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Keynote Speech by Dr. Patrick Njoroge
Governor of the Central Bank of Kenya
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As Prepared for Delivery

Good morning! It is an honour for me to join you at the Kenya Bankers Association (KBA) Sixth Annual Research Conference. At the outset, let me applaud KBA for organising this annual conference over the last six years. The Conference provides an excellent opportunity for us to reflect on the Kenyan banking sector's transformation journey, its milestones, challenges and opportunities. The theme of the conference ***"Intermediation towards Deepening of Financial Inclusion"*** is especially fitting, given Kenya's progress on financial inclusion and pondering the challenges that lie ahead.

Allow me to begin my remarks by considering Kenya's recent experience on this front, and specifically, as concerns the banking sector in its role of financial intermediation. Over the past ten years, the proportion of the adult population in Kenya with access to formal financial services and products has risen from 27 percent in 2006 to 75.3 percent in 2016. This represents a remarkable achievement by any standard, and Kenya's success in financial inclusion has been widely acclaimed, locally and internationally. For instance, two eminent institutions recently recognised Kenya for its digital financial inclusion achievements. In July 2017, the Fletcher School at Tufts University ranked Kenya fourth out of sixty countries on the digital finance momentum index in its *2017 Digital Planet Report.*[1] In August 2017, the Brookings Institute ranked Kenya first in its annual

[1] https://sites.tufts.edu/digitalplanet/files/2017/05/Digital_Planet_2017_FINAL.pdf

Financial and Digital Inclusion Project (FDIP) scorecard, for the third year in a row.[2] These reports recognise Kenya's efforts to develop robust policy environments and regulatory infrastructure for the development of digital finance.

While the important role of financial inclusion in economic development cannot be overemphasized, Kenya's significant strides in this area may obscure some crucial blind spots. Let me highlight two of them.

- **First,** 25 percent of adults in Kenya still do not have access to any form of financial services. This is further reinforced by noting the large swathes of the country, particularly in the northern regions, that are largely devoid of financial services access points. Much work remains to be done.
- **Second,** while we have succeeded in enhancing access to financial services, we are lagging behind on other dimensions of financial inclusion, particularly on usage and quality. The usage of financial services needs to be enhanced, reversing a growing trend of dormant accounts in both banks and mobile phone financial services. Additionally, the growing consumer complaints against financial service providers is a clear indictment of the quality of financial services in Kenya.

Notwithstanding the continued integration of banking and non-banking services in recent years, the banking sector remains the primary channel for mobilizing financial resources towards productive investment. In this central role, therefore, the banking sector is uniquely placed to make a significant impact on financial inclusion, by increasing outreach and by addressing both price and non-price barriers to financial access. These barriers cut across the key service dimensions: proximity to financial access points, cost of services, and minimum requirements for accessing financial services.

Against this backdrop, how then will Kenya's banking sector deliver on deepening financial inclusion? To answer this question it is important to understand where the banking sector finds itself at this moment. We see Kenya's banking sector at an inflection point following a confluence of several domestic and external trends, the most obvious being those that led to the interest rate caps in September 2016. As we know, the road to interest rate capping was paved by the longstanding concern by the public about the high

[2] https://www.brookings.edu/wp-content/uploads/2017/08/fdip_20170831_project_report.pdf

cost of credit on the one hand, and the seeming blindness of banks on the other hand. The sector was seen as driven by the pursuit of supernormal profits on the backs of their customers who also felt mistreated and misinformed.

This is an important experience that banks and other stakeholders must learn from. Other significant trends that need to be considered include the high-paced innovations, the significant economic transformation that is expected, regional integration, etc. The question then is how will banks behave going forward, for instance, in an environment without interest rate caps? Will banks go back to their old ways? What will be different this time round?

In the remainder of this speech I want to set out the CBK's vision of a responsible and disciplined banking sector that will serve the needs of all Kenyans. Quoting the economist John Maynard Keynes, "*The difficulty lies, not in the new ideas, but in escaping from the old ones [which permeate]...every corner of our minds."*[3] Four planks underpin our vision.

First, the banking sector must become customer-centric. Banks must truly adopt customer-centric business models to compete successfully in the future. Products, channels and indeed pricing must be informed by customers' needs, preferences and affordability. Technology provides banks with the opportunity to intimately understand their customers, enabling them to map their customers' journeys end-to-end. This will facilitate the identification of friction points for customers, allowing prompt action by banks to remove them and enhance the customers' experience.

It is worth noting that even as banks embrace technology, their customers have the same expectations as other customers around the world and subject banks to the same standard they hold technology giants such as Apple, Amazon and Alibaba. Customers want fast and simple user experiences that serve their need. With data analytics capabilities, banks can use customers' digital footprints and identities to design suitable well-tailored products. Customer feedback obtained through tailored research could also be used to inform the

[3] John Maynard Keynes *The General Theory of Employment, Interest, and Money*, 1935

improvements that will enhance customer experience. Customer-centric models also require banks to identify cost savings that can be passed on to customers in the form of lower interest rates, commissions and fees. Finally, Customer Relationship Management must be at the heart of banks' business models.

It should also be acknowledged that the outlook of shareholders of banks is crucial for the move towards a customer-centric business model. Part of the implicit cost in the current business models relate to shareholders' expectations of the Return on Assets (ROA)/Return on Equity (ROE). High ROA and ROE expectations when priced into a banks model inevitably raise the costs of product delivery. There has been concerns about the Kenyan banking sector's high average ROA of above 3 percent and ROE of close to 30 percent, when compared to similar economies. Shareholders must therefore temper their ROA and ROE expectations if banks are to deliver affordable products. In any case, the high ROAs and ROEs are not sustainable in the long term as customers cannot afford the high cost of banking services indefinitely.

Second, risk-based credit pricing is imperative. In CBK's vision, customer credit histories must amount to something. Good credit histories portend a less risky customer and therefore lower interest rates. Customers cannot be treated with a broad brush, focusing on the few defaulters while not rewarding the majority of customers who have good credit histories.

The rationale of credit information sharing is to address information asymmetries and enable banks to more effectively price credit risk. Credit Reference Bureaus, banks, and other stakeholders must work together to develop credible credit scores that are incorporated in credit risk appraisal and pricing models. Technology is also providing interesting opportunities to gather customer information through digital identities and footprints that can add to the traditional sources of credit information. On its part, CBK will support this vision by creating an enabling legal and regulatory environment that expands the sources of credit information, ensures data accuracy, and supports an effective resolution of customer complaints.

Third, transparency and information disclosure need to be enhanced. Customers are increasingly demanding transparency and disclosures on interest, fees and charges. On their part, banks must fully disclose their interest rates, charges and particularly the fees that customers perceive as hidden. Transparency and disclosure by banks should be a way of business and not just a regulatory requirement. Technology offers an opportunity to enhance transparency and information disclosures.

A case in point is the cost of credit website that was launched by CBK and KBA in June 2017. The information on this website will be expanded in the future beyond the three loan products that are shown currently, to cover a broader range of loan products and even incorporate deposit products. Moving further, a banking price index of a commonly used basket of products and services can be developed to further enhance customers' comparability of prices of banking products and services.

Customer confidence can only be achieved when they are able to fully understand the true cost of banking products and services. This will allay the ever-present fear of banks hiding some costs up their sleeves, out of sight of customers who only come to know of them much later when they are already in distress.

Fourth, banks need to do the right thing. At the heart of any transformation are people. Without a change of attitude and behaviour by Kenyan and other bankers around the world, any transformation will be futile. The global financial crisis and its aftermath underscored the need to raise the ethical standards of bankers. For instance, the scandals on the fixing of the LIBOR and other rates in Europe, and more recently the exchange rate fixing scandal in South Africa, brought to the fore the greed and deceit that ravaged the global banking industry.[4] To address these shortcomings, there is a recognition of the need for ethics in banking. Ethical banking requires that the needs of society trump those of other stakeholders including shareholders. Banks exist to serve the societies they operate in, and societal needs and aspirations must therefore be at the forefront of every banker's mind. Naturally, these require a change of mind-set by Kenyan bankers beyond the often

[4] On the LIBOR fixing scandal, see for instance, David Enrich, *The Spider Network*, HarperCollins, 2017. On the exchange rate fixing scandal in South Africa, see *Sunday Times* (South Africa), February 19, 2017.

token and symbolic corporate social responsibility initiatives. Bankers should weigh profit targets against what is right and just for the Kenyan citizens that the banks serve.

Undoubtedly, Kenya's banking sector is at a critical juncture. Will it withstand the raging storms or will it be swept away like flotsam in the tides of time? I am confident that the sector will withstand the tempest and reach safe harbour, demonstrating the resilience that has been its hallmark since the first bank—the National Bank of India—opened for business on the Kenyan shores in 1896. The railway from Mombasa to Kampala, the "*Lunatic Express,"* was then under construction. The sector has withstood two world wars and other geo-political shocks, has been there through the struggle for independence, the oil crisis and coffee boom of the 1970's, the Asian financial crisis in the late 1990s, and the global financial crisis. The sector has always transformed itself in these and other circumstances, led by worthy captains of the industry.

As I finish, the challenge I pose to the Kenyan banking sector is, *what will be different this time round?* We must respond convincingly to this question to win the trust of Kenyans and beyond.

I wish you fruitful deliberations over the next two days and I look forward to the outcomes of the conference.

Thank You!