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DETERMINANTS OF INCREASED GROWTH OF COMMERCIAL BANKS IN KENYA

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ABSTRACT

Commercial Banks' profitability and success is important because the soundness of an industry is closely connected to soundness of the whole economy. Profitability of the banking sector is also central as the well-being of the industry is closely associated with the wellness of the whole social economic managerial aspects in general. Thus, a proficient and productive banking sector is able and better placed to endure negative economic shocks. The successful of any commercial bank depends on its critical service delivery of its products over its competitors. Commercial banks in Kenya have adopted managerial and innovative strategies aimed at assisting them to maintain their competitive position in the market and improve their corporate performance. The Market place is changing radically as a result of major environmental forces such as technological advances, globalization and deregulation. As a result of these factors, competition in the Banking industry is getting fiercer. Competitive pressure has forced organizations to adapt the Marketing orientation, which call for constant change as Market conditions evolve, a strategy for dealing with Market turbulence. Banks in Kenya did not feel the need for a Marketing department until fairly recently. We are Currently witnessing a lot of marketing activities by all major Banks in Kenya, which includes Kenya Commercial Bank Ltd. This study therefore identifying the factors that have contributed to increased Marketing Activity by Kenya Commercial Bank Ltd, Establish the Marketing activities perceived to be most important and establish the benefits of increased Marketing activities and increased profitability. Increased Kenya Commercial Bank Ltd has resulted from increased competition, need for

greater profitability and customer sophistication and empowerment. Porters generic strategies and the balanced score card formed the basis upon which the twin objectives were investigated. Internal and external factors were vital. Due to the competitive nature of the industry, most banks were aiming at being the low-cost leader in the market to gain a competitive edge. Central bank of Kenya should develop effective policies on capital adequacy, liquidity and credit risk management to ensure that banks are in a position where they can enhance their profitability.

Keywords: *Bank Marketing, Management, Competition, Market Orientation, Technology*

INTRODUCTION

Since independence, the commercial banks in Kenya have grown both in number, branches, and the variety of services they offer like loans, credit and debit card services, and introduction of automatic teller machines (ATMs), electronic banking and other services (Lyaga 2006). In this period the banking industry, has experienced several upheavals that have led to several reforms in the industry. These reforms are reflected in the 1994 Banking Act (and its amendments), Central Bank Act 1994, and other CBK regulations. These regulations are likely to reduce the impact of global credit crunch on Kenya.

As at 31st December 2013, the banking sector comprised of the Central Bank of Kenya, as the regulatory authority, 44 banking institutions (43 commercial banks and 1 mortgage finance company - MFC), 7 representative offices of foreign banks, 9 Microfinance Banks (MFBs), 2 credit reference bureaus (CRBs), 1 Money Remittance Provider (MRP) and 101 forex bureaus. Out of the 44 banking institutions, 30 locally owned banks comprise 3 with public shareholding and 27 privately owned while 14 are foreign owned. The 9 MFBs, 2 CRBs and 101 forex bureaus are privately owned. The foreign owned financial institutions comprise of 10 locally incorporated foreign banks and 4 branches of foreign incorporated banks (Central Bank of Kenya, 2013).

Kenyan banks are well-capitalized and soundness indicators of the banking system remain above the statutory minimum. Kenyan banks are also on track in implementing the CBK's requirement to have a minimum core capital of Ksh 1 billion by 2012. As of September 2010, 27 banks had reported core capital in excess of the Ksh 1 billion, well in advance of the deadline. Also, the ratio of non-performing loans (net) to gross loans declined further by 200 basis points, from 9.4 to 7.4 % during the first half of 2010.

Kenya's commercial banks operate within a traditional banking model, where interest on
Loans with short maturities are their principle source of earnings, generating about three quarters of the gross income. For Kenyan banks, commercial loans and consumer advances are the principle assets largely funded from retail savings deposits (85 %). This model negatively affects the growth of medium and long-term lending which is required for projects with long gestation periods, especially those in the real estate sector.

Over the last few years, the Banking sector in Kenya has continued to growth in assets, deposits, profitability and products offering. The growth has been mainly underpinned by:

- An industry wide branch network expansion strategy both in Kenya and in the East African community region,
- Automation of a large number of services and a move towards emphasis on the complex customer needs rather than traditional 'off-the-shelf' banking products.

- Players in this sector have experienced increased competition over the last few years resulting from increased innovations among the players and new entrants into the market.2009 saw continued progress on the implementation of regulatory frameworks for deposit-taking MFIs and SACCOs.

In the recent years the banking sector has also seen the rise of the likes of Equity bank in the commercial banks posing competition to other large banks (*banks with a weighted composite index of 5 percent and above*) like Kenya Commercial Bank, Co-operative Bank, Standard Chartered Bank, Barclays Bank of Kenya and CFC Stanbic Bank. In order to fully understand the Banking sector, the following should be considered: the five competitive forces, dominant economic factors, drivers of change in the industry and the industry's key factors.

PORTER'S FIVE FORCES MODEL

Any organization exists within an external environment and therefore must employ strategies so as to remain relevant. The interactions of an organization (a bank) with its external environment can be analyzed using Michael porter's five forces model.

They consist of those forces close to a company that affect its ability to serve customers and make a profit. A change in any of the forces requires a business unit to reassess the market place given the overall change in industry information. The overall industry attractiveness does not imply that every firm in the industry will make more than average profit. Firms are able to apply their core competences to achieve a profit of above the industry average. An example of this is the banking industry in Kenya. Banks are able to apply unique business models in order to make a return in excess of the industry average.

The five forces are:

Threat of new entrants

Despite the biggest entry barrier like regulatory and capital requirements new banks open each year in Kenya.

Factors affecting threat of new entrants include:

- Existence of entry barriers
- Government policy
- Absolute cost
- Economies of scale
- Product differentiation
- Brand equity
- Switching costs
- Industry profitability

Threat of substitute products or services

The banking industry experiences significant threats not from rival banks but from non- financial competitors, investors' non-banking financial corporations and small co-operatives and borrowing avenues e.g micro-financial institutions, Chamas, etc.

No real threat of substitutes as far as deposits or withdrawals are concerned but insurance, mutual funds and fixed income securities offered by non-banking companies.

Factors affecting substitution include:

- Buyer propensity to substitute
- Relative price performance of substitutes

- Buyer switching costs
- Ease of substitution
- Substandard products

Bargaining power of customers

The bargaining power of customer are depended on long term finance, margins and volumes, multiple options, banks competitors and retail lending.

The factors affecting bargaining power of customers include;

- Buyer concentration to firm concentration ratio
- Buyer switching costs
- Buyer price sensitivity
- The total amount of trading

Bargaining power of suppliers

The bargaining power of suppliers relies on customer deposits, mortgage loans, loans from other financial institutions and mortgage securities.

Factors affecting the bargaining power of suppliers include:

- Supplier switching costs
- Degree of differentiation of inputs
- Presence of substitute inputs
- Strength of distribution channel
- Supplier concentration to firm concentration ratio
- Supplier competition

Intensity of competitive rivalry

The banking industry is highly competitive and this can be seen from the tactics employed by banks to increase market share and growth through acquisition and mergers example cfc bank and stanbic bank (*banking merging is making the banking industry more attractive. Because of the large amount of merging occurring in the banking industry, successful banks are only getting larger. The larger the institution, the more likely it is to engage in a wide range of activities (Hanc, 2004)*), and marketing and advertising.

Sustainable competitive advantage through innovation

Competition between online and offline companies

Level of advertising expense

Powerful competitive strategy

Firm concentration ratio

Degree of transparency

DOMINANT ECONOMIC FEATURES

Market share of commercial Banks

Kenyan commercial banks are classified into three peer groups using a weighted composite index that comprises assets, deposits, capital, number of deposit accounts and loan accounts. A bank with a weighted composite index

of 5 percent and above is classified as a large bank, a medium bank has a weighted composite index of between 1 percent and 5 percent while a small bank has a weighted composite index of less than 1 percent.
For the period ended 31st December 2013, there were 6 large banks with a market share of 52.4 percent, 16 medium banks with a market share of 39.1 percent and 21 small banks.
The market share for the large peer group banks declined by 1.3 percent whereas banks in the medium peer group registered an increase in market share by 2.3 percent and banks in the small peer group recorded a decrease of 1.0 percent. The changes in the market share were mainly occasioned by levels of customer deposits as banks deployed various strategies for deposits mobilization.

Scope of Competitive Rivalry

The banking industry is a highly competitive industry. There are not many people out there in the world that do not have a bank account somewhere. Many people think that multiple bank accounts in a different financial institution. The banking industry is changing every day. Financial institutions are offering more and more incentives to their customers or to their would-be customers. Banks will try and do just about anything to try and get would-be customers to leave their current place of banking to come to their bank. Banks want to be bigger and better than their competitors. The banking industry is a highly competitive market because everyone needs a place to put their money and people want to trust who they bank with.
According to Investopedia, these are the mains reasons for competitive rivalry:

- Offering lower rates
- Offering preferred rates
- Offering investment services

Customers

The banking industry has a wide range of customers. There isn’t a standard of what type of customer a bank will take. As long as you have a good financial record, you have money to deposit, and you are willing to open an account, a bank will take you. The customers that bank cater to are the ones that they feel will benefit the most. The ideal customer to most financial institutions is some with money to deposit, someone who is loyal, and someone with a need for that particular financial institution. The smaller financial institutions stick with the customers in their geographical region. Their customer base tends to be what you would call the “home-grown” customers; customers that have been in the same region their whole lives.
Both the larger and smaller banks are trying to reach more and more people every day. They are doing this with the help of technology. They are both trying to improve their online banking services to help reach a broader range of individuals. Banks are also looking towards the younger generations to expand their markets. The idea behind the younger generations comes from the fact that investing at a younger age helps a person accumulate more wealth. Banks want to inform the younger generation about the options that they have to invest their monies in.
Banks also look towards their demographic when they develop new products and services. They look at age, income, ethnicity, gender, level of education, etc when they are in the development stage. Banks want to create marketing campaigns geared towards the customer base in their geographical region. They also use these demographic features when they are deciding when and where to build more branches.

Ease of entry/exit

There are not many firms trying to break into the banking industry. The financial institutions that are in the current market have been around for a while. Today’s economy doesn’t really allow for new firms to enter.

Today's economy is allowing mergers and acquisitions of current financial institutions. It is not easy to just up and start a bank. You have to go through a variety of different legal and financial loopholes to gain access to the financial industry. Since it is difficult to start a bank, there are some people who are starting investment firms that try and take away some other the services offered by banks. Insurance companies are starting to offer investment and mortgage service. This takes away from the banks that are trying to expand their customer base. It isn't easy to become a bank, but it is easier to offer services offered by banks.

Technology/Innovation

With new technology comes a new customer base. One of the first major technology changes was the service of direct deposit. Financial institutions can receive funds electronically to deposit into a customer's account. This allows for cost savings for both the company depositing the money and the financial institutions. Debit cards are also a new form of technology. This allows for the customer to have access to ATMs anywhere they want. They can use the debit card at a store and the funds are instantly taken from their bank account.

Another more recent change in the banking industry is the idea of online banking. Banks are more and more promoting the idea of online banking to their customers. Customers are encouraged to use their financial institutions online banking system to view their account, pay their bills, and retrieve their monthly statements. Online banking is one of the newest technologies available to bank customers. The banking industry is always looking for ways to be cost efficient and keeping up with the newest technology is a way to do just that.

Product Characteristics

There are many products and services offered in the banking industry. Many of these products and services are offered by most of the financial institutions. There are the standard products like savings accounts, transactional accounts, certificates of deposit, debit/ATM cards, and credit cards. Then there are the standard services like online banking, direct deposit, checking ordering, automated tellers and investment planning. The banking industry is always looking for new products and services that it can offer their customers. The different product characteristics all depend on the clientele that they are trying to reach. Usually they offer more than one of every product they have that way they can meet their customer's needs.

Savings accounts:

The banking industry encourages customer to save. Different types of savings accounts can include money markets accounts, certificates of deposits. By encouraging customers to save, they are hoping to create a long-term customer. If banks are competitive with their interest rates for savings accounts, people are more likely to deposit their money into that financial institution.

Credit Cards

Banks can offer a variety of credit cards. They different credit cards have different rates and different functions. There are credit cards with a points system that allows the cardholder to accumulate points to use on airfare, hotel stays, merchandise, and even cash. Some of credit cards have lower interest rates and some of them don't. Banks also offer student credit card and credit cards for someone who is just starting to build their credit.

Auto Loans

When people purchase a vehicle they usually finance it. There are not very many normal people that can walk into a dealership and pay cash. There several different rates for auto loans and there are several different terms as well. The rate and the term are based on the customer's credit.

Industry Profitability

Banks profits depend on the difference between the interest it pays on deposits and the interest that it earns on their loans. Profitability can be summarized as the difference between its earnings and its revenue growth. The banking industry has seen a decline in the profitability. The post-election violence and increase of the lending rate by CBK has taken a lot of the profits away from financial institutions.

To increase their profitability, financial institutions are changing their policies. Because of the mortgage and credit crisis, banks are losing money. Banks are increasing their transaction fees, loans fees, and they are tightening up on their lending. Merging with smaller banks, the larger banks have hoped to increase their profitability. The larger banks are hoping to capitalize on the increase customer demand. People are having problems in the economy that we are in getting loans for vehicles and homes. Banks are trying to increase their profitability by charging higher interest rates to their customers that they feel are a credit risk.

Industry Growth

The Kenyan banking sector registered improved performance in 2013 notwithstanding the marginal economic growth. The sector registered a 15.9 percent growth in total net assets from Ksh. 2.33 trillion in December 2012 to Ksh. 2.70 trillion in December 2013. Equally, customer deposits grew by 13.5 percent from Ksh. 1.71 trillion in December 2012 to Ksh. 1.94 trillion in December 2013.

DRIVERS OF CHANGE IN THE INDUSTRY

Against the backdrop of fairly benign economic conditions, the banks have performed well:

Banks reap from non - interest income (commissions and fees), aggressive recoveries of non-performing loans has enabled banks to post huge profits. i.e. KCB posted a 17 per cent rise in pretax profit for the first nine months of this year to Sh 17.7 billion.

In arriving at cash earnings, income and expenses exclude significant items and certain non-cash items. Non-cash items include the impact of hedge accounting, revaluation of treasury shares and other items reported by the banks. Significant items include restructuring and transformation costs and other items reported by the banks. Some components of income and expenses have been reclassified to improve comparability between banks.

The growth and profitability of banks is usually attributed largely from a stable micro-economic environment across the region. Banks businesses in Kenya are boosted by new ventures in capital, ban assurance all which are key drivers of growth.

Stronger performances from offshore operations, in Uganda, Burundi, Southern Sudan, has seen banks begin to achieve critical mass delivering improved efficiencies and returns on investment.

Regional integration is increasingly becoming a catalyst for the expansion of Kenyan Banks. This is according to research by Kenya bankers association. The banks are pursuing further financial sector integration and deepening, even as the region moves towards its monetary union policy.

Recent trends have seen banks seek partnerships with investors, lenders and stakeholders with aims of enhancing business efficiencies by offering solutions which boost operations and revenue collection. This has been done through the use of alternative channels of banking. I.e. partnerships between KCB & County Governments, DTB received a Shs. 2.6bn loan from French development financial institution, PROPARCO to boost its lending of SMEs with a further expectation of more funding from German lenders.

The competition for market share of the diaspora market has seen the growth of alternative investments and growth in new markets while seeking to increase it’s lending by financing infrastructure projects under the public –private sector partnerships.

The recent upgrade of ATM machines to the EMV Compliance standards has been driven by Technology which has become a persistent and pervasive trend in the financial systems. It is ever evolving rapidly creating the ability for innovators, disruptors and incumbents to analyses significant amounts of structure and unstructured data in real time. This enables organizations to get insights into the behavior and needs of customers, match their needs, inspire trust and generate value for the banking/ financial system.

Increased revenues from asset growth in housing and margin compression as asset price competition is only partially offset by declining funding costs. Net interest margins have contracted 19 bps over the last two and a half years.
Profits from wealth management operations have improved over the years, reflecting the relatively stable equity markets and improved life office claims experience and lapse rates.
Bad debt expenses are at the low end of normal. Reflecting improving business conditions and no deterioration in the quality of the housing book.
Expenses are beginning to climb due to rising salaries and technology costs.
The major banks have a tone of cautious optimism in their most recent outlook statements, and it is hard not to agree with that as the most appropriate view. As always, there are risks and uncertainties in the global economy, but with the US stable-to-stronger and China stable-to-weaker the broad factors seem well balanced, especially as global markets seem content to take developments in their stride at present.

For the banks, the business challenges continue to be realigning their businesses to the requirements of the digital economy, while responding to increasing regulatory requirements and community expectations, and at the same time meeting the well-established market expectations of ongoing growth in profit.

One notable shift over the past six months which will continue to play out for some time is the greater focus by each of the banks on their payments capabilities. In part, progress domestically on the new 'real-time payments' infrastructure is concentrating everyone's attention on payments. More generally, continued globalization, increasing technical sophistication, and rising affluence is fueling global consumer and business demand for convenient, integrated payments solutions.

Cyber security issues are concentrating attention as well. To be successful, banks need to solve for innovation, flexibility and speed to market. However, this is undeliverable without a resilient payment platform. In the high volume, low value retail space, without a resilient payments platform, banks will struggle to compete with offerings from the technology giants, including PayPal, Google, Amazon and Apple. Equally, in the lower volume, high value corporate market, those banks that can deliver on the promise of a resilient platform will steal the march on those that compete only on price.

In a world where speed to market and agility are going to be key in differentiating those who will be able to innovate from those who will be left behind, assurance of a robust system that allows for failure and risk-taking as part of the Growth cycle. Information, and it's increasingly rapid dissemination, and technology are continuing to empower customers and drive their purchase preferences.

Enabling organizations to utilise available technology, encourages innovation and creation of products and services that match the needs of tomorrow's consumer, inspiring trust and generating increased value for the banking sector and the financial system as a whole.

Technology and innovation have been highlighted as key drivers of change against the backdrop of our broader discussion of the philosophy and objectives of the financial system. Other factors include superannuation, bank funding, and taxation.

It plays a key role in generating and harnessing savings to sustain growth and living standards and contributing to inter-generational equity. Whilst the superannuation industry is essentially operating effectively, there are a number of areas that could be changed to increase its efficiency, stability and sustainable growth.

These include: streamlining the regulatory environment and addressing costs; improving governance; improving fund effectiveness through widening the investment pool, extending tax rollover relief, removing barriers to annuities and the restriction of lump sums.

The benefits of lower interest rates are very evident in asset quality, while the banks have held to their lending quality criteria. Business gearing in general remains conservative. The wildcard remains the eventual impact of higher interest rates on the household sector, given household debt to income.

Low interest rates continue to have a positive impact on demand for credit in Kenya, particularly for investment loans, term loans and Small to medium enterprise loans.

During the recent financial crisis trust was the key driver of customer behavior, but more recently this has changed to value.

The sophistication of this bank's Customer enhancement management programs enabled it to shift beyond simply measuring and monitoring a customer score to identify actions and initiatives that drive customer engagement, attract and retain customers and grow wallet share.

Customer behavior and engagement is a key driver of the banking industry.it goes beyond the measuring and monitoring a customer's score to identify actions and initiatives that drive customer engagement, attracts and retain customers and grow wallet share thus fostering liquidity, solvency and proper functioning of financial system.

The bank's Customer enhancement management programs go beyond high-level customer engagement metrics, to capture the underlying drivers of customer behavior and engagement. The bank found these drivers differed by customer segment and over time.

The increase in regulation, improved governance, fund effectiveness through widening of the investment tax pool, extending tax rollover relief, removing barriers to annuities and restriction of lump sums. This in turn affects long term as well as short term gains and in turn drives change. The Banking Act, the Central Bank of Kenya Bank, the Companies Act, Finance Act 2008.

Tax impediments have an effect on efficient and effective allocation of capital but those that would attract/promote greater capital flows. However, this issue can only be effectively addressed within the broader context of wide-ranging tax reform. Both taxation issues within the financial system specifically and also related and contingent issues within the taxation system more broadly.

New regulations which took effect in 2008 which required banks and mortgage firms to build a, minimum core capital of Kes 1 billion by December 2012 helped transform small banks into stable organizations while forced the existing banks to merge and comply.

Formulating and implementation the monetary policy. The global financial crisis experienced in the late 2008 affected the banking industry in Kenya in regard to deposits mobilization, reduction in trade volumes and performance of assets.

The complexity and competitive nature of the taxation system contributes to the distortion of financial systems allocation of capital flows. Tax impediments can hamper effective and efficient allocations of capital greater capital outflows and inflows of the country.

The clientele in the banking sector are increasingly becoming more sensitive to interest rates paid on loans, bank fees. They seek transparency in pricing as such compare and determine the most competitive products. It's against this that the annual percentage rate mechanism was reviewed by the bank finance and credit managers. The framework includes a phased timeline, a uniform calculation methodology and a set of inclusions that would be applicable to all banks.

Funding plays an integral role in allocating capital, including credit across the economy. The changes in funding and risk assessment policies affect the ability to sufficiently fund the investments required for economic growth. Thus, banks strive to mitigate the potential funding gap, encourage low cost deposits, and source for additional wholesale funds from the domestic bond market.

KEY SUCCESS FACTORS IN THE BANKING INDUSTRY

A key success factor is the thing that most affects the ability of a company to succeed in the market. A company must develop competence on its industry's key success factors if it has to remain successful. Key success factors refer to those factors which are important to future competitive success of industry members. These factors include product attribute, competitive capabilities, resources, competencies, market achievements etc. it is very important for the strategies to understand the landscape of industry in order to identify the most important competitive conditions, the key success factors of one industry differ from other. Sound strategy incorporates efforts to be competent on all key industry success factors and to excel on at least one factor.
The key success factors in the banking industry include:

Management

Management plays a key role in ensuring success in almost any initiative within an organization. Nothing makes greater impact on an organization than when leaders model the behavior they are trying to promote among employees. For banks to succeed in their operations, good management practices must be employed.

Human Resource

This refers to the individuals within the firm and to the portion of the firm's organization that deals with hiring, firing and other personal issues. The strategic human resource is based on the deep knowledge of the organization's processes procedures and the business strategy. A well-managed human resource will lead to success in the banking industry.

Equipment and facilities

These play an important role in the success of any industry. Banks should always ensure that they have modern equipment and facilities that are up to date and will enable them to carry out their duties effectively.

Cost of products and operations

This is an important key success factor in the banking industry. Banks should ensure that he cost of their products is affordable to their customers and competitive within the industry and also reduce the cost of their operations so

as to maximize profits. Banks should try to reduce the cost of their operations and maximize revenue so as to be successful.

Technology

Latest technology plays a very important role in the banking industry. It helps in introducing innovating products according to the demand of consumers. Technology can be used to lower down the cost of transaction and improve the quality of products. For example, when the banks realize that they can lower down their transaction cost by installing ATM and debit card they did so. If saved the overhead cost and improve convenience for customer by providing 24/7 service. Online banking is increasingly tremendously due to rapid technological change.

Best Rates

Industry of virtual banking is attracted by low cost. Competition is such high that to survive in industry low cost is very important. As virtual banks have no existence of branches and ATM network so they have great advantage to offer their products at lower rates than brick and mortar bank. Due to low overhead cost, virtual banks are changing lower transaction cost which gives them a plus point. For example, in Kenya we have Housing and Finance that has the best mortgage rates compared to other banks.

Product Innovation

Product innovation is one of the major success factors in the banking industry. Since all the banks are offering similar products therefore differentiation is very important for the future survival. Banks are trying to come with different innovative products, for example mobile money transferred introduced by Equity bank

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