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M-Pesa – Mobile Banking in Kenya

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"M-Pesa is not a charity project. It's actually good business and good for society."
Arun Sarin, CEO of Vodafone Group Plc

John Smith, a consultant at a leading management consulting firm, continued to pore over the fact sheets and reports in front of him. He had to provide his recommendations to the Board of Safaricom on what to do with M-Pesa, one of the company's brightest stars. Over the past few years, M-Pesa had taken Kenya by storm. The product allowed for the electronic transfer of money to and from mobile phones via SMS. Originating from the idea of using mobile technology to help customers make payments to microfinance institutions, M-Pesa had transformed into a nationwide money transfer service used by a large portion of the Kenyan population.

With millions of users and revenues soaring every year, it had slowly become the crown jewel of Safaricom. Given the increased competition in the Kenyan market – which resulted in a substantial decrease of the profitability of the traditional airtime business – the top management of the company was very eager to use the capabilities of M-Pesa to expand the services offered and explore new opportunities. In recent months, the service has been started in Tanzania, where Vodafone, Safaricom's parent company, also had a subsidiary. Despite an intense awareness campaign, the adoption of M-Pesa in this country has been moderate. As a result, the company has been reconsidering the whole strategy of how and when to extend the service to other countries where Vodafone is present, including South Africa.

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Kenya's Socio-Economic Environment

The Republic of Kenya is located in East Africa. The country has a population of around 38 million people distributed over a total area of 580,367 km^2. The country is subdivided into 47 districts, each having its own semi-autonomous government, with a central government located in the capital of Nairobi.

The nominal GDP of Kenya - $29.56 billion in 2010 - was the largest in East and Central Africa, and it had grown considerably in the past 20 years, with expected annual GDP growth of 4% – 5%. The three major components for GDP were services (62%), of which tourism was an important contributor, agriculture (16%) and industry (16%). This was in stark contrast to where the labor force was spread, with most working in agriculture (75%) and the rest divided between industry and services. Unemployment was at 40% based on a 2008 census. Some of Kenya's socio-economic data are summarized in **Exhibit 1**.

Like in many other developing countries, the population was highly stratified with a significant gap in wealth. **Exhibit 2** shows the results of an integrated labor force survey from 1999 that describes the disparity in income and consumption among the top and bottom of the pyramid. The human poverty index for Kenya, a UN measure designed to gauge standards of living in the country, ranged from 29.9% to 50% across the country, with the bulk of the richest districts located in Nairobi and the surrounding Central Province. The wealth gap among regions in Kenya could also be seen in the Gender-Related Development Index and Human Development Index ratings for the regions, which also show that the Central Province and Nairobi have better standards of living compared with the poorest provinces, such as the North Eastern region.

Literacy was fairly high in the country compared with its African neighbors. The majority of the regions in Kenya had literacy rates above 75%, with only the North Eastern region having a literacy rate lower than 40%. Kenya had one of the strongest educational systems in the region. Primary school education had become mandatory and fully subsidized in 2003 and the country had enrollment rates close to 100%. A significant drop-off to 38% was seen, however, in secondary education.

As with most developing nations, radio continued to be the most prevalent form of media, with 87% of the respondents of a nationwide survey saying that they owned a radio. Coming in second was ownership of a mobile phone, with 71% of respondents. Other forms of communication and media were significantly lower and included television, Internet and landline phones. Nor were newspapers a critical source of information for most Kenyans, with the majority of settlements outside Nairobi receiving significantly less circulation.

Kenya also compared favorably against most other East African countries in road and transportation infrastructure. It had an extensive road network and railroad system that linked major cities to each other and with neighboring countries. By comparison, Africa's road access rate was an average of 34% despite the fact that 90% of the transportation by people and for goods and services used roads. Maritime ports and inland waterways typically were not used for transport, while the existing railroad systems were sparse and not easily interconnected. In Kenya, however, there were 15 airports with paved runways and an additional 20 with unpaved runways.

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The Telecommunications Industry in Kenya

Kenya's first analog cellular service was launched in 1992, soon followed by a GSM network in 1997. The uptake of mobile services by customers was slow due to both the high cost of procuring and maintaining a mobile phone and poor network coverage. However, phenomenal growth followed the introduction of a second GSM network during 2000, and the partial privatization of the state-owned monopolizing company Telco led to the creation of Safaricom Ltd. As in other Sub-Saharan countries, the rapid adoption of mobile telephones in Kenya quickly made the number of cellular phone lines overtake landlines, with mobile phones becoming the core of telecommunications. In December 2010, the total number of mobile service subscribers was 25 million compared with the number of landline subscribers reported at 0.25 million, according to the Communications Commission of Kenya. While in developed countries growth in mobile telecommunications usually came after growth in fixed lines, Kenya and most of the rest of Africa jumped straight to mobile telecommunications, avoiding the extremely high costs of initial deployment of fixed line infrastructure. **Exhibit 3** shows the historical growth of the mobile phone subscription and mobile phone penetration in Kenya. **Exhibit 4** summarizes the capacity and usage of various forms of telecommunications in Kenya.

Four mobile network operators offered services in Kenya: Safaricom Ltd., Airtel Kenya, Orange Kenya and Essar Telecom. Safaricom Ltd. was the market leader with the highest subscription market share at 69.9% (see below for more details about Safaricom). Ranking second with a market share of 15.2%, Airtel Kenya had been the closest competitor to Safaricom for a decade but had seen several ownership changes over the last 10 years (starting as Kencell in 2000, it was changed to Celtel Kenya in 2004 and then to Zain Kenya in 2008.) As of 2010, Indian Bharti Airtel acquired Zain Kenya, along with Zain's other operations in 15 other African countries. As with its other subsidiaries around the world, Bharti Airtel focused on being the low-cost player in the Kenyan telecommunication industry to penetrate the market that was at the time controlled by Safaricom.

New entrants Orange Kenya (8.5% market share) and Essar Telecom Kenya Ltd. (6.4%) were the smaller players in the industry. Orange Kenya was launched in 2007 when a French consortium took control of 51% of the state-owned company Telkom Kenya. Soon after, Essar Telecom Kenya Ltd. launched a mobile network under the brand name "Yu" in November of 2008. **Exhibit 5** summarizes the increase in mobile phone subscribers across the different competitors over the past years.

Although many changes occurred in the last years in the industry, the most relevant was the drop in tariffs (see **Exhibit 6**). The main reason for this industry-wide reduction of prices was due to a change in the interconnection rates issued by the Communications Commission of Kenya. Previously considered a significant barrier to switching from one operator to another, the lower tariffs had allowed the market to slowly open up. In addition, the entry of new players, in particular Bharti Airtel, further increased price pressure.

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