BANKING IN KENYA

The banking industry in Kenya is highly competitive, faced with new entrants and new versatile products for clients. Currently there are forty-six (46) banking and non-banking institutions in Kenya. The functions of banks vary from each institution but the common functions include:

- Receiving deposits from customers
- Advancing loans to both corporates and individuals at an interest rate
- Foreign exchange dealings
- Safeguarding customer's deposits
- Paying bills on behalf of customers at a fee, such as standing order arrangements.

REGULATORY ENVIRONMENT

The banking industry is under the Central Bank of Kenya (CBK), Banking Act and Company Act. There are also prudential guidelines provided for by the Central Bank of Kenya. The roles of the Central Bank on banks can be found under the Bank Supervision section of its website. The main role however, is formulating and implementing monetary policies and stimulating liquidity, solvency and proper functioning of the financial system. The Banking Act is Cap 488.

The Central Bank of Kenya recently authorised all banks to handle transactions over Ksh.1 million with extra caution by asking customers to fill in details of the intended transactions in transaction forms. This was introduced after the rise in corruption and fraud cases in Kenya. A new law for forex bureaus was also introduced effective from April 2016. Forex bureaus are required to raise their core capital from Ksh2.5 million to Ksh.5 million. Their minimum balance was also to remain at Ksh.340, 000 and the application fee went up by 100% to Ksh. 20,000 which was declared non-refundable.

The banks in Kenya also have the Kenya Bankers Association (KBA) through which banking institutions articulate their interests. They also voice their challenges and concerns under the same forum.

GROWTH OF THE BANKING INDUSTRY

Some of the drivers of the banking industry that determine the growth of a bank include Compound Annual Growth Rate (C.A.G.R.) in Profits Before Tax, total assets, customer deposits and loan advances. Kenyan banks are portraying robust growth in the recent years. At the beginning of the millennium, the country had only 5 local banks out of the total 43. This has changed over the years. There are 13 foreign-owned banks now, one mortgage company (Housing Finance Company of Kenya), seven representatives of foreign banks and 9 deposit-taking microfinance institutions. However, there are only two Islamic banks; Gulf African Bank and First Community Bank. Three banks are state-controlled; Consolidated Bank of Kenya, National Bank of Kenya and Development Bank of Kenya.

The lending banks have reported growth in interest incomes and growing returns from loans and advances as the main growth drivers. Deposits in banks have increased from 0.57 trillion in 2006 to 2.6 trillion in 2015 and the same robust growth is seen in loans and advances as from 0.45 trillion in 2006 to 2.3 trillion in 2016. Banks are also utilising technology to stimulate growth in the banking industry, for example mobile banking, done using cell and smart phones. With the drastic increase of use of mobile phones in Kenya, banks have made it convenient for its customers to access their accounts and carry out transactions. Equity Bank for instance launched its own sim card and virtual network, Equitel, which not only helps one access their bank account, but also make calls, browse the internet and send text messages. Other banks have launched mobile applications which offer various services from withdrawing, depositing & transferring money, paying bills, applying for loans and advances, opening accounts, buying airtime for mobile phones and also prepaid services for electricity tokens among others.

The use of banking agents in the estates is also a key growth driver of banks. In 2013, Kenya Commercial Bank had to retrench about 120 employees, because the revenue they brought to the bank was little as compared to estate agents. This succeeded a 2010 retrenchment where up to 1,000 jobs were lost. Agency banking also has improved accessibility of banking services to the rural areas.

The Banking Industry was liberalised in 1995 in Kenya after the exchange laws were lifted. It is now the third largest financial hub behind Nigeria and South Africa in Sub Saharan Africa.

EMERGING ISSUES IN THE BANKING INDUSTRIES IN KENYA

Since the new governor of Central Bank took over in June 2015, the banking sector registered a decline in profits by 6.8% to Ksh. 132 billion, which is a first in more than 10 years. The banks previously had not been truthful about their provisions for non-performing loans which went up by 44% (Ksh. 159 billion) in the 2015 financial year, considering the exponential increase in loans and advances given to borrowers. The decline of three banks since July 2015 has sent jitters to Kenyan depositors; Dubai Bank, Imperial Bank and Chase Bank. The coming years are expected to be tougher for the banks in Kenya as Governor of Central Bank of Kenya, Patrick Njoroge is scrutinising the financial statements himself.

Barriers to entry in the banking industry

Government regulations

Most governments around the world as well as the Basal Committee keep revising the capital requirement for tier 1 and tier 2 capitals. In Kenya, the Finance Act of 2008 required a minimum capital of Ksh.1 billion by the end of 2012. These aimed at making these financial institutions stable. The government also limits new entrants through licencing requirements and giving firms a 'grace' or what is known as product testing regulations. Mergers, charters and the opening of new branches are highly regulated in the banking industry.

Economic conditions

Economic conditions revolve around cost of producing, selling and marketing. An already existing firm has already incurred these costs while a firm entering the market has to run these costs. Some of the costs include research and development, structural and organisational costs, advertisement and economies of scale. Most incumbent firms deviate from the short term objective of new firms, which is profit maximisation. Rather, they work to become the monopolistic firms in order to enjoy supernormal profits in the long run. New entrants could also be switching firms where they have to incur switching costs such as buying new working equipment, recruiting or retraining staff, and reorganisation costs. Another economic threat is the sunk costs experienced by a firm entering a market. This means the unrecoverable costs incurred by a firm in case it decides to shut down. This is a major threat for risk averse persons.

Market conditions

The market goes through boom and depression periods. These sessions are determined by the forces of demand and supply, which cause inflation of the currency. The banking sector is a monopolistic market where there are numerous number of buyers and sellers, and the sellers can differentiate services offered and also set their own prices. In order for customers to remain loyal to their original banks, banks have to be creative at all times and set competitive prices. These strategies are also available to new firms trying to penetrate the industry.

Competitor reactions

For every action, a reaction exists. The incumbent firm can counteract in case of a new entrant in the market such reducing price levels, introducing new products, or even registering patent rights. The aim of firms already in existing in the market is to remain the price leaders in a certain industry.

STRENGHTS VERSUS WEAKNESSES OF THE BANKING INDUSTRY

Strengths

Banks in Kenya are prospering in terms of profitability, capitalisation and reaching for larger markets.

Product diversification

Banks in Kenya offer a variety of other services except ones aforementioned such as trading securities, insurance covers, mortgage facilities among others.

Mobile Banking

With increasing number of internet users in Kenya, most banks have introduced Mobile Applications where clients can access their accounts and keep track of the transactions. Other services offered are statements of account, paying bills, getting an advance or a loan and buying airtime.

Revenues from loans and advances

With a growing economy, more Kenyans are applying for loan facilities. When the demand is high, banks flex their rates upwards, increasing their revenues. Loan rates are currently not below 20%. This is one of the key drivers of growth for the sector.

Growing clientele

More people are opening bank accounts which only means business for banks.

Diaspora banking

Kenyans living in the diaspora can do banking here in Kenya. This leads to increased Foreign Direct Investment. In January 2016, remittance inflows from foreigners increased by 19.9 % from USD 114.6 million in January 2015. Most of the monies were from North America.

Weaknesses

Banks also have shortcomings that slow the attainment of their goals down. They should focus on improvement of such areas and become more competitive in others. Kenyan banks face the following weaknesses:

Low staff morale

Bankers have long working hours and are not remunerated in a manner which they would deem commensurate to their efforts and input.

High loan interest rates

High interest rates by banks only push Kenyans to look for cheaper sources of funds such as savings and credit cooperatives (SACCOs), shylocks and microfinances. This only means loss of revenue from credit facilities.

Low customer satisfaction and the time factor

Long queues and slow services have been a problematic area for banks until the recent introduction of ticketing systems, and seats for waiting customers. Mobile banking has also solved the issue of customers having to queue to check balances, deposit money and what a view.

Opportunities

Opportunities in a bank mainly sprout from external factors such as the market which could increase growth of the banking sector. Such openings include:

- More Kenyans learning the importance of saving. The banks could woo the potential customers to bank with them by offering low minimum balance, low ledger fees, free cheque books and so on.
- Needs of the market are very dynamic. Banks could always be on the lookout to be innovative in order to satisfy their clients. KCB, Barclays and other banks developed the mortgage facility at low interest rates. Other banks offer insurance covers for their

clients. Banks such as CBA and Cooperative Bank have platforms for their clients to utilize their savings in the securities market.

Threats

These are risky areas that could affect the banks negatively, causing declines or a total shutdown. These could be:

- A declining economy that leads to a weaker currency. This leads to loss of value for the money. Just recently, KCB reported losses in Southern Sudan because the Sudan Pound lost its value completely.
- More competitors in the market only means bargaining power lies with customers.
- Another threat is an increase in the unemployment rate in the economy. This means people do not have money to save; they live from hand to mouth.
- Mergers and takeovers can lead to dilution of power, high reorganization and restructuring costs, disintegration of management and cultures, all which could affect the Going concern for banks.
- Collusive fraud in banks where employees collude to steal from customers is a major threat to the image of banks. An example is the case of Imperial Bank and Chase Bank, both of which were subsequently placed under receivership in 2013 and 2016 respectively.
- Non-performing loans lead banks to provide for such debtors, provisions which might eventually be written off, especially where the debtor is declared bankrupt or dies. This mostly works for clients with no credit histories.
- Global financial crisis is a major threat to banks in mobilizing their deposits, performance of trading assets, foreign exchange and also trading volumes.