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FOCUS NOTE

Digital credit in Kenya:

Facts and figures from FinAccess 2019

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Creating value through **inclusive finance**

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Introduction

Since the launch of M-Shwari in 2012, the number of digital lenders and loans disbursed has grown substantially. Advances in credit scoring, few regulatory barriers and the widespread use of mobile phones and mobile money have enabled growth of the digital lending industry, giving borrowers a quick and convenient option for credit.

However, industry practices around pricing, marketing and debt collection have raised concerns. In addition, the widespread negative listing of digital borrowers in credit reference bureaus points to the difficulty many borrowers have in repaying digital loans. The objective of this note is to contribute to this discussion by drawing on nationally representative survey data to contextualize the use of digital loans in the broader credit landscape.

Throughout this note, digital loans are used a shorthand for loans obtained via mobile banking (for example, M-Shwari and KCB-Mpesa) or a smartphone app (for example, Branch and Tala). Airtime advances and other forms of digital borrowing (such as Fuliza) are not included in the definition of digital borrowing[1].

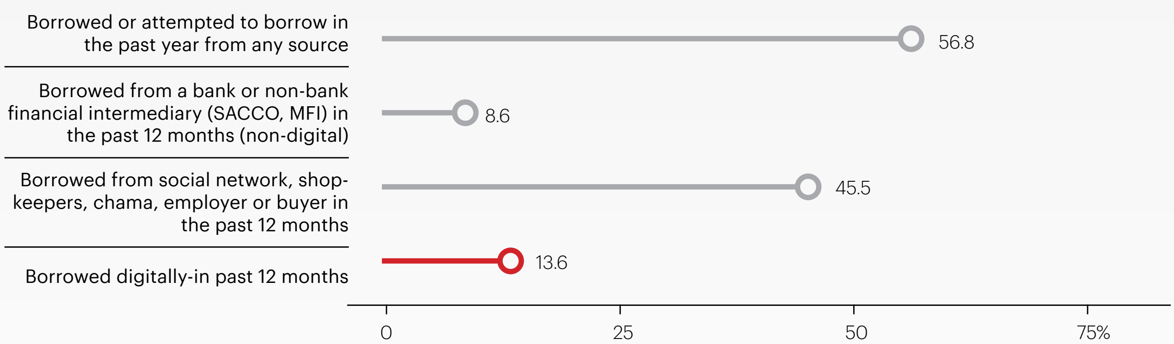
How prevalent is digital borrowing among adults?

The latest FinAccess survey conducted between October and November of 2018 found that 13.6 percent of adults (18+) nationally (3.42 million adults)[2] had used a digital (mobile banking or app) loan in the year prior to the interview. To put this into context, consider that 9 percent of adults reported using a traditional loan from a bank or non-bank financial intermediary and 45 percent of adults reported using a loan from informal sources such as friends or a community savings group in the past year. (See **Annex 1**)

Figure 1: Borrowing prevalence

The demand for credit is widespread and primarily met by informal sources, but a substantial share of that demand is being satisfied through digital credit

% of adults who used a loan in the past year by source of loan



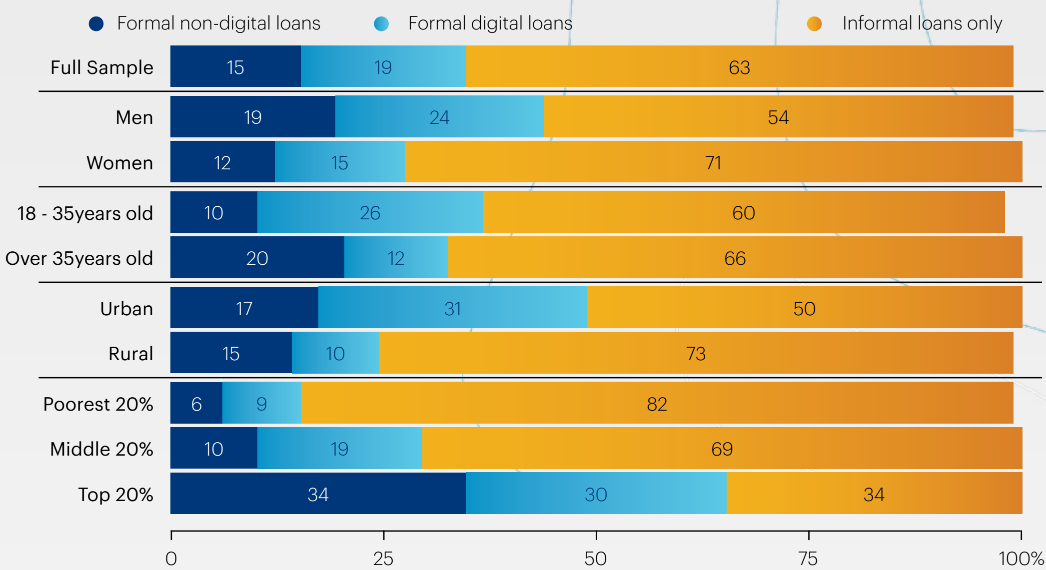
Source: 2019 FinAccess household survey (Nationally representative sample of 8,267 adults ages 18 and above)

1. To enforce this definition, individuals who reported using an app loan who did not report owning a mobile phone with the ability to download and install applications were not considered digital borrowers. In addition, reported digital loans that were less than Ksh 100 in size were dropped from the analysis. See annex for more details.
2. The sampling frame for FinAccess (NASSEP V) was derived from the 2009 Census, but the sampling weights have been adjusted so that the weighted adult population (18 and above) represented in the survey matches the projected population of 25,104,968 (for 2018, KNBS estimate).

Figure 2: Formality of loan use

For 1 in 5 borrowers digital loans are the most formal loans in their portfolio.

The share of borrowers in one of 3 mutually exclusive groups defined by the most formal loan used by the borrower



For 19 percent of borrowers, digital loans are the only formal, institutionally sourced, loan they use and nearly one in ten borrowers rely exclusively on digital loans to meet their financing needs.

Source: 2019 FinAccess household survey (Nationally representative sample of 8,267 adults ages 18 and above)

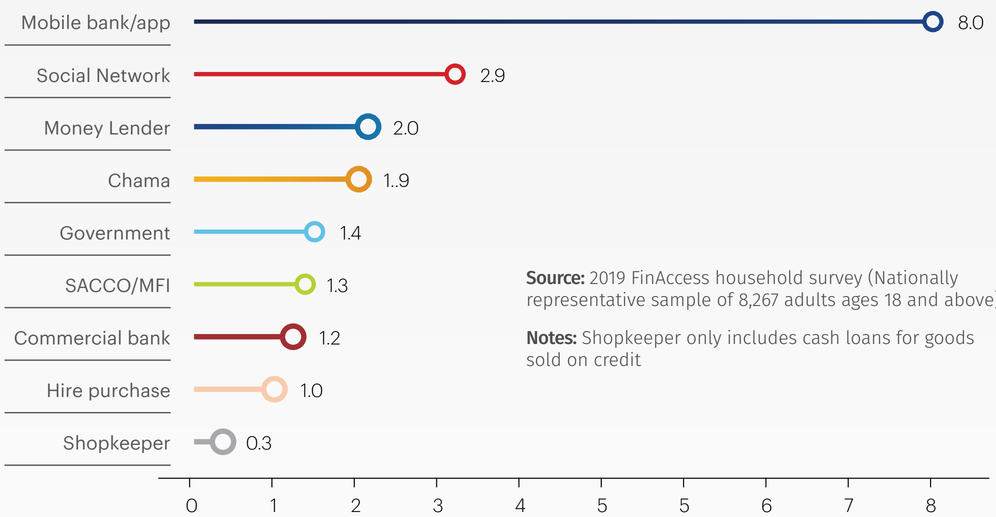
How large is the market for digital loans?

Digital borrowers reported taking an estimated total of 25 million[3] digital loans or 8 loans per borrower in 2018, on average (the median was 2)[4]. However, the distribution of yearly digital loans used is concentrated among a minority of digital borrowers: 80 percent of all digital loans used in the past year were taken by just 24 percent of digital borrowers.

Figure 3: Average number of loans per person

Digital loans are the most recurrently used loan in Kenya, behind social network and money lender loans

Average number of loans per person taken in the past 12 months, by source of loan



Source: 2019 FinAccess household survey (Nationally representative sample of 8,267 adults ages 18 and above)

Notes: Shopkeeper only includes cash loans for goods sold on credit

3. It is important to note that all estimates from FinAccess draw inferences about the total population of adults or loans from a sample, unlike a population census or supply side data, the estimates presented here are probabilistic and carry uncertainty. The likely range of the total size of the yearly digital lending market by volume is 15.4 to 29.6 million loans per year. Under simple assumptions, by value, the total size of the digital lending market is likely to be in the range of KSh 39 and KSh 195 billion.

4. The median number of loans per digital borrower is 2. The 24 percent of digital borrowers that are responsible for 80 percent of the demand for digital loans annually were observed to take between 6 and 500 loans per year.

Figure 5: The market for cash loans in Kenya

Due to repeated, high frequency borrowing, digital loans are the single most common type of loan (formal or informal) in use, accounting for a majority (54 percent) of the total observed market for yearly loans by volume[5].

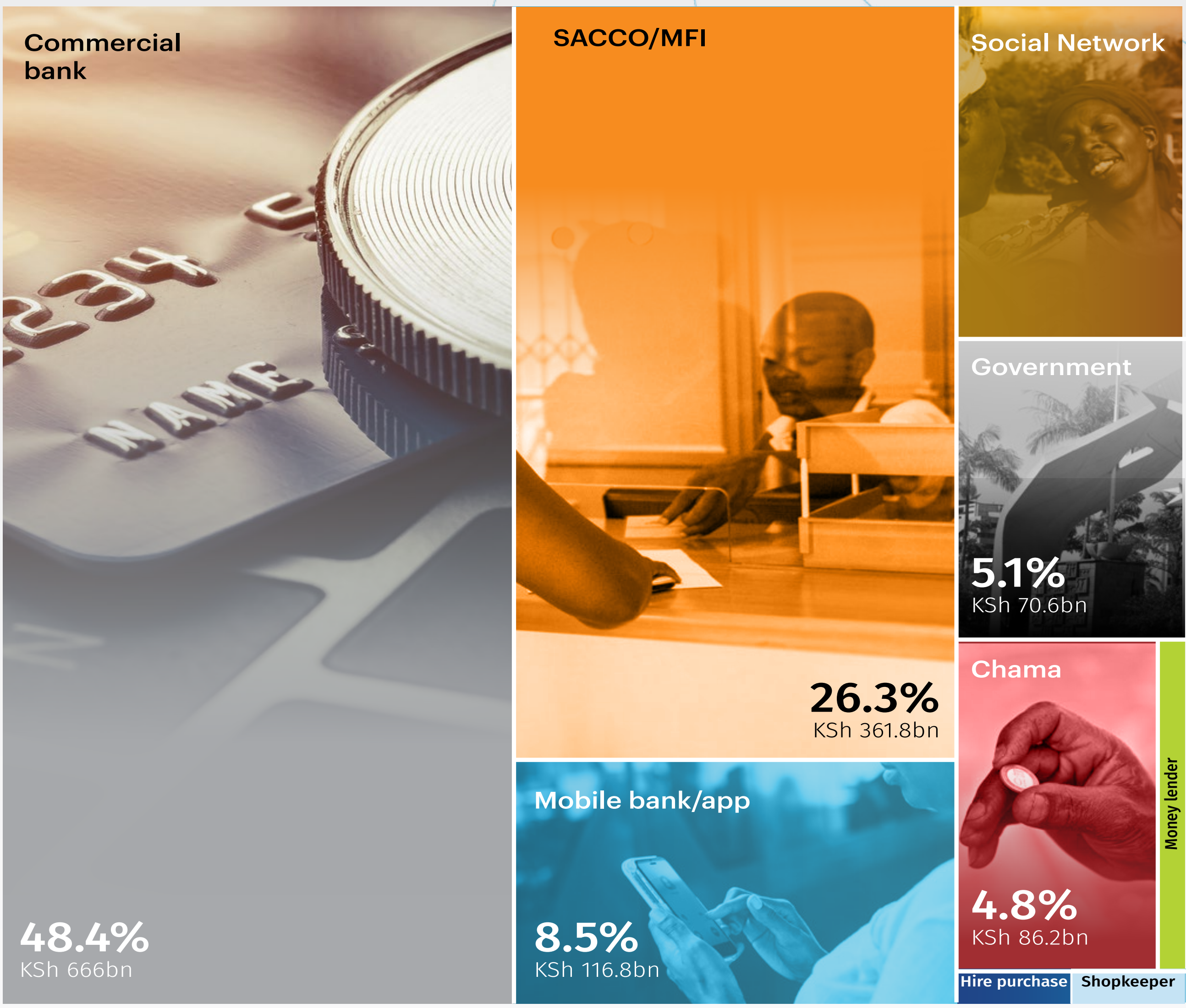
Total yearly volume of loans disbursed by lender

5. This analysis excludes shopkeeper credit for goods/services sold, loans/credits from buyers of harvests and credit card loans for which number of loans taken in the past year was not obtained.

Figure 6: The market for cash loans in Kenya

The total estimated value of digital loans disbursed to borrowers in 2018 was KShs 116.8 billion - or KShs 37,464 per digital borrower per year on average[6]. Digital loans represent just under 9 percent of the total observed market for loans by value and are the third largest source of credit by value after non-digital commercial bank loans and loans from SACCOs/MFIs.

Total yearly value of loans disbursed by lender



6. This estimate assumes that the most recent loan taken by digital borrowers (for which detailed data was taken) represents the typical amount borrowed per loan in the past year.

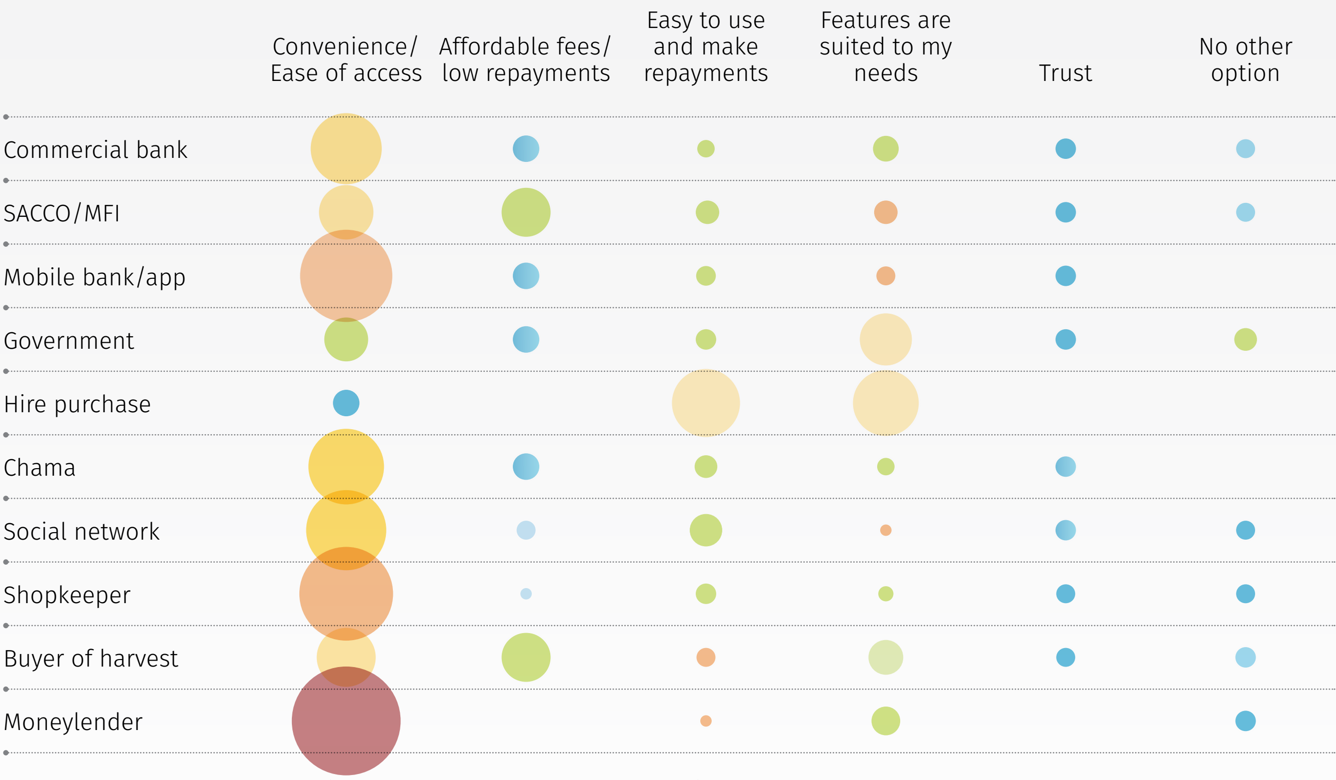
Who uses digital loans and why?

Nearly 2 in 3 digital borrowers report convenience/ease of access as the main reason for choosing digital loans. However, less than 5 percent of digital borrowers report trust as the main reason they borrow digitally compared to the nearly 10 percent of commercial banks, social network or chama borrowers who cite trust as a main reason for borrowing from those sources.

Figure 7: Drivers of loan use

Mobile loans are predominantly taken because of their convenience and ease of use

% of loans used by reason loan is preferred and source of loan



Source: 2019 FinAccess household survey (Which recorded a total of 7,668 currently in use). **Notes:** Only reasons make up at least 2.5 percent of loans by lender are shown

The demographic and socio-economic features that most distinguish digital borrowers from other borrowers are age, household location and income. Like borrowers who use formal financial intermediaries (banks, SACCOs, MFIs) digital borrowers are predominantly male (60 percent) but unlike other formal and even informal borrowers, digital borrowers are predominantly under the age of 35 (62 percent). Digital borrowers are more heavily concentrated in urban areas (67 percent live in urban settings versus 44 percent of other formal and 34 percent of informal borrowers).

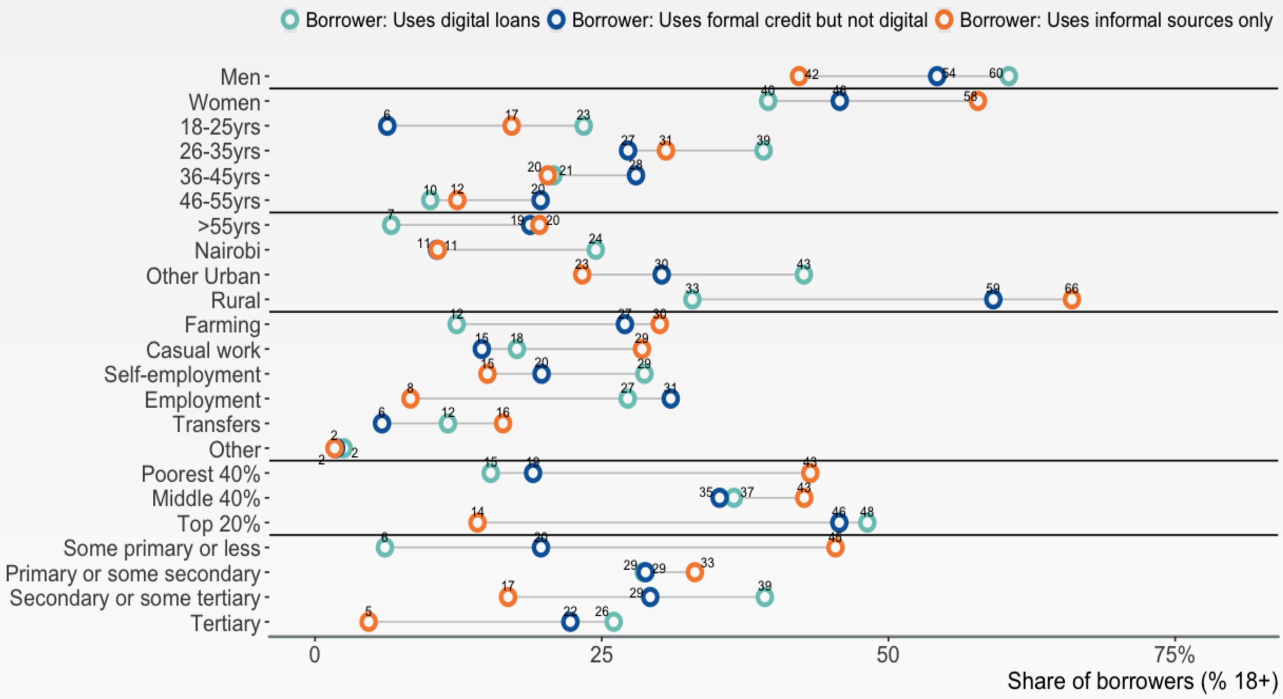
A majority of formal non-digital borrowers derive most of their income from farming or employment (70 percent), and a majority of exclusively informal borrowers derive most of their income from farming or casual work (58 percent). But the distribution of digital borrowers among livelihood categories is more uniform: self-employed individuals constitute the single largest category (29 percent) by a small margin over employed individuals (27 percent).

In terms of income, digital borrowers occupy a middle ground between exclusively informal borrowers who fall predominantly at the lower end of the income distribution and formal (non-digital) borrowers who fall mostly at the upper end of the distribution. The average self-reported monthly income of digital borrowers is KShs 20,120 compared to KShs 7,705 among exclusively informal borrowers and KShs 28,608 among other formal borrowers.

Figure 8: Use of loans by population sub-group

Compared to other formal borrowers, digital borrowers are more likely to be younger, live in urban areas outside of Nairobi, be casual workers and have incomes among the lowest 60% of the distribution.

% of adults who used a loan in the past year by gender, age, location, livelihood income group and educational attainment



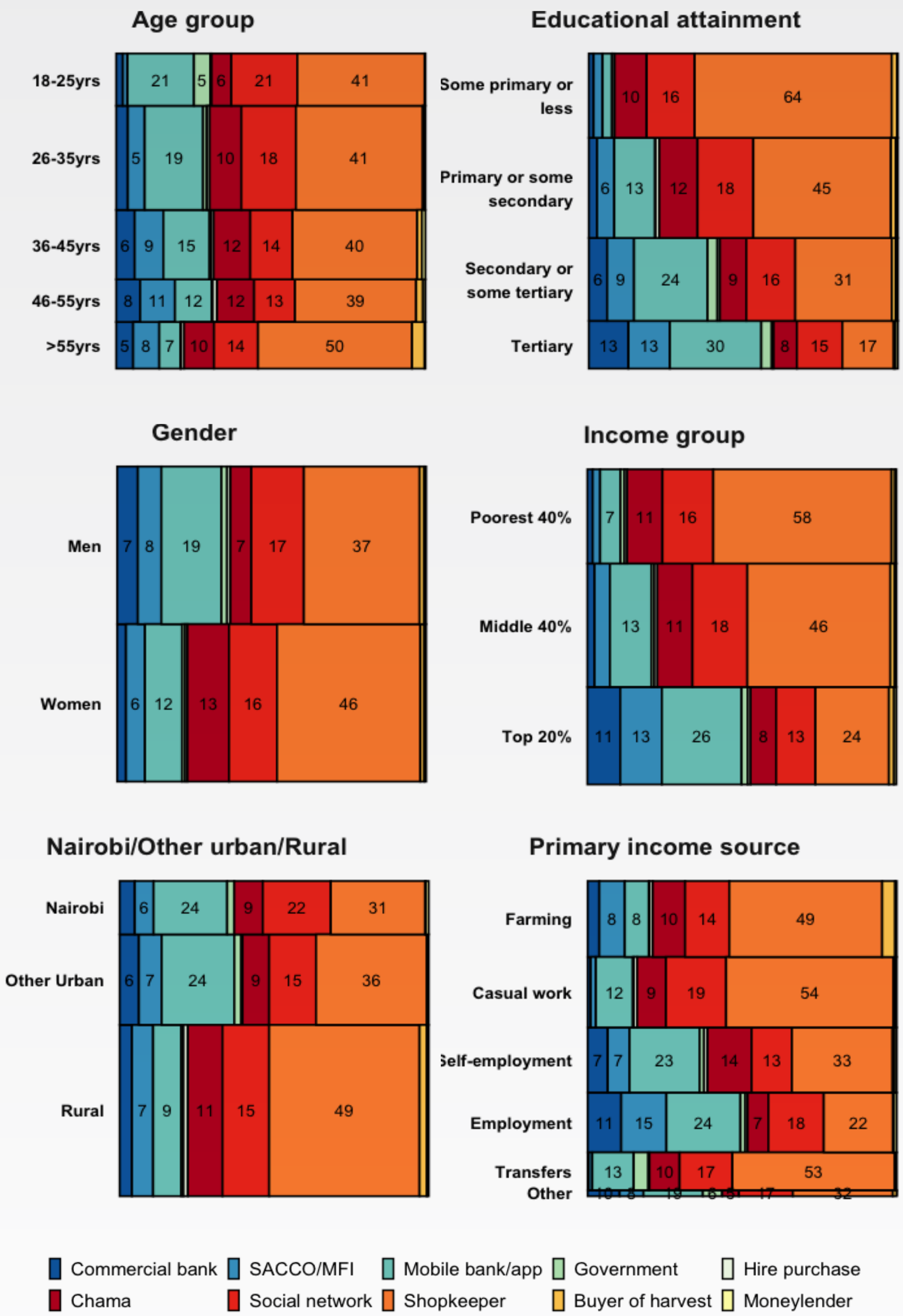
Source: 2019 FinAccess household survey (Nationally representative sample of 8,267 adults ages 18 and above). Notes: Tertiary denotes population subgroup that completed university or technical training.

For Kenya's top 20 percent of income earners, university or technical training graduates and the employed, digital loans are the single most common current or recent loan in use, representing at least 25 percent of loans in use for these population segments.

Figure 9: Loan profiles for population sub-group

For the top 20% of earners, university or technical training graduates, and the employed, digital loans represent the single most common source of credit.

% of loans from 10 lender categories by population sub-group



Source: 2019 FinAccess household survey (Which recorded a total of 7,668 loans currently in use).
Notes: Labels represent the percentage of loans sourced from a specific lender. The width of the bars represents the share of borrowersin each population sub-group.

How large is the typical digital loan and what is it used for?

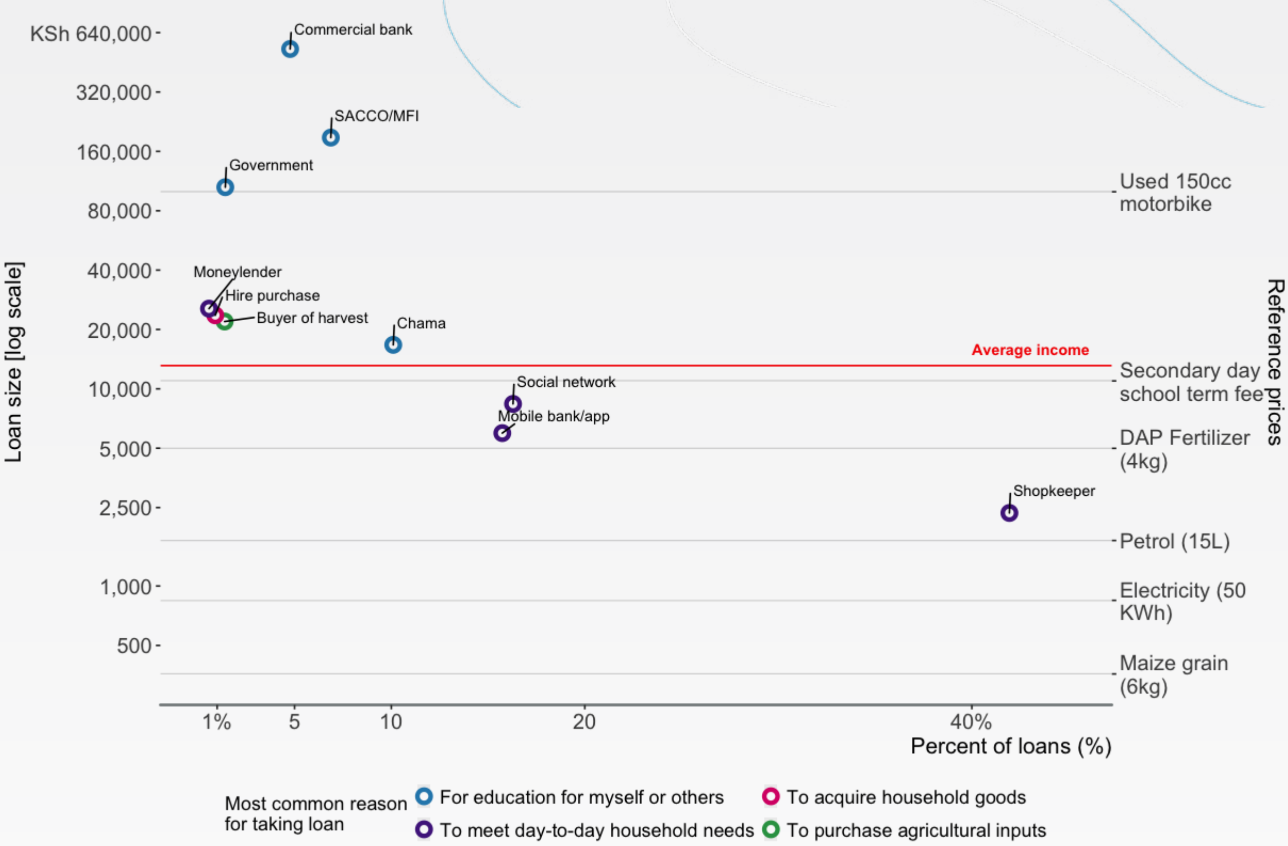
The average size of digital loans[7] is in the range of KShs 4,588 – 7,336[8] (or 42 – 62 percent of the monthly incomes of digital borrowers[9]), but as the distribution is characterized by a few borrowers who can borrow large amounts[10], the median loan size is KShs 2,500. Digital loans are most commonly used for meeting day-to-day household needs[11] (44 percent of digital loans in recent use) and emergencies (29 percent of loans in recent use).

Digital loans most closely resemble social network and shopkeeper loans in terms of their size and most common use case. Other formal loans, such as non-digital loans from commercial banks, SACCOs or MFIs, tend to be significantly larger (in the range of KShs 80,000 to 600,000) and are most commonly used for education and business or farm investments.

Figure 10: Size and prevalence of loan, by lender category

75 percent of loans currently in use are from 3 sources (shopkeepers, mobile banking or app and the social network), typically range from Ksh 2,000 - 10,000 and most commonly used to meet day-to-day household needs.

Average size of loan vs. percent of loans currently in use, by lender



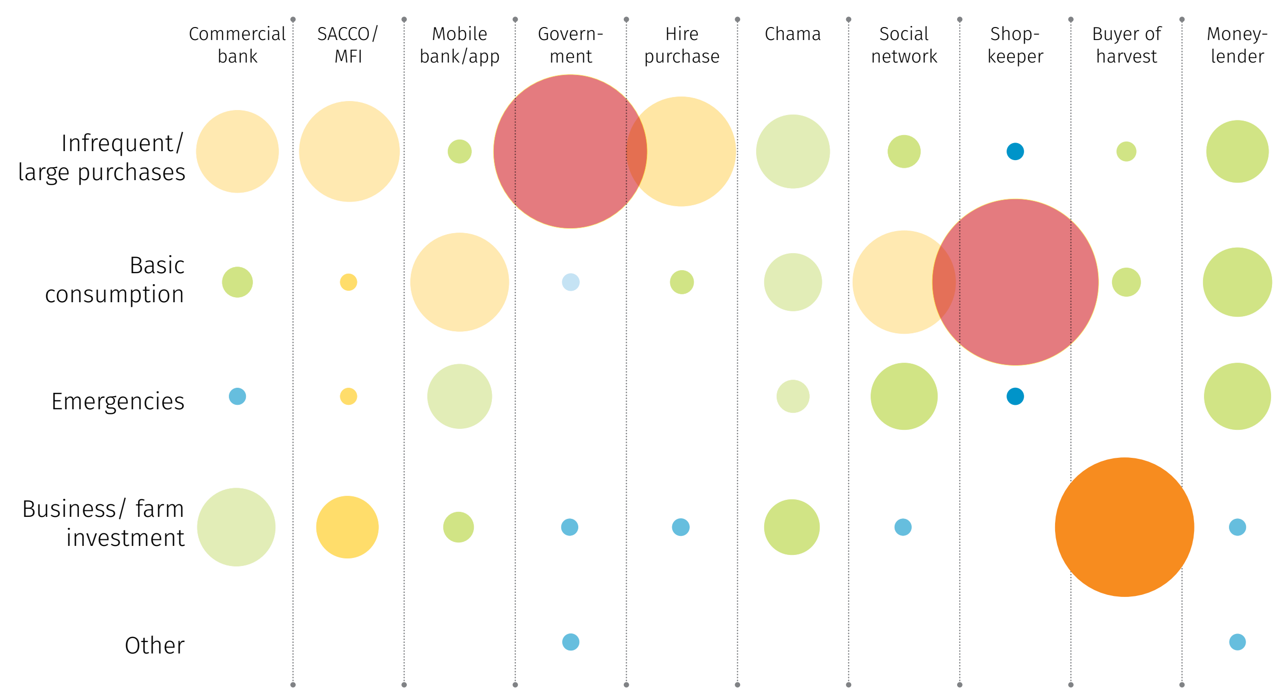
Source: 2019 FinAccess household survey (Which recorded a total of 7,668 loans currently in use). **Notes:** Reference prices for Petrol, Electricity and Maize grain were obtained from the 2019 Economic Survey. The average price for a used 150cc motorcycle (e.g Boxer) was estimated from on-line classifieds. The out-of-pocket secondary day school term fee was obtained from the Kenya Ministry of Education

7. Among loans currently or most recently in use by digital borrowers.
8. This range is the 95% confidence interval of the mean loan size among outstanding or most recent digital loans. The point estimate for the mean digital loan size is KShs 5,962. In the data, the smallest recorded digital loan was KShs 100 and the largest was KShs 300,000.
9. The mean monthly income among individuals who have used a digital loan in the past year is in the range of KShs 18,301 – KShs 25,647.
10. This also relates to the fact that in an environment where digital credit adoption is rising quickly a cross-sectional survey will "net" relatively new users with a limited borrowing history (and thus an opportunity to raise their loan limits).
11. Uses for loans are implied from responses to the following survey question "What was your main reason for taking this loan?".

Figure 11: Use of loan, by lender category

Like social network loans, mobile loans are predominantly used for day-to-day household needs and emergencies.

% of recent loans by use-case loan is used and lender (%)



Source: 2019 FinAccess household survey (Which recorded a total of 7,668 currently in use).
Notes: Only reasons make up at least 2.5 percent of loans by lender are shown

Do digital borrowers face greater repayment stress than other borrowers?

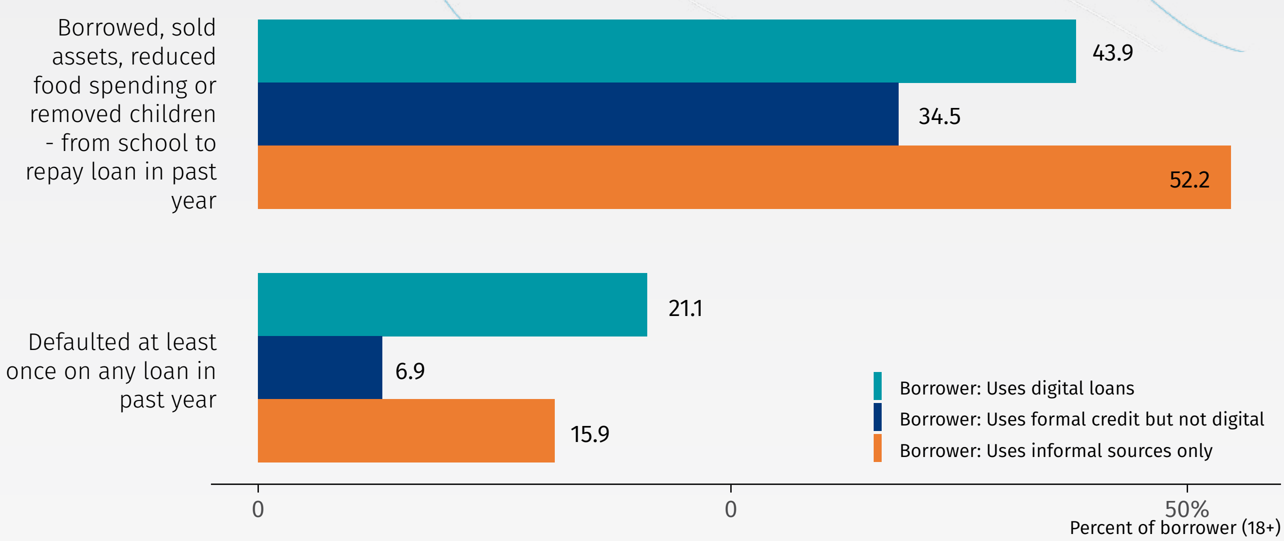
Digital borrowers are more likely to show signs of debt stress than other formal borrowers (who do not use digital loans), but show similar levels of debt stress to exclusively informal borrowers. Nearly 1 in 2 digital borrowers reported having had to borrow more, sell assets, reduce expenditure on food or take a child out of school to repay a loan in the past 12 months.[12]

However, digital borrowers are nearly twice as likely to default on any loan: 21 percent of digital borrowers reported defaulting on at least one loan from any lender in the past year, compared to 13 percent of all other (non-digital) borrowers (including informal). 14 percent of digital borrowers reported defaulting specifically on a mobile banking or digital app loan in the past year. (see **Annex 2**)

Figure 12: Indications of debt stress

Indicators of repayment distress for digital borrowers resemble those of informal borrowers more than other formal borrowers, and default rates among digital borrowers are especially high.

Prevalence of adverse repayment and default (% of borrowers) by type of borrower



Source: 2019 FinAccess household survey (Nationally representative sample of 8,267 adults ages 18 and above).

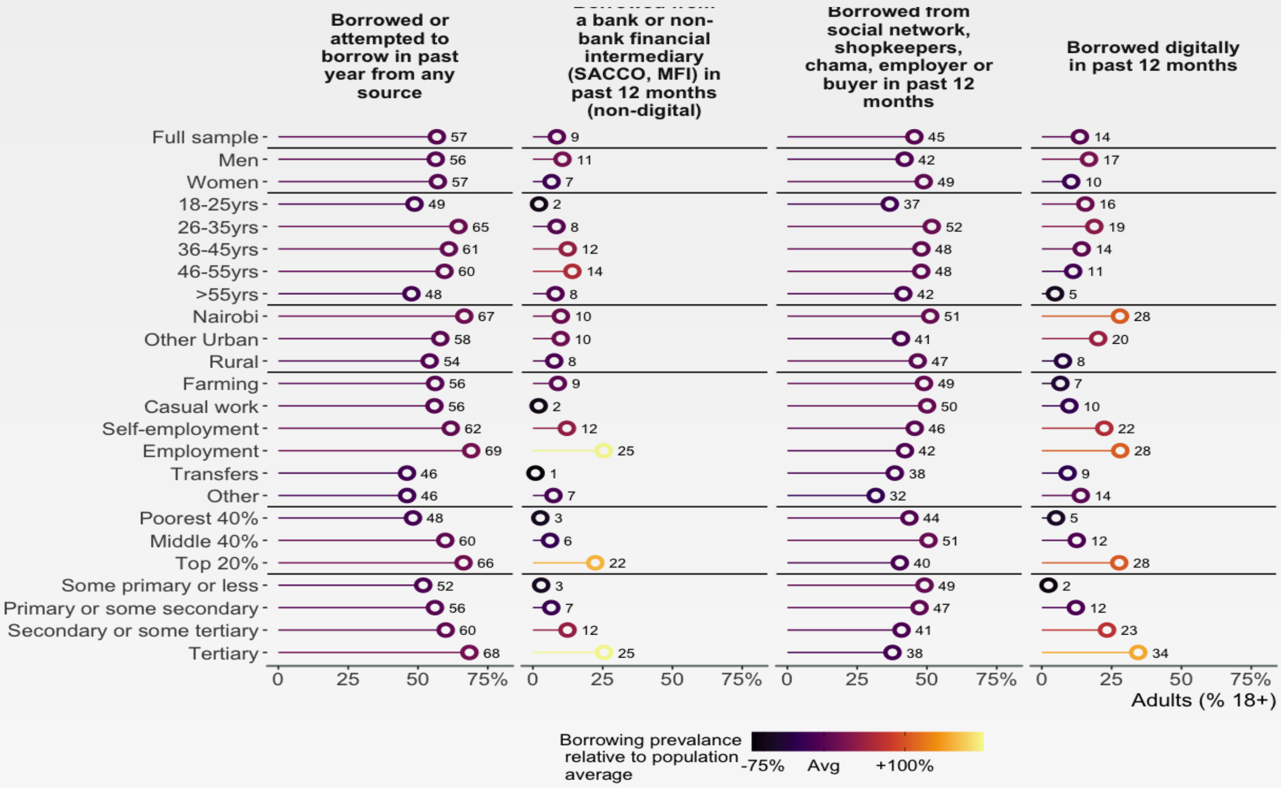
12. 47 percent of digital borrowers report using a potentially adverse repayment strategy compared to 48.7 percent of all non-digital borrowers – these differences are not statistically significant, but the differences are significant comparing digital borrowers to other formal borrowers and informal borrowers separately.

Annex 1: Detailed charts

Figure 13: Borrowing prevalence by source of loan and population subgroups

The demand for credit is widespread and primarily met by informal sources. Access to all formal and digital loans varies widely by livelihood, income and most prominently, educational attainment. For example, only 2 percent of adults with some primary schooling or less have used digital loans in the past 12 months compared to 34 percent of adults with tertiary education.

% of adults who used a loan in the past year

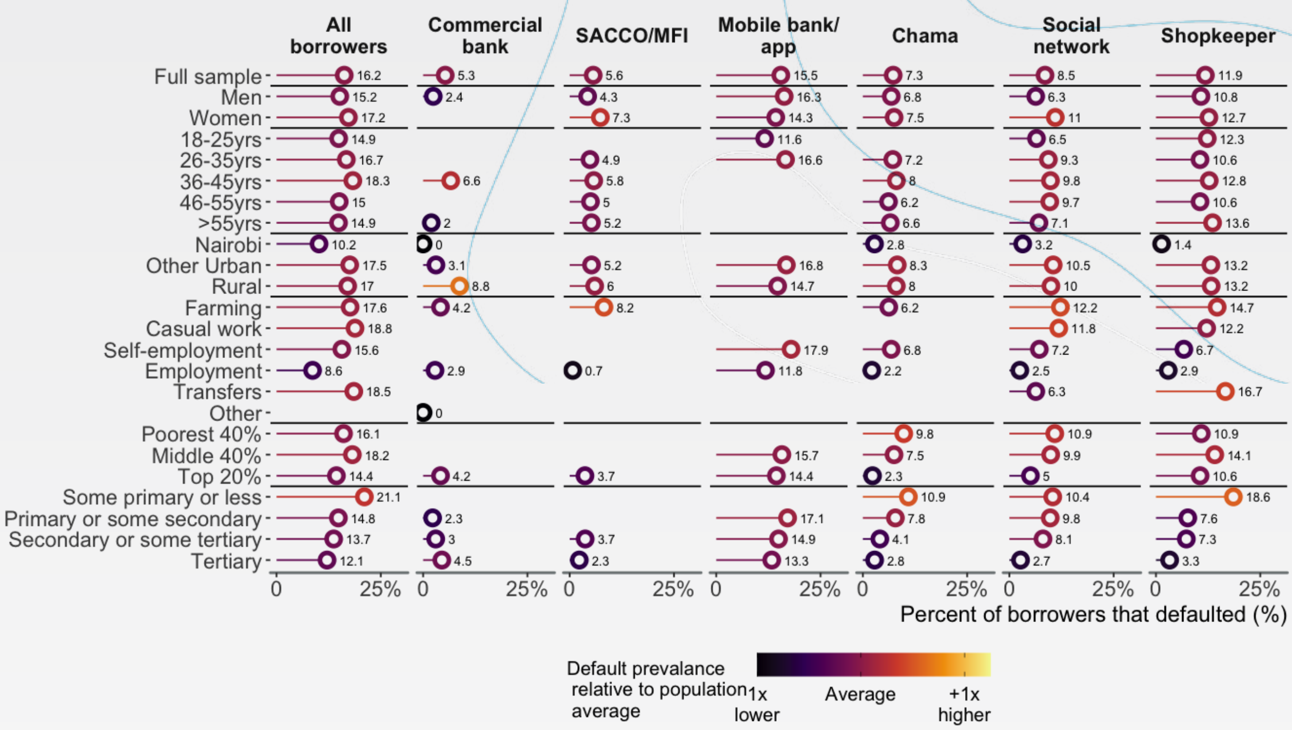


Source: 2019 FinAccess household survey (Nationally representative sample of 8,267 adults ages 18 and above). Notes: Tertiary denotes population subgroup that completed university or technical training.

Figure 14: Default rates by population sub-group

Sixteen percent of borrowers defaulted on a loan in the past year. Digital borrowers have the largest rate of default; commercial bank borrowers have the lowest.

Default prevalence among borrowers by loan in default and population sub-group



Source: 2019 FinAccess household survey (Nationally representative sample of 8,267 adults 18 and above).
Notes: Excludes default prevalence point estimates with a greater than 5 p.p margin of error. Default prevalence is defined as the percentage of 12-month active borrowers from a specific lender who reported defaulting on a loan from the lender in the past 12 months. This chart excludes borrowers of loans from government and money lenders. Tertiary denotes population sub-group that completed university or technical training.

Annex 2: Classification methodology

Indicators on the prevalence of digital borrowing (among adults) are derived from Section C of the FinAccess questionnaire which identifies for each respondent the range of financial services they use, based on the following question: "Do you currently use, used to use, or have never used, in your own name…".

To be classified as a digital borrower, individuals had to answer that they use either currently or used to use (in the past 12 months) one or both of the following: (a) a "Loan from mobile banking (e.g. Mshwari, KCB M-PESA, M-Co-op cash, Eazzy Loan, Timiza, HF Whizz)" OR (b) "Digital loans that you get through the phone that you download through apps (e.g. Branch, Tala, Utunzi, KopaCredo, Haraka loans etc.)".

Indicators on the size of the market for digital loans by volume and value are derived from a separate section (Section E) of the FinAccess questionnaire which asked all borrowers to list the most recent loan taken from each of the providers they reported as using in Section C. For each listed loan, additional information was obtained such as total number of loans taken in the past year, the size of the most recent loan and the reason for taking the loan (digital borrowers could report up to 2 digital loans if they used loans both from mobile banking or a mobile app-based lender). Among the 1,389 listed recent or active digital loans listed by individuals identified as 12-month active digital borrowers, 352 of those loans were reported as being less than Ksh 100 in size. Almost all of these loans were reported having been sourced from mobile app-based lenders). What this indicates is that some respondents were reporting airtime advances resulting from including in the questionnaire prompt "KopaCredo" which is Airtel's airtime advance services, which offers loans in the range of Ksh 5 to Ksh 1000. (Other MNOs also have airtime credit products e.g. Safaricom's lending service - Okoa Jahazi provides loans from Ksh 10 to Ksh 1000 and Equitel's airtime lending services, Jiokolee Credo, provides loans of Ksh 10, 20 and 50).

Out of the 633 respondents in the FinAccess sample who report using app loans in the past 12 months (Section C) 293 (46 percent) DO NOT report having a phone that can download and install applications. The fact that adults without smartphones were reporting using mobile app-based loans reinforces that the survey instrument captured more than just app-based borrowing (e.g. airtime advances).

Creating value through inclusive finance

About FSD Kenya

The Kenya Financial Sector Deepening (FSD) programme was established by the UK's Department for International Development (DFID) programme in 2001 to support the development of financial markets in Kenya. In 2005 we were constituted as an independent trust under the supervision of professional trustees, KPMG Kenya, with policy guidance from a Programme Investment Committee (PIC). Our aim today is to help realise a vision of an inclusive financial system to support Kenya's goals for economic and social transformation. We work closely with government, financial services industry and other partners across key economic and social sectors. The core development partners in FSD Kenya are currently the Bill and Melinda Gates Foundation and the Swedish International Development Agency (SIDA).

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