Pesa to digital tokens, christened Sarafu Credit, which could be used via mobile phones and which was meant to help with the security and transparency of transactions. More recently, the organization has been experimenting with the demurrage concept whereby the Sarafu Credit would be devalued over time. This was meant to discourage the accumulation of the tokens at certain business points and encourage circulation. These sets of experiments by Grassroots Economics in Kenya highlight just some of the challenges with community currencies and suggest that there is still work to do to devise a community currency that will stand the test of time.

There is, however, a shortage of concrete, independent studies that appraise community currency initiatives in Kenya. In a report co-authored by the figurehead behind Grassroots Economics, William Ruddick, the authors seem less secure about the impact of their community currency projects; the report proposes that more studies be carried out to investigate the socio-economic outcomes of community currency projects (Bendell et al., 2015). In my view, William Ruddick does not oversimplify the challenge of advancing financial inclusion and tackling poverty. He is cognizant of the difficulty in coming up with a community currency that will be widely adopted and has kept on adapting through the years to try and reach a more promising solution.

Another novel way that money is being reimagined is through virtual currencies, better known as cryptocurrencies. Cryptocurrencies surfaced in 2009 when Bitcoin was launched on the back of the 2008 financial crash which had left many disillusioned with the structure of finance and the monetary system at large. Cryptographers use cutting-edge computer science to develop a currency that is free of government control. At its inception, Bitcoin was projected to be the future of money and has gone on to dominate the discourse on moving beyond the conservative fiat money system. Bitcoin gets the most attention among its crypto peers due to its first-mover advantage. However, many private cryptocurrencies have been floated in the last decade. The number of actively traded cryptocurrencies is unclear, perhaps due to the collapse of a number of them. Cryptocurrency exchanges have also been launched to facilitate the buying and selling of cryptocurrencies.

Sceptical observers offer several criticisms about cryptocurrencies as a means of moving beyond fiat money. These criticisms range from its structure, usability, and the volatility of its value, to significant fraud instances. I will briefly highlight two of these drawbacks. The first is that cryptocurrencies are not currently used as a medium of exchange, the main function of money, but rather held as speculative assets. Cryptocurrency trading has invited hoarding and speculation, leading to significant volatility in cryptocurrencies' value which makes them an unreliable store of value. For instance, big spikes in the price of Bitcoin in recent years have cast doubt on the predictability of its value, even in the short term. Yermack (2015) observes that Bitcoin's volatility is significantly greater than the volatilities of popular currencies. The second major drawback of cryptocurrencies is the fact that they are impractical for commerce. Given that the primary function of money is being a medium of exchange, cryptocurrencies are ideally meant to facilitate mass consumer exchange. This means that in an ideal situation, cryptocurrencies should be more widely and equitably distributed and that businesses of all kinds would be willing to accept payment in Bitcoin, including the government for the payment of taxes. However, it is difficult and costly for the poor to access cryptocurrency. Also, few businesses accept payment in Bitcoin or other cryptocurrencies at the present time.

Central banks all over the world have been closely watching the development and growth of virtual currencies over the last decade. They have been most worried about what the rapid adoption of independent cryptocurrencies could mean for their ability to implement monetary policy and respond to what is happening in the economy. Central banks have also viewed the growth of cryptocurrencies as having the ability to weaken the banks' control of the financial system. With these concerns in mind,

central banks have in the last two to three years been scrambling to respond by creating their version of virtual currencies, central bank digital currencies (CBDCs).

The Bank for International Settlements, which has been monitoring the development of CBDCs worldwide, notes that 20% of central banks are likely to issue CBDCs over the medium term (within six years) while 80% of central banks are in various stages of research, piloting or development of CBDCs (Auer, Cornelli & Frost 2020). Central banks in the developing world have also been feeling pressure to act and have been racing to develop their own CBDCs. In early 2022, the CBK issued a discussion paper on central bank digital currency which sought to obtain views from the public on the potential applicability of a CBDC in Kenya (Central Bank of Kenya, 2022). Currently, there are discussions in Kenya about what CBDCs will portend for M-Pesa's quasi-monopoly, particularly if the use of CBDCs would lower or eliminate the cost of making digital payments and transferring money, if this would yield any benefits for financial inclusion, or whether CBDCs will simply be a digital equivalent of fiat.

Evidently, there are no easy solutions to the question of transcending the current monetary system. Complex questions arise when one considers the ability of each of these experiments to bring about true financial inclusion. These questions need to be addressed before too much faith is put in these experiments as tools for tackling poverty and inequality. What is clear is that while these innovations are not necessarily solutions unto themselves, they suggest the people's opposition to the monetary system which I argue is at the core of the financial inclusion project.

8.4 Summary of thesis

Financial inclusion was popularized by IFIs in the early 2000s as a definitive empowerment tool where financial institutions of different kinds would act as agents of poverty alleviation by extending their services to the poor. Many critics however have not shared in the confidence of the IFIs and other proponents of financial inclusion. Notably, accounts in the literature and praxis that back and oppose this claim have often done this without much engagement with the people on the ground. This thesis has explored financial inclusion from the lenses of people who directly experience two of the most important lending models in Kenya.

The first lending model that this thesis has explored is the co-operative model. Co-operatives not only have a long and somewhat complicated history in Kenya but have also transformed tremendously over

the last two decades. These changes have been influenced by global developments, including the drive for financial inclusion. Two of the most material changes were the expansion of SACCO membership to those outside the common bond and the offering of banking or FOSA services to non-members. SACCOs that made this leap hoped that more people would access financial services which will have some poverty reduction impact and simultaneously ensure the financial security of the SACCO. Indeed, some SACCOs found security after doing this, but this represented a small minority, roughly 10% of Kenyan SACCOs. Today, a majority of SACCOs, some who made this leap and some who did not, find themselves financially vulnerable. The thesis argues that the fundamental reason for this is that membership in a SACCO or the use of FOSA services requires the poor to have savings which they often do not have. This thesis argues that the fragile state of a majority of Kenyan SACCOs and the evolution of SACCO membership and services have not done much to advance financial inclusion.

The second lending model this thesis has dealt with is the digital lending model. The inception of mobile money in 2007 and its rapid adoption were seen by IFIs and other observers as path-breaking and leading quickly to other mobile-based financial services including digital credit. Nowhere is this more evident than in Kenya. Digital lending emerged in 2012 and has been growing rapidly over the last five or so years. In the last decade, digital credit has indeed reached the people at the bottom of the pyramid in Kenya. However, this thesis has shown that digital loans have proved harmful in the long run for these low-income borrowers. This is primarily because low-income borrowers routinely use digital loans for day-to-day household consumption and financial emergencies. Indeed, the small size and short tenure of these loans precludes them from being used for more productive or income-generating purposes. Consequently, many low-income borrowers in Kenya have become heavily dependent on digital loans as evidenced by loan stacking and over-indebtedness among this category of borrowers.

This thesis has also shown that moderate to high-income borrowers also use digital loans. However, their interaction with digital credit is vastly different from that of low-income borrowers. Moderate to high-income borrowers use digital loans mostly as a convenient tool. Their higher level of expectation and relatively higher and predictable incomes make digital loans relatively insignificant in their financial and social lives. It is argued here that the financial inclusion discourse has little to do with convenience borrowing by high-income individuals but rather is meant to address poor borrowers who have no other access to credit. This thesis argues that simply lending to the poor does not impact critical variables that could enable the poor to improve their livelihoods through entrepreneurship or similar

means. In this view, proponents of financial inclusion overestimate what digital loans are, what they can do, and to whom they are useful. The thesis shows that many industry insiders are becoming less and less confident about the wisdom of this financial inclusion strategy and have started to reverse course.

The futility of financial inclusion efforts in the last two decades, as demonstrated above, brings us to the issue of money. This thesis has argued that the problem of financial exclusion is symptomatic of a much bigger problem, which is the current monetary system. This is because consumer credit fuels monetary systems globally. In other words, new money is conjured into existence by issuing more debt which is sold to poor people as a way to access finance and escape poverty. This thesis shows this is not the case.

This thesis concludes by highlighting the changing landscape of money and several alternatives proposed to bypass the current monetary system. Whether community currencies, cryptocurrencies, CBDCs, or mutual credit exchanges are suited to replace or improve upon existing monetary and financial infrastructure is less clear for now. Nonetheless, these experiments demonstrate society's readiness to devise ways that go against the formal financial system. With this in mind, we need a clearer understanding of which of these experiments are good for the people and which ones are not. Most importantly, we need to understand what financial inclusion dividends are likely to accrue from these proposed new ways of thinking about money.

In the end, I venture to argue that monetary reform is possible, even if only as a futuristic prospect, and that it could provide a more credible path to true financial inclusion. However, I conclude that if we rely on conservative institutions, the elite, or the state to lead this change, we will not get far. Real monetary reform will require broader alliances and collective action by the people, the financially excluded, who best understand their circumstances.

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APPENDICES

Appendix I: Summary of pseudonyms

Pseudonym	Description
AC loans	A local non-bank digital lending platform that started in 2019 and collapsed in 2020
Aisha	A fresh law graduate who is newly employed. A digital borrower and a member of the medium-sized Sheria SACCO
Auditor SACCO	A small and successful closed-bond SACCO with roughly 450 members who are well-paid finance professionals
Bankers SACCO	A small and successful closed-bond SACCO whose members are well-paid banking professionals
BCK loans	A large bank-based digital lending platform
Biashara Credit	A digital lending platform offering credit in form of inventory to MSMEs
Big 4	A professional services firm whose employees started Auditor SACCO
Brian	A gig worker who gets a moderate income. A digital borrower and a non-member customer of the large open-bond Mwalimu SACCO
Church SACCO	A medium-sized open-bond SACCO which was started by members of a Nairobi-based church
City SACCO	A large open-bond SACCO with a large membership of roughly 100,000 and with four branches nationwide
Coffee SACCO	An open-bond SACCO with a large membership
Cop SACCO	A large open-bond SACCO with 6,000 members and eight branches

Fertilizer Limited	A medium-sized company on the outskirts of Nairobi City specializing in the manufacture of fertilizers and related products
Fertilizer SACCO	A small, struggling closed-bond, employer-based SACCO which draws its membership from staff of Fertilizer Limited
Jeanne	Techie, closely involved in the development of various digital lending platforms. Currently manages a large non-bank digital lending platform (Pioneer Nanoloans)
John	Manager of a small digital lending platform (Kash loans) and a former moneylender
Leah	Manager of the small closed-bond Auditor SACCO
Lydia	Tech entrepreneur and founder of Biashara Credit
Kash loans	A local, non-bank digital lending platform
Magale Senior	Retired co-operative practitioner who worked for the Co-operative Registrar's office for over thirty years
Makosa	An over-indebted digital borrower, currently employed as a guard with low income
Meyo	Former banker currently working as an independent consultant, runs a financial academy and writes a column on personal finance
Odongo	A digital borrower running his own boda-boda taxi business
Omollo	Retired co-operative practitioner, worked for Co-operative Registrar's office for over twenty years and headed the credit department for a SACCO for over ten years
Patrick	Manager of Fertilizer SACCO, a small closed-bond, employer-based SACCO
Patel	A Manager at Fertilizer Limited and a member of Fertilizer SACCO

Pioneer Nanoloans	An international non-bank-based digital lending platform
Sarah	FOSA branch manager at the medium-sized Uni SACCO
Shirley	A financial services consultant, formerly a Banker and CEO of a Microfinance Institution
Siaya	Manager of the large deposit-taking Cop SACCO
Sino loans	Chinese-owned non-bank lending platform
Uni SACCO	Medium-sized open-bond SACCO with roughly 6,000 members and four branches
Vicar	A credit officer working for Church SACCO
Vivienne	Member of a closed-bond SACCO, employed as a banker with a high income