A STUDY OF THE KEY FACTORS THAT AFFECT COMPETITION IN THE BANKING INDUSTRY OF KENYA

BY

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A Project Report Submitted to the School of Business in Partial Fulfillment of the Requirement for the Degree of Masters in Business Administration

UNITED STATES INTERNATIONAL UNIVERSITY

SUMMER 2005
STUDENT’S DECLARATION

I, the undersigned, declare that this is my original work and has not been submitted to any other college, institution or university other than United States International University in Nairobi for academic credit.

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This Project has been presented for examination with my approval as the appointed University Supervisor

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ABSTRACT

The study focused on the competitive strategies in the Kenyan banking industry. Due to competitive pressures from the international banking markets, the local banking industry in Kenya had experienced substantial competitive conditions. As a result, they had to rethink their marketing strategies in order to stay competitive and grow. The purpose of the research was to evaluate the competitive strategies adopted by banks to compete effectively in the industry. The research questions were: What are the key factors influencing bank competition, What are the benefits of information technology in banking competition, What is the role of the size of a bank in formulating competitive strategies in the industry and Specifically what are the competitive strategies in banks resulting from the evolution of the ATM market.

The descriptive study approach was used. Ten banks were identified to form a representative sample of commercial banks in Nairobi and from these, staff from four divisions of these banks namely the strategic management, information technology, marketing and research and the development divisions comprised the sample of 240 respondents as they represented the strategic and operational levels of the banks. A purposive sampling technique was used to collect data from the ten commercial banks operating in Nairobi. Structured questionnaires were used as the data collection instrument. Data was analysed using SPSS and Excel programs and presented through frequency tables supported bar graphs and pie charts.

Ease of communication and better connectivity were major findings highlighted in the key factors influencing bank competition. On the issue regarding the benefits of information technology in banking competition, over half of bank customers accessed banking services via internet. Interestingly also less than half had no access to bank services through the internet. On the availability of bank products over the internet most respondents rated product information as the highest response. Respondents also cited better service provision and reduced waiting time as the benefits of computerization. The use of E-commerce was also on the rise and was used to give banks a competitive edge. It was found that under what role the size of a bank was in formulating competitive strategies more than half of the bank branches had 1000 – 1500 customers, in addition most of the banks had over a third of international business. In the determination of what
competitive strategies in banks resulted from the evolution of the ATM market, banks information technology and the development of ATMs had enabled time saving, cost effectiveness, customer satisfaction and improved the bank’s image as shown by respondents while a large number of the banks had their own in house technical staff to manage the ATM system.

The major conclusions were that as liberalization and globalization of world markets became more apparent, communication was becoming more crucial in today’s global banking environment. Information Technology and ATM networks had resulted in an increased range of products that given many banks a competitive edge in business.

To improve their competitiveness commercial banks should endeavour to have better leased line facilities with faster speeds and more capabilities of serving a wider network range with better communication and should consider ATM internetworking between themselves at a small fee to provide access to those branches or banks that have fewer ATM services.
ACKNOWLEDGEMENTS

I owe my gratitude to a lot of people who in one way or another have contributed to the completion of this project. However, due to limitations in trying to include everyone’s name in this project, I cannot name them all. I very humbly request that those concerned accept my thanks. The following people however deserve special mention.

My special thanks go to my supervisor, Dr. Lewa for his guidance, support and patience. I called his office and house at all sorts of hours and he very kindly tolerated my requests and enquiries. His family was also very patient in this respect. I am also indebted to all the academic staff in the MBA programme, School of Business, for their advice and guidance at one time or another during the whole course. The relevant Faculty support-staff are also acknowledged for their assistance.

My gratitude also goes to my MBA colleagues who from inception to the completion of the course provided their company, friendship, support and encouragement.

Others who must be remembered are my office colleagues who helped me in typing, proof reading, questionnaire preparation and administration or who helped in one way or another in meeting the final document requirements. There are others in my research team who deserve mention for their data collection and analysis. Those are John Ngwele and Walter Mwania. I am grateful for their contribution.

Special thanks go to those who very kindly completed the questionnaires. Their effort will go along way towards contributing to knowledge in general.

Last but not least, I am indebted to my family for being tolerant of my absence from many family gatherings during the course of this study.
DEDICATION

To My Parents, Daniel and Theresa Kiago
who taught me the value of prayer and hard work and
to Joyce whose encouragement kept me going.
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CHAPTER ONE

1.0 INTRODUCTION

1.1 Background of the Study

At independence Kenya inherited a financial system typical of all British colonies in Africa - a currency board, a commercial banking system wholly dominated by two major British Banks, a Post Office Savings Bank and a small number of non-bank financial institutions providing mortgage finance, insurance and other near bank financial services. The Kenyan banking sector has become substantial, sophisticated and complex over the years. Recent years have witnessed a restructuring of the sector through liquidations and mergers brought about by a declining client base and non-performing loans as well as overall poor management of small indigenous banks (Central Bank of Kenya, 2004).

A report on the banking industry in Kenya by Anyanzwa (2004) showed that the industry had become significantly more competitive than in the past, and competition was likely to increase further. In addition it had changed dramatically over a relatively short period, from being a virtual cartel to a highly competitive market. During the past one decade, the banking industry in Kenya and indeed the world over has experienced substantial competitive conditions. This was because new competitive pressures were emerging from abroad, owing to the liberalisation of international banking and capital flows, and as a result of the adoption of new banking technologies. It is a well established fact that well-functioning banks promote national economic growth, improve the efficiency with which credit is allocated, and boost the growth prospects of small and medium enterprises. Thus, information on which policies enhance the operation of banks is relevant for developing national strategies to promote overall economic development and alleviate poverty. Thus the style and intensity of marketing activities that exist today in the banking industry are a recent phenomenon.

The emergence of both new local and foreign banks and financial institutions, has brought a competitive challenge. In the 1960's, there were only four commercial banks operating in the Kenyan market. These were National and Grindlays Bank, Barclays Bank DCO,
Standard Bank and Bank of India. Currently, the Kenyan financial system is quite diverse and active with 44 commercial banks, 4 non-bank financial institutions (NBFIs), 2 mortgage finance companies, 14 building societies and 71 forex bureaus in the banking system by the end of December 2004 (see Appendix 3). Total assets of the banking system increased to Kshs.459.6bn in January 2003 from Kshs.422.4 billion in January 2002. Loans and advances, which accounted for 56% of total assets increased by Kshs.9.5bn to Kshs.257.1bn in January 2003 from Kshs.247.6bn in January 2002. Deposits, including interbank deposits and accrued interest, held by banking institutions increased by 11% to Kshs.364.1bn in January 2003 from Kshs.328.0bn in January 2002. In terms of market share, the largest ten commercial banks accounted for 77.3% of all deposits in the banking system (see Appendix 4). Unaudited pre-tax profits of the banking sector increased by 2% to Kshs.1,325m for January 2003 from Kshs.1,302m in January 2002 (Kenya Monthly Economic Review, 2003).

According to Keenan (1998) increased competition and the use of IT had forced banks to respond in three key ways. Firstly to maximize customer retention through close attention to customer needs and quality of service. Secondly to reduce costs, mainly through making greater use of information technology, downsizing and process re-engineering and thirdly to innovate and develop more profitable products, and to promote them efficiently to maintain market share.

Banks compete for customers in many more ways than simply through the prices they charge for services and the interest they offer on deposits. The convenience of a bank’s location, the services and personal attention it offers, the location and number of Automatic Teller Machines (ATMs) it can provide and the networks that the bank’s ATM card can access, the number and identities of the merchants that accept the bank's ATM card, the fees associated with accounts, and the interest rate paid on deposits or the rate available on loans are all factors in a consumer's decision of where to open a bank account. With the advent of widespread surcharging by ATM owners, ATM fees now constitute another element in the decision about where to bank. Competition policies in banking may involve difficult trade-offs. While greater competition may enhance the efficiency of banks with positive implications for economic growth, greater competition may also destabilize banks with costly repercussions for the economy (Berger and DeYoung, 2001a).
There is not a single, accepted measure of bank competition. For lack of a better measure, bank concentration is often used as an indicator of bank competition (Balto, 1997). The competitive environment is also influenced by bank regulations, such as restrictions on entry, exit, and bank activities, as well as national institutions that govern economic freedom in general. The ownership structure of banks, such as the extent of state or foreign ownership in banking, and macroeconomic and financial conditions may also play an important role. Banking is not an industry with much so-called hit-and-run entry—most people want their bank to be stable and do not want to do business with a fly-by-night firm. As an industry, banking has fairly high fixed start-up costs (for example, capitalization, regulatory compliance, and brick-and-mortar branches) and relatively low marginal costs (the ongoing operating costs). Generally speaking, in terms of costs, ATM networks (both shared and proprietary networks) exhibit increasing returns, meaning that the larger the scale of operation, the lower the cost per unit. In terms of demand, ATM networks also exhibit economies of density or economies of ubiquity within a geographic area (that is, the more ubiquitous, the more valuable the network). Theoretically, in an industry with high fixed and low marginal costs as well as increasing returns, one large bank would tend to dominate (Kerber, 1997).

To compete effectively in providing ATM services in an area in which an incumbent dominant bank already exists, an entrant bank may need to deploy a fleet of ATMs that is nearly as large as that of the incumbent dominant bank. To attract depositors, they must deploy a large number of ATMs, but the demand for ATM use in the relevant market may not be great enough to sustain all of the ATMs deployed by both the incumbent and the entrant (Evanoff and Evren, 2001).

1.2 Statement of the Problem

The key issues affecting the banking industry in Kenya are: changes in the regulatory framework, increased liberalization in a restrictive market, declining interest margins due to customer pressure, mergers and reorganizations, increased demand for non-traditional services including the automation of a large number of services, a move towards emphasis on the customer rather than the product, and introduction of non-traditional players, who now offer financial services products. As a result the banking sector was
poised for significant product and market development that should result in further consolidation of the banking sector (Muchene, 2003).

The banking industry has changed dramatically over a relatively short period, from being a virtual cartel to a highly competitive market. Financial deregulation and increasing globalization have brought new competition to domestic banking and allowed considerable diversification by banks, insurance companies and cooperatives. Information technology has provided many opportunities for creating new financial products and distribution methods for example Automated Teller Machines, telephone banking and computer banking and reduced the need for investment in conventional branch infrastructure (Allen et al., 1999).

Competition in the banking industry in Kenya (Muchene, 2003) has witnessed many banks losing their market share and hence being closed. Customers changing tastes and preferences from day to day have forced many banks to make competitive strategies that bring value to their business. In view of these changing customer demands, market forces and globalization, the research aims to analyze and evaluate the competitive strategies adopted by the banking sector.

So many changes have occurred in the Kenyan banking industry. They include regulatory changes, increased liberalization and demand for automation of services. These changes portend increased competition in terms of customer service, revised marketing strategies and future survival. Banks in Kenya have responded in many diverse ways, key among these being mergers and acquisitions, improved information technology and installing ATM technology. Critical in this is the use of ATMs. In future competition in banking in Kenya is likely to be determined not by one factor, but by a myriad of factors. For small and large banks questions can be raised on how banks in Kenya have responded to these changes particularly in terms of size, IT and ATM provision. The knowledge gap to be addressed by the study is that due to increased competition in the Kenyan banking sector, banks are witnessing changing market share, increased customer preferences for faster services and adoption of technological changes. As a result competitive strategies must be sought and adopted to enable them meet their objectives.
1.3 **Purpose of the Study**

The purpose of the research was to evaluate the competitive strategies adopted by banks to compete effectively in the Kenyan banking industry.

1.4 **Research Questions**

The study was guided by the following research questions:

1) What are the key factors influencing bank competition?
2) What are the benefits of information technology in banking competition?
3) What is the role of the size of a bank in formulating competitive strategies in the industry?
4) Specifically what are the competitive strategies in banks resulting from the evolution of the ATM market?

1.5 **Justification of the Study**

The results of the study would help management of banks to appreciate the need for competitive strategies in the industry necessary in the changing environment and try to invest in strategies such as information technology, decentralization and ATM ownership in order to compete effectively in the industry. The study will also be essential to bank customers to evaluate and understand strategies being adopted by banks to offer better services. In addition the research will make suggestions to the banks that can aid them have a competitive edge in the market. Investments in newer technologies must be made to modernize existing operations, to face competitive challenges, and to meet customer expectations. Indeed, some of these investments will also be made in the hope of achieving cost savings and other efficiencies. However, bank management needs to approach these investments recognizing that the full benefits may not be gained quickly; may, if gained, be competed away; and may, indeed, not be captured at all. History teaches that costs may emerge long before expected revenues, and that operational risk can either decrease or increase as a result of making major technology investments.
1.6 Scope of the Study

The study focused on the competitive strategies formulated by banks in Kenya to counter competition in the industry. The sector was characterized by changing customer needs and industry trends hence the need to analyze strategies needed by banks to counter these changing trends in the industry. The study intended to cover all the commercial banks in Kenya but due to their geographical location, time and the nature of the research, only ten banks from Nairobi were analyzed. The ten banks were: The Head Offices of Barclays Bank, Standard Chartered, Cooperative Bank, Comercial Bank of Africa, Investments & Morgages Bank (I & M), Kenya Commercial Bank, National Bank of Kenya, Citibank N. A., National Industrial Credit (NIC) Bank, and K-Rep Bank.

1.7 Definition of Terms

1.7.1 Competitive strategy
The method by which an organization attempts to achieve its mission and objectives (Porter, 1980).

1.7.2 Automatic teller machine (ATM)
A terminal used by most bank customers to perform withdrawals and other transactions concerning their bank accounts (European Monetary institute, 1996).

1.7.3 Information system
A set of interrelated elements or components that collect (input), manipulate (process), and disseminate (output) data and information and provide a feedback mechanism to meet an objective (Baba & Takai, 1990).

1.7.3.1 Internet
The world's largest telecommunication network (Baba & Takai, 1990).

1.7.3.2 Information
A collection of facts organized in such a way that they have additional value beyond the value of facts themselves (Baba & Takai, 1990).
1.7.4 Transaction
Any business related exchange (Coombs, Saviotti & Walsh, 1987).

1.7.5 Smart card
An intelligent card with an embedded computer. It holds a great deal of information that identifies the bearer. They are commonly used in the telecommunication, banking, airline, transportation and medical industries (European Monetary institute, 1996).

1.7.6 Innovation
A series of scientific, technological, organizational, financial and commercial activities (Baba & Takai, 1990).

1.7.7 Payment System
A set of instruments, banking procedures and, typically, interbank funds transfer systems that ensure the circulation of money (European Monetary Institute, 1997).

1.7.8 Market Power
The ability of firms to raise prices above the level that would obtain in a purely competitive market. Those higher prices basically represent a transfer of income from other firms and from consumers to the companies with market power (Coombs, 1987).

1.7.9 Commercial Banks
These are institutions that are engaged in day-to-day financial transactions. They in general accept deposits from customers, provide custody for the financial instruments and provide loans as need arises (Wikipedia, 2004).

1.7.10 Banking industry
Establishments primarily engaged in accepting time deposits, making loans (mortgage, real estate, commercial, industrial, and consumer), and investing in high-grade securities. Savings and loan associations, savings banks, and commercial banks are included in this industry (Bitpipe, 2004).
1.7.11 Regulation Q

A United States government regulation that put a limit on the interest rates that banks could pay, including a rate of zero on demand deposits. The government-imposed interest rate of zero on demand deposits encouraged the emergence of money market funds and the growth of substitutes for and alternatives to banks. Regulation Q ceilings were for the most part phased out in the early 1980s by the Monetary Control Act of 1980 (Wikipedia, 2004).

1.7.12 Check 21

A federal law that is designed to enable banks to handle more checks electronically, which should make check processing faster and more efficient. Today, banks often must physically move original paper checks from the bank where the checks are deposited to the bank that pays them. This transportation can be inefficient and costly. Check 21 became effective on October 28, 2004 (Federal Reserve Board, 2004).

1.8 Chapter Summary

In this chapter an introduction was made highlighting the general information about competition in the banking industry in Kenya. The need for the research was presented in the problem statement. The research objectives, importance and scope of the study and definition of terms were also addressed in this chapter.

The next chapter presents the literature review.
CHAPTER TWO

2.0 LITERATURE REVIEW

2.1 Introduction

The previous chapter provided an introduction to the study. This chapter focuses on relevant literature and is organized as follows. The introduction is in Section 2.1. The meaning and scope of bank competition in section 2.2. Section 2.3 addresses the global banking industry with subtopics addressing the key factors influencing bank competition, the benefits of information technology on bank competition and the role of the size of a bank in formulating competitive strategies. Section 2.4 presents the competitive strategies in banks resulting from ATM market. Section 2.5 looks at Kenya’s banking industry, 2.6 Key developments in Kenya’s banking industry and Section 2.7 the summary.

2.2 Key Factors influencing Bank Competition

2.2.1 Meaning and scope of bank competition

2.2.1.1 Meaning of bank competition

In defining bank competition the Global Finance Magazine (2005) gives the example of the Fortis Group which states that in order to them to retain customers and attract new ones, they have no choice other than to be better than their competitors. They have to consider technology and innovation as allies in their striving for superior customer satisfaction.

In their survey conducted on several worldwide banks the Global Finance Magazine (2005) provides several examples of bank competition in which it shows that a bank must be able to respond quickly with innovative services that reduce the day-to-day operational hassles of the corporate client. In addition it adds that it is advantageous for customers to choose a financial group that can deliver a total package of services, including banking, securities, insurance and leasing and local and international presence. They conclude that banks should have a strong local presence, with a large branch network and a clear, long-term strategy,
2.2.1.2 Scope of bank competition

According to Milbourn, Boot and Thakor (1998) banks are getting bigger and doing more to increase their shareholders wealth and/or merely to enhance the reputation of their management. Also it could be to offer strategic benefits in an environment with sufficient probability in current operations and substantial uncertainty about future core competencies. The most recent global mergers in banking have occurred in the USA, Japan and Europe. Chemical Bank Corporation paid $14.5 billion for Chase Manhattan. In Europe, Union Bank of Switzerland and Swiss Bank Corporation merged and in Japan, the most spectacular merger of all produced the new Tokyo-Mitsubishi Bank with over $700 billion in assets.

Claessens and Klingebiel (2001) state that country experiences and theory demonstrate that increased competitiveness within the Banking Industry enhances the functioning of the financial sector. Entry policies matter importantly in determining the level of competition in a banking system. Foreign bank entry can improve the functioning of National banking markets, though putting additional pressure on domestic firms to improve their productivity and services and allowing firms access to foreign technologies and ideas to help them raise efficiency. Openness to foreign competition would thus have positive welfare implications for banking customers and countries. Argentina, Colombia, Hungary, Ireland, Portugal, Spain, Turkey and others both opened internationally and deregulated rapidly domestically and reaped substantial gains. Opening up to foreign competition need not imply that foreign banks will dominate.

Banking is becoming more competitive and banks therefore need to improve their cost efficiencies to compete more effectively. This leads them to grow bigger to exploit economies of scale. Moreover, competition squeezes margins in traditional commercial banking, making it more attractive for banks to look for other sources of profitability. Expanding scope means banks can offer customers a greater diversity of financial services possibly at lower cost. The principal advantage of expanded scope is that the bank gains first mover advantage in a new market and learns about the match of its skills to those needed to compete effectively in that market. The expansion of scope and early entry offers potential strategic advantages that could lead to the discovery of skills that
allow for more efficient delivery of activities and make the bank a more credible competitor (Milbourn et al., 1998).

In most countries, regulation rather than competition determines the range of products and services a bank can offer, types of assets and liabilities it can hold and issue and the legal structure of its organization. Different countries have configurations of permissible activities for various types of financial institutions. These can either be a separate financial system where banks are not allowed to engage in any type of securities or other non-credit financial services or a completely integrated system where banks can provide all types of financial services either directly or indirectly (Claessens et al., 2001).

A report by RTB Business (2005) stated that weak bank competition costs consumers and as a result they have not had better services, prices and products. When banks such as the Bank of Ireland and AIB have 70% of the personal banking market this shows a lack of competition. They recommend that banks should do a lot more by making easier for consumers to switch direct debits and mortgages. And be able to access cheaper loans.

Hanford (2004) stated that in its July 2003 ranking of world banks, The Banker magazine saw US banks as eating up the competition. In an era of low interest rates, US banks keep increasing their profits and their overall size, while banks from most other countries remain stagnant or even lose money. The high profit margins are due, in part, to consolidation, which is eliminating some of the smaller, poorer performers. However it was evident that consolidation has been slower in other countries.

A report by Zarettsky (2004) showed that between 1990 and 2002, the total number of banks and thrifts in the United States fell from 15,131 institutions to 9,336. The foremost cause of the decline was a significant relaxation of U.S. bank branching laws, which allowed mergers and acquisitions that previously had been prohibited. These procedures are an effective and consistent method by which federal banking regulators ensure that bank mergers and acquisitions do not substantially lessen competition in any line of commerce in any section of the country in the present or future.

According to the Canadian Federation of Independent Business (2003) in Canada the federal government has rejected all proposed bank mergers, citing competition issues as a concern, however the final decision over bank mergers rests with the Minister of Finance
based on public interest considerations that includes the costs and benefits to individual consumers and small business owners, as well as regional impacts and employment. Supporters say there is currently insufficient competition in the banking industry and allowing bank mergers would only worsen the situation, while Opponents say the Canadian banking industry is competitive, but to protect consumers and small business in the long run, banks need to increase in size and pool their resources to offer the full range of banking services at competitive prices. A bank merger is simply a business strategy and Ottawa should not interfere in deciding what a bank's business strategy should be. Many other countries allow bank mergers as a way to strengthen their banking industry.

Berger (2003) reported that competition forces the inefficient banks to either improve or to leave the market. As the lowest cost producers of banking services expand across many borders, they drive prices closer to marginal costs. Despite an explicit commitment to a level playing field, European governments often promote the expansion of their own nations' banks through tax subsidies, guarantees and direct ownership. As a result these government policies inhibit cross-border competition.

Ward (2002) stated that British banks are under unprecedented pressure over the "uncompetitive" banking market. In his research he showed that personal banking was not competitive, but technological progress was spurring competition. In addition in an earlier reports from The Competition Commission he reported that the big four clearers had earned £726m a year in excess profits from SME banking services in England and Wales, largely by paying insufficient interest on current and deposit accounts. The commission rejected the idea of requiring branch disposals, because customers would suffer from losing banking relationships. Instead, it recommended that the eight biggest banks facilitate account switching, limit service bundling, provide information on alternative suppliers, give more information in bank statements, and share branches.

In competitive markets, banks must adapt to survive, and when only a few firms compete, are they likely to possess market power, charge higher prices and produce lower quantities. Opportunities for mutually beneficial exchange are missed, and cartels are formed creating inefficiency (Ward, 2002).
2.2.1.3 Global Banking Industry

Osuagwu (2003) and Abraham (1999) both concur that the key factors influencing bank competition are technological, regulatory, demographic and geographic.

Abraham (1999) stated that in a survey of European banking and banks carried out in 1993 by Arthur Andersen, the EU Single Market Program was ranked as a major driving force for the bank strategies in the years to come. Nevertheless in a later survey done in 1995/1996 the same factor ranked only fifth in the list of other factors. The factors that were fundamental in influencing bank competition and development of strategies were technological change, domestic competition, domestic regulatory developments and competition from financial firms in other EU and non EU countries.

In his survey Abraham (1999) identified changes in technological, deregulation attitudes to shareholders value and demographic trends in the industrial countries as the underlying forces for change in European banking. The impact of the Euro was found to be significant as a catalyst for change, but only temporarily.

Berger and Robert (2001a) stated that the impact of geographic deregulation could be thought of as a two-sided coin. One side of the coin is the increased geographic mobility and growth opportunities for banks. The other side of the coin was increased competition for incumbent banks located in the target markets. Competition in local banking markets has probably grown more intense. A number of recent studies found that local banks tended to operate at higher levels of efficiency after an out-of-market bank acquires one of their local competitors. There are a number of explanations for this phenomenon, all of which begin with a post-merger change in the behavior of the acquired bank. The new owners of the bank often replace under performing managers, reallocate assets to higher yielding investments, slash expenses, introduce new products and services, cut fees, raise deposit rates, or make numerous other changes that intensify competitive rivalry in the local market.
2.3 Information Technology in Banking Competition

The key issues discussed under IT in banking competition are financial technologies, internet application, switching costs, cross selling and electronic payments and implementation.

2.3.1 Financial Technologies

An explosion in the growth of new financial instruments and institutions over the past two decades has placed increased competitive pressures on commercial banks. Bank depositors now have access to a vast array of mutual funds as an alternative vehicle for savings and liquidity (Petersen and Raghuram, 2002). Bank borrowers now have access to a greater set of financing vehicles, like commercial paper for the most creditworthy firms and junk bond financing for riskier firms. Result of these new financial instruments and institutions. But the loss of market share has been limited, in part, because banks have responded with new financial technologies to create entirely new business strategies. In many cases, these changes have fundamentally changed the way that banks do business. For example, by securitizing their loans (rather than holding them in portfolios) banks have economized on increasingly scarce sources of funds. Similarly, by reorienting their business mix toward off-balance sheet activities like back-up lines of credit, banks have continued to earn revenues from business customers that switch from loan financing to, say, commercial paper financing. And banks have made themselves relatively more attractive to depositors by offering increased convenience (e.g., ATM machines) and a broader array of investment options (e.g., proprietary or third-party mutual funds). These changes have greatly affected the composition of bank revenues, particularly at large banks (Petersen et al., 2002).

A bank with a securitized lending strategy collects little interest income because the loans it underwrites are not held for long on the books, but it collects lots of non-interest income (e.g., loan origination fees) because the volume of loans it underwrites increases. Similarly, a bank that writes backup lines of credit (rather than writing loans) receives a fee for this service, but receives interest income only in the rare case that the client draws on the credit line. And a bank with a large ATM network will receive fee income from third-party access fees, as well as disproportionate amounts of fee income from its own
customers, who arguably chose the bank because of its large ATM network and are presumably willing to pay for this convenience (Berger et al., 2000a).

2.3.2 The rise of internet in Banking Industry

As social pundits and industry analysts are fond of reminding us, the Internet changes everything. In banking, the Internet is changing the strategic landscape in two fundamental ways. First, the Internet reduces the importance of geography in the production of financial services and the maintenance of financial relationships. Second, the Internet greatly reduces the cost of delivering most financial services from the standpoint of the strategic map (Berger and Robert, 2001a.)

At its most basic level the Internet is simply an alternative distribution channel, so clues to how a bank will use the Internet can be gleaned from how it uses its more traditional distribution channels. The number of ATM locations has increased even faster than the number of branches. ATMs deliver a more limited array of services, but do so at increased convenience because they are located close to the customer - a convenience for which many customers are willing pay fees. While ATMs cost the bank less per transaction than brick and mortar branches, they accomplish this chiefly by replacing human tellers with automated tellers, and as such they cannot provide personalized service. Thus, an expanded network of ATMs is more consistent with the arms-length, high-volume, commodity-like business strategies of large banks. It is not yet clear whether Internet distribution is more consistent with large bank strategies or with small bank strategies. Internet web sites offer bank customers increased convenience: banking transactions can be performed at home, and pairing ATMs with hardwired computer terminals at public kiosks allows customers to perform Internet transactions while also making cash withdrawals or deposits (Hunter, 2001).

The Internet distribution channel naturally extends the large bank retail strategy. But the Internet also fits well with commercial bank business practices. Because providing and processing an Internet transaction costs banks much less as compared to transactions made at its branches, banks can substantially reduce their costs by encouraging their retail and business customers to migrate from branch banking to Internet banking. Thus, the Internet distribution channel naturally complements a commercial bank's business
strategy by simultaneously reducing its high expenses and providing its computer-savvy customers with additional options (Hunter, 2001).

2.3.3 The Internet and switching costs

Historically, both large banks and commercial banks have felt that they owned their deposit customers. Banks provided a limited range of financial services to deposit customers, including primary checking and savings accounts, credit cards, and access to settlement and clearing procedures. Customers had only to choose a bank, deposit money, and draw on those funds at some future date. To a large extent these customers were captive – that is, there was little threat that they would move their deposits to a different bank, because the costs of switching banks generally exceeded the benefits of switching. There were often few competitors (due to geographic and product market restrictions); competing banks could not compete freely on prices (due to Regulation Q); and most banking transactions required visits to physical bank offices (because ATMs, telephone banking, and Internet banking had not yet been introduced). Most deposit customers simply selected the bank that was located closest to their homes or work places, and as a result had inelastic demand curves that allowed banks to charge high prices for financial services (Berger and Robert 2001b).

Furst et al. (2000) wrote that formerly it simply didn’t pay for depositors to switch banks, but today customers have a wider range of choices. In the days when a customer had to be physically present to engage in most banking activities, proximity to the bank branch was important. A bank’s best customers are the customers with the most inelastic demand were those who lived closest to the branch. As lower communications costs and near universal access to the Internet have greatly expanded the geographic area within any given bank’s reach, the geographic distance between a bank and its deposit customers has also become less important. Deposit accounts can now be opened over the Internet without ever visiting a bank or branch office. As a result, customer switching costs are declining substantially, depositors have become more price sensitive, and this reduction in demand elasticity has sharply reduced bank pricing power. At the same time, deregulation (which allowed market entry by other banks) and financial market innovations (such as checkable money market mutual funds) had increased the number of financial institutions to which depositors could switch.
2.3.4 Customers’ deposit inertia

Banks are having to rethink their deposit and retail banking business, and relearn how to exploit their increasingly tenuous deposit relationships to create rents for the bank. However, there is a great deal of inertia among deposit customers. Many customers still prefer to use bank branches for as depositing checks, despite the fact that ATM machines can produce records just as well as tellers in manned branches. Similarly, customers who are perfectly willing to use ATMs are often unwilling to conduct basic banking transactions over the Internet. This hesitancy to use new banking technologies will undoubtedly fade as time passes, as the cost of contacting and switching to competing financial institutions continues to fall, and as local bank customers move up the technological learning curve. But until that happens, depositor inertia may provide a window of opportunity for banks to impose new switching costs on these depositors (Furst, Lang and Nolle, 2000).

2.3.5 The Internet and Cross-selling Financial Services

One way to increase the switching costs of local deposit customers is to embed them even more firmly in the local branch network. Banks can do this by cross-selling an array of products to these customers, with the goal of making the branch network the customer’s primary gateway to financial services. This is advantageous for the bank, because the cost of switching to a different bank increases with the number of services the customer accesses through the bank. Providing personal advisory services for these customers is an excellent, albeit costly, way to do this because it builds human bonds that are hard to break (Berger and DeYoung 2001).

Another approach is to offer a variety of services in a manner that makes them appear seamless – for example, a bank can link a home equity loan, a credit card, an overdraft facility, direct payroll deposits, insurance services, and perhaps even automated payment services to these customers’ deposit accounts, and present a consolidated statement to the customer at the end of every month. Once these relationships have been solidified – that is, once the switching costs of local branch depositors have been increased by binding these customers even more closely to the bank – the bank can safely begin to wean these customers from the branches and migrate them to Internet distribution. This has three
benefits for the bank. First, Internet transactions are less expensive to produce than branch transactions. Second, once customers begin to use the Internet, the bank can widen the gateway further by linking customers to even more cross-selling opportunities. Third, the specialized computer software required for the customer to gain access (which the customer must install, initialize, and learn to use) acts as yet another switching cost (Hunter, 2001).

2.3.5.1 Cross selling

Cross selling involves one business helping another business sell products and services. Usually the businesses are within the same corporate family, but joint ventures and other arrangements are also used to promote sales (Michaels, 2005). Cross-selling a vast array of financial services can require a bank to operate at a large scale and/or have a high degree of financial expertise. By offering access to more than their own in-house products and services, banks will become more attractive as an access point if it offers the best services. By offering other firms’ services, banks also make a commitment to customers that they will not be over charged, ripped-off, or gouged later if they lock themselves into their banks. Moreover, the banks are then in a position to extract rents from the other services providers, not vice versa, because it is the banks that control the unique assets: captive customers and the access gateway (Sullivan, 2000).

2.3.6 The Internet and Electronic Payments

According to Sullivan (2000), payments services have always been a primary service provided by banks, and access to the payments system is central to the value of a banking franchise. The Internet will eventually cause a change in the production of payments services – away from physical checks, toward electronic impulses – and this change could have a potentially large and negative strategic impact on commercial banks. Most analysts agree that payments provision is a high fixed cost/low variable cost business. In high fixed cost industries, service providers have an incentive to acquire a large share of the market, because this allows them to spread their high fixed costs over a larger base of customers. In addition, gaining a dominant market share in payments might allow a firm to establish industry standards for hardware or software, giving it a competitive advantage over new entrants who must adopt these standards in order to access to the system.
Being a dominant firm in payments may also allow a bank to exploit scope economies or economies of sequencing that give it cost advantages over competitors in other product markets. If electronic payments provision does become concentrated in a handful of few large financial institutions, standard economic theory suggests that these firms will be able to exploit monopoly power. Dominant firms will not face much competition, because entry is unlikely: a failed attempt at entering the business will saddles the prospective entrant with large sunk costs. In addition, financial institutions with large market shares and thus low unit costs in this segment may be able to exploit their positions by engaging in limit pricing that further reduces the chance of competitive entry. Thus, small banks may be at a disadvantage in offering electronic payments to their customers. Being too small to economically produce the service themselves, they may have to pay high prices to dominant firms in order to purchase electronic payments on behalf of their deposit customers. Furthermore, the dominant providers may be able to extend their monopoly power in payments services into more traditional banking services (Hunter, 2001).

2.3.7 The Internet and overarching Bank Strategies

If banks use the Internet mainly as a substitute for, or as a complement to, more traditional distribution channels, then the current strategic banking environment will not materially change. Large banks could expand their customer base without having to acquire other banks, and without having to operate their expensive branch networks, but result in becoming less attractive for the high-value, relationship-based target customers of commercial banks. Commercial banks would be able to maintain their profit margins without cutting their costs, and as a result they could simply use the Internet as a complement to their existing branch networks, offering only a limited array of convenience services at their websites. Commercial banks would remain pinned in the northeast corner of the strategy space, producing high-cost, customized services for local customers (Sullivan, 2000).

2.3.8 Internet implementation

The Internet can be an opportunity for commercial banks as well as a threat. On one hand, commercial banks are unlikely to successfully use the Internet to acquire new customers, because small banks cannot afford the high advertising expenditures necessary to support a web-based marketing campaign. It is noted that one of the ironies of e-commerce is that
advertising in the print media and on television is often needed to attract customers to a new web site. On the other hand, it is absolutely crucial for commercial banks to offer transactional web sites in order to retain their existing high-value customers, who are willing to pay high prices for differentiated, highly personalized products and services, but who also want the flexibility and convenience of performing some of their financial transactions over the Internet (Hunter, 2001).

In some ways the Internet may level the playing field between large banks and small banks. The expense of setting up a basic transactional web site is relatively low, which allows small banks to offer their basic retail customers a web channel that is competitive with those offered by larger banks. Once the web site is in place, commercial banks could reduce their unit costs by eliminating some of their expensive brick and mortar branches locations. This must be carefully done, because overdoing this costcutting strategy could diminish the branch-based, person-to-person contact upon which the commercial banking strategy is based; in other words, commercial banks cannot run the risk of getting too far out in front of the migration of captive, inertial local branch depositors to the Internet. But as time passes, the Internet should allow commercial banks to stay in close touch with their high-value customers while selectively pruning their physical plant and personnel overhead (DeYoung, 2000).

The current conventional wisdom is that both large banks and commercial banks will combine the Internet channel with their traditional brick and mortar branches (Hunter, 2001). An alternative approach is the Internet-only, or virtual bank, distribution strategy that eschews brick and mortar branches altogether. Only a few Internet-only banks are operating in Kenya., and to date these banks have not performed well – but Internet-only banks are using a very new business model, and it is possible that both these banks and their customers are only just learning how to efficiently use this model, and that financial performance will improve in the future. If the Internet-only delivery model ultimately proves to be profitable, it would seem to be well-suited for banks that have the capacity to offer large volumes of low cost, standardized products and services (Furst, Lang and Nolle, 2000).
Continued technological change in the banking and financial services industry and in electronic or Internet banking are inevitable. The degree to which large banks are successful – and hence the amount of profitable market share ultimately retained by commercial banks – may depend on how well both sets of bankers can harness the benefits of new technology in an increasingly competitive and fully deregulated environment (DeYoung 2001a). These changes pose great challenges and offer potential opportunities for commercial bank, regional banks, and large banks alike. DeYoung (2001a, 2001b) found that new Internet-only banks perform poorly relative to other new banks, but he also finds some evidence in support of the proposition that Internet-only banks are moving up a steep learning curve.

2.4 Role of the Size of a Bank in Formulating Competitive Strategies

The key issues considered were branches, mergers and acquisitions, scale economies, centralization, outsourcing and affiliations, internet implementation and innovation.

2.4.1 Branches

According to a study by the Federal Deposit Insurance Corporation (2004) Internet primary banks were institutions that delivered banking services mainly online. By eliminating physical branches and employing fewer employees, they could potentially provide banking services at lower cost. In reality, however, Internet banks underperformed “brick-and-mortar” banks. This reflected limited consumer demand for Internet banking services and the lack of barriers of entry for other banks to offer Internet banking. They were also at a competitive disadvantage relative to “brick-and-mortar” banks in lending to small businesses because they lacked the means of building long-term relationships with borrowers.

Bank branches in the United States of America were costly, so non-interest costs were higher for banking organizations operating multiple branches versus companies with a single office. However, banking organizations with larger branch networks generally had much higher non-interest revenue, and as a result, better efficiency ratios. The increase in branches was driven by customers demand and location choice. However, the general trends suggested that branching would continue, at least in some markets, particularly in
those with strong population and employment growth (Federal Deposit Insurance Corporation (2004)).

2.4.2 Mergers and Acquisitions

Thibault, (2003) analyzed mergers and acquisitions in banks and found that in an increasingly competitive context with reduced leeway, the American banks and the European banks had set off on a soft-footed offensive. While the exponentially growing former were multiplying their arranged marriages, the more cautious latter preferred either forced celibacies or careful unions. As for the banks of Southeast France, they preferred emphasizing localized service. The acquisition of Bank One in the United States of America in mid-January 2004 by JP Morgan Chase, at a record $58 billion, a giant merger that positioned it now as the second American bank behind Citigroup and in front of Bank of America, initiated a new era favouring the concentration of domestic banks.

In view of the sheer heft taken up by the American heavyweights, Old Europe’s financial institutions no longer had much choice. They had to pursue the consolidation route particularly since they had the necessary means. At the end of 2003, the European banking sector had 33 billion euro in shareholders’ equity, including 11 billion for the British establishments and nearly 10 billion for the French. The problem was that, for competitive reasons, the British banks could no longer merge among themselves. In France or in Italy, where the parts of the market were more divided, connections were halted by the dread of misalliances between mutual and capitalist banks. The only solution was external growth that naturally offered a united Europe, reinforced by its sole currency, while the persistence of regulations and of national taxation prevented the fulfillment of cross-border synergies in the field of retail banks. The most efficient banks of Monaco, such as Crédit Foncier de Monaco, private banks for the most part, essentially oriented towards an international clientele, were observing the strategic movements of Europe’s banks with vigilance, consolidating their funds and investing in efficient computer systems to best prepare for their entry into the European Union (Thibault, 2003).

Mergers according to Milbourn et al. (1998) appear to improve the profitability ratios of banks. Mergers between small banks appear to increase lending to small businesses, but
mergers between larger banks generally decrease this type of lending or leave it unaffected. According to De Young (2000) banks have a variety of motivations for making acquisitions. Benefits from increased scale are the most obvious, including but not limited to: reduced unit costs; higher per unit revenues; improved access to capital markets; the ability to make larger loans or offer broader product lines; the ability to attract and retain high quality managers; reduced portfolio risk from diversifying into new geographic markets; and network benefits from integrating systems of branches and ATMs that cover different geographic areas. For banks that use traditional bank distribution channels, acquiring existing banks is simply faster and easier than growing internally by building new physical capacity. Acquiring physical branches may become a less important motivation for bank mergers as banking products and services are increasingly delivered over electronic banking channels. The impact of geographic deregulation can be thought of as a two-sided coin. One side of the coin is the increased geographic mobility and growth opportunities for banks. The other side of the coin is increased competition for incumbent banks located in the target markets.

Banks in the US either responded in kind or they lost market share. By making repeated market extension mergers, large banks found themselves competing in hundreds of different local markets. Not only were these super-regional banks substantially larger than the community banks they faced in these local banks, their business strategies tend to diverge from those of community banks. These shifts in large bank business strategies can create important profit opportunities for community banks. For example, when a large out-of-state bank acquires a small local bank, the acquired bank often reduces its commitment to small local businesses. These "abandoned" small business customers provide a growth opportunity for other local banks, or provide a critical mass of business for new start-up banks to enter (Berger et al. 2001a).

2.4.3 Scale Economies

An objective of large banks merging is to achieve scale of economies and this is backed up by studies that find opportunities for significant economies of scale at regional, super regional, and global banks. Larger banks also tend to sell a non-traditional mix of services, using production and distribution techniques that give them access to deep scale savings but that require higher operating leverage (lower per unit expenses but higher
fixed expenses). The most extreme cases of this are “mono-line” banks that employ new financial technologies to specialize in a single standardized product (e.g., credit card banks, mortgage banking) which enjoy scale economies out to very large sizes. But standardized (i.e., undifferentiated) products do not command high prices, so for large banks the path to higher profits requires continued growth to capture additional scale-related savings (Whalen, 2001).

2.4.3.1 Cost Reduction

Another reason that the profit margins of large banks rely so much on cost reductions is the plentiful competition among large banks in most retail and wholesale markets. Scale and scope economies typically have important implications for the structure of an industry – if such economies are substantial, an industry will tend to be relatively concentrated and entry will be difficult. But despite the large cost savings apparently available from increased size in banking, there is currently little evidence of market power for large banks in banking markets. As long as industry consolidation does not devolve into a tight oligopoly and pricing power – and currently there is little reason to expect this, given continued entry by large domestic banks, large foreign banks, and de novo banks – there should continue to be pricing pressure on large and small banks alike. In such a world, a bank cannot raise its prices unless the products they are selling are differentiated from their competitors’ products.

2.4.3.2 Bank Proximity

Hunter and Timme (1991) provide evidence that large and small banks use entirely different production functions. Their research suggests that efficient scale for commercial banks is well below efficient scale for large banks and like all physical phenomena, there are limits to scale-related gains. They state that interpersonal phenomena may be more limiting than physical phenomena especially when business units move further away from headquarters and become more difficult to control in their activities. These difficulties are amplified at cross-border banks in addition to the problems of managing a geographically diverse company. As a result cross-border banks must overcome differences in language, culture, currencies, regulations, and local business practices that could drive up costs, depress revenues, or hamper growth. As time passes, improved technology is likely to partially mitigate the operational and managerial problems of distance by allowing banks
to better control the operations of their affiliates as these offices move further away from the headquarters.

2.4.4 Centralization in Banking Industry

2.4.4.1 Decision making

Imposing centralized decision-making authority may also help mitigate the agency costs found in large, geographically dispersed banks. In many ways, a centralized management model goes hand-in-hand with the ongoing movement of large banks from the northeast corner to the southwest corner on the strategic map. Centralization is consistent with standardized products and services; centralization seems like a natural way to limit agency costs as an organization grows in size; and centralization may become easier to implement as new technologies allow headquarters managers to better communicate in real time with branch managers (Rossi, 1998).

2.4.4.2 Centralized Decision making

According to DeYoung (2000) for most banks, the optimal organizational structure combines some degree of centralized decision-making authority with some degree of decentralized decision-making authority. Decentralized authority gives the operations side of the bank the flexibility to exploit local market information advantages, while centralized authority allows the product side of the bank to exploit opportunities for product synergies, scale economies, and innovation. Geographically dispersed bank that sells completely standardized financial products has little need for local information gathering or decision-making, while a very small commercial bank that personalizes all of its retail and small business relationships has little need for centralized command and control type decision-making. Decentralized decision-making is a good fit for commercial banks, because it keeps bank decision-makers in close proximity with the customer and with local information, but has some potential disadvantages such as branch office managers can misusing the autonomy granted to them by senior management, and foregoing opportunities for scale or scope economies in certain product processes.

Strahan and Weston, (1998) indicated that small banks as opposed to commercial banks are less likely to have internal information and management control (agency) issues, as
they have relatively limited access to economies of scale and scope. However, as we move into a more integrated electronic and Internet banking world in which geographic location is less important for defining a bank's customer base, maintaining a decentralized decision-making approach may become less important for commercial banks. For banks that possess special localized knowledge about their markets but recognize that retail customers in an Internet banking world will have fairly low switching costs a combined strategy of decentralized operational decision-making and centralized product decision-making may make more sense.

2.4.5 Outsourcing and Affiliations in Banking

Commercial Banks lack significant scale and as result will always be at a cost disadvantage relative to large banks (Berger, Rebecca and Strahan, 1999). Some small banks have attempted to mitigate their lack of scale by outsourcing back office operations to large-scale venders (to reduce unit costs) or by affiliating with large-scale providers of nonbank financial services (to provide their customers with broader access). However, when attempting to circumvent the weaknesses of their small-scale and decentralized strategy, commercial banks must be careful. Outsourcing must be done without sharing a substantial portion of their profits with the outsourcing venders, and without having their a substantial portion of their customers captured by the access providers. More fundamentally, focusing too closely on scale can be a strategic mistake for commercial banks because – as illustrated in the strategic map analyses – large scale operations can be antithetical to relationship-based services, and commercial banks over-reaching for scale can easily lose their core strategic advantage (Berger et al, 1999).

2.5 Competitive Strategies in Banks resulting from the Evolution of the ATM Market

In explaining competitive strategies Shaberg (2004) noted that they were a way for banks to stay ahead in today's market while according to Osuagwu (2003) competitive strategies were means to assess customers needs and the bank's potential to gain competitive advantage through strengthening its domestic base to ensure survival and growth. The key
issues addressed under competitive strategies in banks are global trends, competition in banks, a look at African banking industry and innovation.

2.5.1 Global Trends

Carey (2004) wrote that for banks to realize new revenue streams as payment transactions evolved, they needed to redefine their value proposition to existing and prospective customers. Banks it was noted had to go beyond managing the movement of money and consider managing the information embedded in the payments that came in over multiple payment networks. In the US preparation for implementing the Check Clearing Act for the 21st Century (Check 21) had prompted many banks to invest in IT. One challenge banks were dealing with was the gradual phasing out of checks as a way to make payments. At the same time the number of electronic payments was growing as shown from 30.7 billion in 2000 to 45.1 billion in 2004 to an estimated 60 billion in 2007. She recommended that banks needed to move from hand wired payment processing to distributed processing modes and adopt strategic IT models that brought them competitive advantage.

In his research on competitive strategies Shaberg (2004) stated that a community bank with strong financial performance, a diversified income stream and a desirable branch network would always have more success in raising capital. He further went on to point out that many community banks were also creating competitive strategies to help them stay ahead in today’s market. Banks needed to periodically evaluate their type of character, form of organization and operating structure to determine if they were best positioned to take advantage of market opportunities. Many community banks were forming parent holding companies allowing them to offer a broad array of services and products. Others were taking advantage of branch sales in connection with large scale mergers as a way to increase market share and expand their presence in their communities. In addition, other institutions were creating operating subsidiaries to engage in financially related services (such as trust, insurance and investment advisory services) as a way to diversify their operations and create services of non-interest income.
2.5.2 *Competition in banks and shared ATM networks*

According to the Financial Standard (2004), during the year 1999, the banking sector in Kenya embraced the changes occurring in information technology. The banks which were front runners had already achieved branchless banking. The big banks expanded their networks of Automated Teller Machines (ATMs) while the small and medium size banks were exploring possibility of establishing shared ATMs. Several banks also entered into internet banking and established websites. However, internet banking is still in its infancy and is also hampered by the lack of modernization in the telecommunications sector.

Small banks feel that they have suffered at the hands of shared regional networks in which the largest banks control the networks. Accordingly, the shared-ATM networks are not acting on their own behalf but serve to increase the market power of the large regional banks as opposed to being able to provide customers with access to many ATMs. A bank with more ATMs can give its depositors better value than a bank without a proprietary fleet of ATMs. That fact will play into the preexisting trend toward consolidation of the banking industry. Opponents of surcharging assert that it confers a competitive advantage on banks that own large numbers of ATMs because it induces customers of banks that own few ATMs to move their accounts to avoid surcharges. Supporters point out that it enhances cardholder convenience because it allows ATM owners to deploy their machines in locations that otherwise could not support one on the basis of interchange revenue alone. ATM surcharging has also encouraged non banks to enter the market and become ATM owners (Keenan, 1998).

Before surcharging became common, the cost to cardholders of using any ATM on the shared network was the same as using one of their bank's own ATMs, except in the case in which the bank levied a so-called foreign fee. Now most cardholders seek out their bank's proprietary ATMs to avoid paying surcharges. Given that access to ATMs and the cost of using them are now a significant part of the way banks compete for customers, ATM surcharges may put small banks—or, more accurately, banks that do not own many ATMs—at a disadvantage. Overall, the competitive landscape in the ATM market is complex. Understanding supply and demand in any market helps illuminate the state of competition. In the ATM market, supply is driven primarily by the economics of investing in ATMs while demand is characterized by consumers' willingness to pay for
the convenience ATMs offer. Those forces, the characteristics of networks, and the incentives of bank and nonbank ATM deployers are all aspects of the competitive environment of the ATM market (Robin, 1997).

2.5.3 African Banking Industry

In a study of African Banks, Osuagwu (2003) analysed Nigerian banks and showed that results implicated competition as the most important and impacting factor in the strategic marketing practice of Nigerian banks. This was followed by economic factors, bank clients’ behaviour, technology in banking, government policy, legal provisions and banking culture. Political factor (and structure of the Nigerian banking industry) were found to be the least important (and impacting) factors in the strategic marketing behaviour of these banks. The highest salience given to the environmental factor of competition in banks’ strategic marketing practices may have been occasioned by the deregulation in the banking industry which encouraged new banks to enter into the Nigerian banking system, resulting into intense competition within the banking industry. As a result of this intense competition, Nigerian banks had started exploring new services and markets to ensure survival and growth.

In Nigerian banks, the marketing strategy employed according to Osuagwu (2003) focused explicitly on the quest for long-run competitive advantage. As such, it had a high degree of overlap with corporate strategy and could be viewed as an integral part of, and perspective for, corporate strategy. Marketing strategy’s difference was that it served a link role function between a firm and its customer, clients, competitors and other stakeholders (i.e. its environment) and was uniquely able to assess consumer needs and the firm’s potential for gaining competitive advantage, which ultimately could guide the corporate mission. A good deal of the bank strategies in European banks according to Abraham, (1999) were of the accommodating type, adjusting both at the industry and the firm level. In addition, market share strategies also existed aimed at strengthening the domestic base of the banks.

2.5.4 Innovation

According to Berger et al. (2001), as large banks exhaust all the potential gains from increased scale – or after they grow so large or geographically diverse that their agency
problems become unmanageable—large. One potentially long-lasting innovation is to identify areas of high transaction cost and to reduce those costs by *internalizing* the transactions. To the extent that there are first-mover advantages in this approach, the bank can build a long-term franchise. For example, Citibank has recognized that there are still very high costs in making cross-border payments. By setting up a global network of branches and developing tremendous expertise in foreign exchange transactions, it has internalized cross-border payments. The savings in transactions costs coupled with the very high volume of transactions make this a very profitable franchise. Moreover, other banks are unlikely to challenge this franchise because of the high costs of setting up a competing network, and the formidable position now occupied by Citibank. Berger et al. (2001b.) also give the example of Schwab who used innovation to build a captive customer base. As one of the first brokerages to allow customers to trade electronically, it cross-sold a variety of products, including information services and mutual funds services that locked the electronic customer into a relationship with Schwab and allowed the scale to pursue further innovation.

### 2.6 Kenya’s Banking Industry

#### 2.6.1 Structure and Conduct

The Banking industry in Kenya is governed by the Companies Act, the Banking Act, the Central Bank of Kenya Act and the various prudential guidelines issued by the Central Bank of Kenya (CBK). The banking sector was liberalised in 1995 and exchange controls lifted. The CBK, which falls under the Minister for Finance’s docket, is responsible for formulating and implementing monetary policy and fostering the liquidity, solvency and proper functioning of the financial system. The CBK publishes information on Kenya’s commercial banks and non-banking financial institutions, interest rates and other publications and guidelines (Central Bank of Kenya, 2004)

#### 2.6.2 Conduct

There are forty-eight bank and non-bank financial institutions, two mortgage institutions, fourteen micro finance institutions and seventy one foreign exchange bureaus. Thirty-five
of the banks, most of which are small to medium sized, are locally-owned. The industry is dominated by a few large banks most of which are foreign-owned, though some are partially locally-owned. Six of the major banks are listed on the Nairobi Stock Exchange (Central Bank of Kenya, 2004). The banks have come together under the Kenya Bankers Association (KBA) which serves as a lobby for the banks’ interests and also addresses issues affecting member institutions. The commercial banks and non-banking financial institutions offer corporate and retail banking services but a small number, mainly comprising the larger banks, offer other services including investment banking (PricewaterhouseCoopers, 2003).

According to Oloo (2005) The Central Bank of Kenya has in the past proposed that section 44 of the Banking Act be repealed in line with the Government liberalization policy. However until such a time when Parliament repeals this section, banks will continue to seek approval from the Minister for Finance in compliance with the current law. Parliamentary debate and final resolution of this issue is awaited, following the President’s memorandum returning the Banking (Amendment) Bill, 2004 back to Parliament. The objective of Central Bank in publishing interest rates and bank charges by various banks is to provide information to bank customers to enable them chose the most competitive banks. This ultimately increases competition among commercial banks and facilitates in pricing of their services.

2.6.3 Key factors influencing Bank Competition in Kenya

2.6.3.1 Challenges

According to the Banking Survey of 2003, Economic Intelligence (2003) reported that the year 2002 presented a watershed for the banking industry. For a number of years, the industry has been experiencing challenging times. Some of the challenges have been external—a hostile operating economic environment and poor macro-economic policies. Others factors include poor supervision by the regulatory body (Central Bank of Kenya), a slow and cumbersome judicial process, poor debt culture and political patronage that had worked to the detriment of the industry. The general low profitability of the industry in recent years has been mainly as a result of the poor performance of the three of the top six banks, that is Kenya Commercial Bank, Co-operative Bank and National Bank. From
the first quarter results posted for the year 2003, it is beginning to look like there is some light at the end of the tunnel. This is a reflection of the current high optimism in the rest of country with expectation of improved economic performance.

The most problematic issue has been that of non-performing loans (NPLs). Now peaking KSh73 billion, representing 27 percent of total advances, banks have had to incur heavy losses as a result of massive provision and write-offs. Some of the challenges facing the industry have been of their own making; a huge bad debt portfolio, a weak capital base, weak management, the initial poor handling of the ‘Donde Bill’ (which sort to control interest rates) and the tendency to be reactive rather proactive to the challenges that the industry faces. It is common knowledge that many banks forgot what their core business was and all they did was to invest on government securities. The other area of focus for banks in an effort to generate income has become consumer loans. However, they are all chasing the salaried group target market which is a very small market indeed, leading to cut throat competition banks have to think outside the box in service provision, products and pricing. The consumer is becoming increasingly aware and empowered (Economic Intelligence, 2003).

In the Banking Review 2004, Mr. Andrew Mulei, the Central bank of Kenya Governor, as quoted in the Economic Intelligence (2004) stated that the face of Kenyan banking was changing in many ways. Some of the small to medium sized banks were beginning to compete with the big boys for both the corporate and retail market. NIC, CFC, Diamond Trust formerly non banking financial institution had been busy reinvesting themselves as commercial banks and were now taking on the biggest in the market i.e. Barclays, KCB and Standard Chartered. ATMs were no longer the preserve of the big three but there were now more than 10 ATM switches with two shared options available from Kenswitch and Paynet.

2.6.3.2 Bank failures

The Economic Intelligence (2003) introduced their report on the Customer Survey for 2003 for banks in Kenya by emphasising that bank failures could cause damage not just to Depositors, but much more widely across the economy. Banks were needed, not just for intermediation between lenders and borrowers but also to oil the wheels of everyday
commerce. If the banking system collapsed, the infrastructure for making and receiving payments collapsed too, and the rest of the economy would follow closely behind.

Bank failures in 2002 led many customers to believe that government involvement in the banking system was what aggravated matters by having virtually unregulated quasi-banks operating: government operatives urging banks to lend to specific firms with little regard to creditworthiness, connected lending and/or insider loans. In addition bank closures have been a common feature for several years, to the dissatisfaction of many bank patrons. In 2001, Barclays Bank closed more branches than any other bank. Kenya Commercial Bank Ltd, meanwhile, now has the largest network of branches (Economic Intelligence, 2003)

2.6.3.3 Tariffs

In their analysis on why banks in Kenya were defiant on tariffs, Economic Intelligence (2004) found that when the Central Bank Amendment Bill 2000, commonly known as the Donned Bill was unanimously passed by Parliament and received wide public support, banks cleverly read the signs and embarked on a gradual process of moving away from interest based income to non-interest revenue. With this came a myriad of bank charges on the account holders resulting from fees and commissions. Between 2002 and 2003 alone, bank charges rose by 10 percent from Kshs 13.8 billion to Kshs 15.2 billion against the backdrop of government attempts to force them to lower the charges. Indeed as the five top largest banks control over 80 percent of the sector the cartel like tendency has not augured well for the other players. The Central Bank pointed out that unless the sector retracted its steps to the core business of lending, the problem of high bank charges would be here to stay. Reasons for the lack of effective competition could be attributed to the barriers to entry and exit in which the Central Bank of Kenya has effectively frozen new banking licenses over the last 5-8 years. Secondly customers faced high costs of changing banks by being subjected to punitive penalties and charges when moving accounts. Thirdly Kenya’s financial system had systemic weaknesses that lowered competition, resulting from undeveloped credit rating systems and underdeveloped financial and capital markets.
2.6.3.4 Banking Innovation

Innovation in the banking system was seen by the Economic Intelligence (2004) as the smart response to the heightening competition as the scramble for a thinning market took its toll on banks. They gave the example of the National Industrial Credit Bank (NIC, 2003) which successfully launched the revolutionary banking concept dubbed the Right Move- a current account with a flat ledger fee of Kshs 800 per month. This concept redefined the personal concept in the country. In addition NIC bank also planned a five year expansion strategy to enable more products reach the market.

2.6.4 Information Technology in Banking Competition in Kenya

2.6.4.1 Banking and Technology in Kenya

In answer to the question on why technology was such a key player in the day to day operations of banks in Kenya, Adam Messer, was reported in Economic Intelligence (2004) as saying that they provided two crucial components- efficiency and security. In addition successful banking demands secure, reliable, efficient data communications which propels faster information flow and quicker decision making. As a result business processes depend on the flow of information. Distributing information more rapidly speeded up the entire business cycle. Today Kenyan banks are becoming more selective and discerning buyers of IT software, services and infrastructure. In the past, Kenyan banks were short-changed by buying into out-dated technology that frequently came without adequate local support. Now IT customers in banking wanted to know that the technology worked for them; and they demanded reliability and guaranteed support services. Most banks were moving towards electronic delivery of services because they realize that customers are beginning to demand this.

The biggest challenge for the I-bankers was the fast changing finance technology and the internet as noted by the Economic Intelligence (2004). In addition the increasing developments in the internet industry produced online I-bankers who had eaten into the full services of investment banking.
2.6.4.2 Adoption of new technology in Kenyan Banks

Electronic funds transfer system (EFT), i.e. the application of computer technology to banking especially in payments (deposit transfer) aspect of banking, radically altered the face of the Kenyan banking environment (Economic Intelligence, 2003). In addition new IT products changed the way banks did business, increased transparency, weakened the traditional relationship between clients and their banks, and drastically intensified competition, both among banks and between banks and non-banks. The same could be said of card-based payment systems. The branch network system (where branches were networked), was popular with customers, and Standard Chartered Bank closely followed by Barclays lead the pack. Together with Diamond Trust, one was not restricted to transacting at the branch where one opened an account. For Consolidated Bank and Co-operative Bank of Kenya, high spending on modern technology and on staffing would continue to be unavoidable.

Customers according to Economic Intelligence (2003) also felt that there was no convenience for most ATMs to be located around bank premises and preferred that a system should be set up so that a person could go to a supermarket and withdraw currency from their account through the help of technology. There can be no doubt that the ATM is going to grow in importance as an electronic channel, as it is already a competitive factor. Offering as many transactions as possible via the ATM and enhancing security are major challenges that will remain in the years to come. A lot is yet to be done on the technological front by banks, especially the smaller ones, as only two out of five customers rated the current use of technology as excellent or very good. Barclays and Standard (both big banks) came ahead of the others. Co-operative Bank of Kenya and Fina Bank need to revamp their current technological set-up further.

2.6.4.3 Benefits of IT in Kenya's Banks

According to the Daily Nation (2005, June 10), Equity Bank is to spend up to Sh. 600 million to upgrade its computer technology. It has contracted three technology firms to provide solutions for its branch network, automated teller machines (ATM) rollouts and product diversification. As a result the Bank's managing Director Mr. James Mwangi envisioned that their customers would enjoy among other services, Internet Banking, point-of-sale deposits, ATM services, true secure mobile banking, SMS alerts and
greater customer-profiled products. This opportunity would enable technology to support its aggressive expansion plans. And help drive its customer based micro-finance sector.

Writing on information technology in the Kenyan banking sector the Financial Standard (2004) gave the example of the Co-Operative Bank which is 100 per cent owned by the Co-operative movement in Kenya. It was currently in the league of banks that are offering the most competitive, technology-led innovative and time saving services, the latest being the introduction of Mobile Telephone Banking, trading as M-Banking. The introduction of new products that provided customers with convenience in accessing their accounts and greater control over their money were expected to sharpen the bank’s competitive edge, bringing additional depositors and revenue to keep the bottom line growing. The bank note that it was well aware of the growing competition in personal and customer banking segment of the banking business and believed the turf war could only be won through high-tech banking. In this regard they sought to install more ATMs at their various branches countrywide alongside the existing 32 already installed.

2.6.4.4 Trends and IT in Kenya

Mr. Takawira of Barclays Bank was quoted in a Economic Intelligence (2002) article as stating that the recent acquisition of a VSAT license was another development that would certainly have a major impact in the bank’s business and bottom line. This license, which the bank applied for seven years ago, would allow it to commence using satellite technology, which would allow the bank to provide more electronically driven products and improve on the quality of existing ones like the ATMs. It meant that Barclays' ATMs would be more reliable as would the card business. The bank would also be able to offer smoother cross-border transactions. Standard Chartered acquired a similar license after Barclays, spelling stiff competition ahead between the two multi-nationals. The bank had been preparing to launch the new e-banking services, but it would first launch a fully-fledged internet banking service. A pilot scheme with Africa Online, known as e-world had been on course for the last one year. Since the adoption of VSAT technology would make money transfer at the point of sale more reliable, the bank was likely to see the banking halls getting less congested. The impact of all this to Barclays was that they would certainly invest more heavily in the card business, as would other banks that were to acquire this technology.
2.6.5 Role of the Size of a Bank in Formulating Competitive Strategies in Kenya

2.6.5.1 Bank size

Economic Intelligence (2004) noted that four of the top 5 banks by size of profits in 2002 and 2003 were also the top ranked banks across the board on a broad range of performance indicators. They used shareholder’s funds more aggressively and deployed equity more effectively to make money. They ventured to propose that two basic factors drove success in Kenyan banking. Firstly the scale effect where size of bank mattered, in which the number and size of deposits, total assets and total lending was considered. Secondly, the quality and selectivity of clients, products and positioning. These two factors appeared independent of foreign or local ownership. The class leaders in the banking industry were Standard Chartered, Citibank, Barclays and Commercial Bank of Africa, while the bottom ranked banks were Akiba, Paramount, Delphis-Oriental, Giro Commercial and Fidelity Banks.

2.6.5.2 International business

International business is of prime consideration for multinational banks. In Kenya banks such as Standard Chartered, Barclays and Citibank have been able to dominate the banking scene by dealing in external import and export banking business and therefore taking up large corporations banking space. Banks such as Stanbic and Commercial Bank of Africa are also trying to conduct more of the same business, as a result the banking industry is slowing coalescing into a 3-tier system that developed markets like Japan and Germany (Economic Intelligence, 2004).

2.6.5.3 Branch Growth

There had been phenomenal growth in branch banking over the years. The reasons for this growth has varied over time – sub-urbanization (as the banking clientele moved to the outskirts of towns, and particularly as neighbourhood shopping malls were established, the downtown banks needed to follow their customers). In 2001, branches (including the head office) of commercial banks accounted for 89% of banking offices. In 2002, due to bank branch closures, this figure dropped to 80%. More branch closures are probably in
the offering as banks proceed with their rationalization strategies. Unfortunately, there is no plan in place to ensure that rural Kenyans maintain access to essential financial services. Through innovation, banks could achieve a much finer degree of control over financial risks. Across the entire economy, this made it possible for an investor to achieve a given return at a lower risk, or to earn a higher return for assuming the same risk as before. Banks should thus have endeavored to devise more efficient products that met the requirements of their diverse customers. Diamond Trust Bank once again took the lead on this score (Economic Intelligence, 2003).

2.6.5.4 Branch banking

The Economic Intelligence (2003) article on Branch banking noted that the increased Internet bubble in the 1990s saw banks book much of their business through the ‘wire-systems’ and in the process phased out the branch networks in the name of centralization of operations. Unfortunately, they have begun to realize that they are losing touch with their customers and are, by extension, losing out on customer-relations game. Consumers are insecure about their financial planning and banking. They desire a personal banking relationship that offers appreciation for their problems, clear expectations, new ideas for solution, and of course, relatively painless transactions. Bankers can learn from the experience of retailers, particularly regarding service mentality, ways to build loyal and trusting relationships, brand consistency, and store ambiance.

Banks needed to build a branch strategy that offered a totally new experience to customers. What customers are dying for are cross-trained and empowered staff that can execute teller tasks as well as open new accounts and approve some degree of lending, observe the 10-10 rule (open ten minutes early, close ten minutes late), and with reduced teller keystrokes. The key is to match products to customer needs and to know whom to target and when. Banks can do things more proactively. In this multi-channel era, customer initiative can be captured not just locally, as people walk into the branch, but centrally, as customers browse the bank’s website or contact the call center (PricewaterhouseCoopers, 2003).
2.6.6 Competitive Strategies in Banks resulting from the Evolution of the ATM market in Kenya

2.6.6.1 ATMs in Kenya

In the past, Banks have implemented ATMs whose main function has been cash dispensing and other traditional cash related functions. However with the challenges of fierce competition for customer's wallet share, pressure on profit margins, burgeoning customer expectations on service and convenience, declining customer allegiance and evolving market place, Banks like Consolidated Bank of Kenya (CBKL) have shifted to the implementation of modern full-function ATMs with unprecedented capabilities for customer convenience, wide variety of services/ information resources and revenue generation. The result is enormous benefits to consumers in terms of the ease and cost of transactions while enabling the financial institution to attract investment that boost profitability, operational efficiency, and continued growth (Consolidated Bank, 2003).

In August 2003, according to D'Souza, (2003) medium and small banks were introduced to joint ATM services through the Kenswitch project which was spearheaded by the Central Bank of Kenya. It was an initiative by a consortium of 20 banks to provide banks with ATMs and POS (point of sale) devices for their customers. This strategic move was expected to revolutionize the banking system by enabling more banks to enjoy the reduced transaction costs and increased efficiency of centralised ATM management that was dominated by a few big banks.

In their article on ATMS, Consolidated Bank of Kenya Limited (2003) stated that in extending the potential of ATMs to e-banking, the Consolidated Bank of Kenya Limited (CBKL) was leveraging the trust its customers already had in the automated technology, a high-level electronic platform that provides customers with secured, single sign-on transactional capability to conveniently access a bank's entire financial service offering. The increasing demand from customers for branchless electronic transactions had led to increased deployment of ATMs and other self-service cyber banks, raising the possibility of a future with clicks and no mortar as service providers competed for the customer's wallet share. CBKL has adopted a phased approach to its ATM deployment. In the first phase, the Bank implemented two multi-function ATMs installed at Koinange and Thika branches and integrated to Kenswitch. These ATMs can now be accessed by staff and
customers of Consolidated Bank as well as customers of other Kenswitch member Banks using their ATM cards for convenient automated teller services including cash withdrawals, PIN Change, balance inquiry and mini statement. A third ATM belonging to CBKL has been delivered to Mombasa and will provide services after installation in December 2004. The Bank's full-function ATMs are designed to provide cash dispensing, account transactions, deposits, document processing, envelope dispensing, mini-statement printing, passbook updating, high quality statements, coupon printing and advertising.

2.6.6.2 Upcountry branches

Kenya Commercial Bank has the widest network of upcountry branches in Kenya (Kenya Commercial Bank, 2005). In its completed three year strategic plan they were quoted by the Economic Intelligence (2004) as having further undertaken to refurbish these branches, expand their ATM network, reorganize staff and invest in Information Technology that would centralize its operations in one hub. KCB had chosen to remain as the ordinary Kenyan’s bank as their new project 'anteja' suggested. To ensure the success of this strategy they were endeavoring to avoid clogging the banking halls by installing an additional 56 ATMs. These the bank believed would serve a dual purpose of improved automation in branchless banking and provide several advertising points for its products and services.

2.6.6.3 Growth strategy

Diamond Trust Bank's income growth strategy (Daily Nation, 2004, Oct 7) revolved around income diversification and seeking lending businesses with ancillary earnings. This strategy had worked to the bank’s advantage enabling it to achieve high levels of growth despite the tight lending margins. This strategy also allowed the bank to successfully venture into non-interest earning business which had grown by 117 percent. The introduction of the Western Union money transfer services was also credited as the main factor in this respect. The bank’s regional status has enabled it foster closer working relationship with its associate banks in Tanzania and Uganda and the complete replacement of its information technology structure would enable it harmonize operations in its regionally offices and lay better groundwork towards moving into broader based retail banking.
2.6.6.4 Kenswitch

In their article on 'Kenswitch finally takes off' Economic Intelligence (2003) wrote that one key competitive edge for the larger banks in Kenya had been automatic teller machines (ATMs). The shared system of ATMs that some 20 Kenyan banks mooted in 2001 in conjunction with the Central Bank of Kenya was now read. The high cost of personal banking services to the retail customers led to the formation of Kenswitch. As technology moves in leaps and bounds some of the larger banks have rolled out new high-tech products. Kenswitch in recognition of the market trend towards new and innovative delivery channels is in the process of rolling out additional Value Added Services (VAS) in conjunction with providing ATMs. This will enable its member banks to stay competitive. Currently 25% of Kenswitch members are connected with a further 25% undergoing a certification process which all banks on the switch undergo in order to get connected. The other 50% of its members should be connected by the end of the year.

ATMs are very costly and depending on the type of machine it can easily cost up to $26,000 for a level-entry ATM and this does not take into account the additional maintenance costs. It is for this reason that the consortium of banks decided that it would be prudent for them to form a separate entity that will buy and run the ATM network since each bank could not afford its own network of ATMs. By using the Kenswitch model each bank can participate in a network, which is set to grow to 50 ATMs by year-end, at a cost of less than the cost of a single ATM! And in the era of branchless Internet banking, customers demanded a scenario where they did not have to bank with you in order to use your services. The Kenswitch system is supported by the Central Bank of Kenya (CBK) together with the Kenya Bankers Association (KBA) under the auspices of the National Payment Systems (NPS) Modernization and Reform Process Project. Although the electronic switch infrastructure is shared, the services and products on offer are tailored made by individual banks to meet their customers’ needs. When all the services on the system are up and running, for the very first time in Kenya, bank customers will have access to various services including cash withdrawals, bill payments and mobile phone recharge via multiple delivery channels including ATMs, POS, mobile phones and the Internet. However the Kenswitch board management team recognized that you built these types of networks through 'evolution not revolution', so the initial primary focus remained cash withdrawal at the ATM (Kenswitch, 2005).
Economic Intelligence (2003) explained that banks joined the system for different reasons. For some banks the switch will offer a channel by which to expand their customer base through the use of virtual branches or branchless banking while for others it is a cost reducing measure and would be a value added service for their clients. The banks also take comfort in the fact that Kenswitch is a local operation with the banks having the option of taking equity in the network. By virtue of its connectivity to multiple banks Kenswitch will provide a true Internet payment gateway thereby allowing business-to-business and business-to-customer e-commerce type of transactions.

2.6.6.5 Pesapoint

In an article titled ‘Paynet Plans New Banking Service’ the Daily Nation (2005, May 10) reported that a technology Technology firm, Paynet, was to begin work on a new automated teller machine (ATM) service called the Pesapoint, a third-party ATM network, that would be the largest such system in Kenya. The concept is to offer all financial institutions access to the network so that their cardholders can benefit from a wider footprint of ATMs. The first phase, comprising 120 ATMs, is expected to begin by mid July, and be completed by November 2005. Pesapoint is a separate company to Paynet, but the latter will provide all the management services, and Pesapoint will use the Paynet Outsourced ATM services to run the network. The only fee payable to Pesapoint is be a transaction charge per withdrawal through ATMs by bank card holders. The fee is fixed at Sh22 per transaction, which is expected to be marked-up by the financial institution before being passed on to the card holder. Paynet managing director, Bernard Matthewman, told Business Week that cardholders of partner financial institutions will be able to withdraw cash, do balance enquiries and mini statements as well as top up their mobile phones.

From a location perspective, the company intends to place Pesapoint ATMs in both rural and urban locations with particular emphasis on where people live, shop and work. The company says the services will be available to all financial institutions, including microfinance firms, savings and credit cooperative societies, building societies and banks. For those that do not have centralised, computer based financial systems, Paynet will find ways of helping them, one of which might be in partnership with a bank. The company’s first customer, NIC Bank, is acquiring transactions at their Move ATM’s, but not point of
sale transactions from merchants. The ATM transactions are fast, said Mr. Matthewman, adding that NIC has outstanding upload times which is good news for any Visa card holder who wishes to use their ATM's (Daily Nation 2005, May 10).

From the merchant perspective, the Daily Nation (2005, May 10), further stated that the firm provides 24-hour card authorisations services, which should help with authorisations for merchants when their links are down. The projected investment in the project at this point is around Sh600 million, said Mr. Matthewman. The company has also installed all the technology to provide a complete back office for credit and debit cards. This ranges from credit scoring at the take-up stage, to the final production of statements on a monthly basis. The advantage for a bank is that it does not have to go through the capital expense and time to set up their own processing centre. Paynet hopes to attract financial institutions in two aspects. First, it suits those that start with low volumes as their corresponding processing and capital costs stay down. Secondly, it reduces the overheads and management time required to run a processing centre. The company uses the CTL Prime, Online and Fraudguard systems that it says are the most advanced in the market. Paynet is targeting a wide range of banks from those starting up card operations to those with mature processing centres wishing to reduce costs. Regionally, the firm is eyeing institutions that have not yet issued credit or debit cards, but have a number of significant prospects. The rising cases of credit card fraud is a matter of concern to the company. However, Paynet says its Fraudguard system from CTL plays a major role in detection. For credit card processing, Paynet will maintain the full back office so any technical requirement for the bank is unnecessary. And for debit cards, the technical criteria is the same as for PesaPoint. Finally, Paynet needs to certify with the institution to ensure the whole process is behaving as it should.

2.6.6.6 ATM positioning

In October 2004, the Daily Nation (2004) reported that Diamond Trust Bank (DTB) Kenya had entered the retail banking market, with a new initiative termed Open Banking. The new prong in the Diamond Trust's business offered greater choice, fixed costs, internet banking and automated teller machines (ATMs) in the three cities of Nairobi, Mombasa and Kisumu. The bank had been positioning itself to take a fresh approach by introducing a range of products designed for the personal banker. The theme for the new
initiative revolved around the term ‘open’, denoting that the bank was open for business via the internet and ATMs, open to change through new products and committed to open and honest communication with customers. With regard to choice, it had three distinct packages. The ‘open plan’ package was designed for the customer who wanted a standard banking relationship, reliable service and a highly competitive fee. Open air option was a premium one, with internet banking, while the third option, open sky, offered a full suite of banking services.

2.7 Chapter Summary

This chapter provided a review of relevant literature on competition in the banking industry. Starting with a review of general factors that affect or influence competition, it went ahead to isolate IT and the role of ATMs as critical factors in this process. After this key issues in regard to the banking industry of Kenya were examined. The key issues arising out of this were the option of sharing ATM networks or installing individual bank ATMs, information technology as a source of comparative advantage and the challenges of sustaining the customer base.

Having reviewed the relevant literature, the chapter that follows presents the research methodology.
CHAPTER THREE

3.0 RESEARCH METHODOLOGY

3.1 Introduction

Having presented the literature review relevant to this research in the previous chapter, it suffices at this point to discuss the research methodology employed in this research. This chapter is organized as follows. Section 3.1 is an introduction. The research design is presented in section 3.2. Section 3.3 is on population and sampling design. Section 3.4 addresses the data collection methods used in the study. The research procedures are presented in Section 3.5. Section 3.6 addresses the data analysis methods and Section 3.7 the chapter summary.

3.2 Research Design

A descriptive study of commercial banks operating in the Kenyan economy was carried out. A descriptive study describes phenomena systematically to reveal patterns and connections that might otherwise go unnoticed. This approach was chosen as it enabled the characterization of the population in terms of certain attributes and described the system and product in use (Cooper and Schindler, 2001). A structured questionnaire was administered to the sample size of banks. In addition published information and data about the banks was also used to supplement the questionnaire data.

3.3 Populations and Sampling Design

3.3.1 Population

Cooper and Schindler (2001) define population as the total collection of elements about which the researcher wishes to make some inferences. The population of the research comprised a class of institutions that are known as commercial banks currently operating in Kenya, which are 48 in number. These are institutions that are engaged in day-to-day financial transactions. They in general accept deposits from customers, provide custody for the financial instruments and provide loans as need arises. From each of the 10 banks the population comprised 10 persons
from both the management and senior members of staff of the strategic management division, 16 from the information technology division, 22 from the marketing and research division and 20 from the development divisions of these banks as they represented the strategic and operational levels of the banks.

3.3.2 Sampling Design and Sample Size

A sample is a group of people that will be representative of the population (Cooper and Schindler, 2001). The commercial banks share common characteristics, this therefore made it easy to pick ten of them as a representative sample using purposive sampling. The total population of the four divisions of these ten banks comprised 680 employees. The study took 35% of this population as a sample. This represents a sample of 240 respondents.

3.3.2.1 Sampling Frame

This study collected data from 10 commercial banks operating in Nairobi Central Business District. The head offices of the following banks were involved in the study; Barclays Bank, Standard Chartered, Co-operative Bank, Comercial Bank of Africa, Investments & Mortages Bank (I & M), Kenya Commercial Bank, National Bank of Kenya, Citibank N. A., National Industrial Credit (NIC) Bank, and K-Rep Bank. Since it was not possible to collect data from all banks in the said region, banks with the highest asset portfolio and competitive trends in the industry were used as the frame from which the sample was identified. In each of the banks the head of operations provided the names of management and senior members of staff in the four divisions of strategic management, information technology, marketing and research and development for the study.

3.3.2.1 Sampling Technique

A convenient and purposive sampling technique was employed to collect data from ten (10) commercial banks operating in Nairobi. The purposive sampling technique was chosen as the respondents selected in each bank represented diversity and also enabled the probing of particular issue (Mayoux, 2003). A choice of banks from Nairobi area was preferred because is high competition and business transactions, which renders the banks
operating in the region to be competitive. To come up with a fair and representative sample, considering the banks asset portfolio and its competitive trends in the market used a purposive sampling technique. From each of the four divisions respondents were divided into two strata to constitute the heads of the division and senior staff members comprising managers and supervisors from which a random number was then selected.

3.3.2.3 Sample Size

As already indicated ten (10) commercial banks operating in Nairobi Central District Division were used as the sample size for this research. The total sample from the ten banks consisted of 240 respondents, 30 from the strategic management division, 60 from the information technology, 90 from marketing and research and 60 from the development division. A sample distribution is shown below.

<table>
<thead>
<tr>
<th>Bank Division</th>
<th>Population</th>
<th>Percentage</th>
<th>Sample Size</th>
</tr>
</thead>
<tbody>
<tr>
<td>Strategic Management</td>
<td>100</td>
<td>30</td>
<td>30</td>
</tr>
<tr>
<td>Information Technology</td>
<td>160</td>
<td>38</td>
<td>60</td>
</tr>
<tr>
<td>Marketing and Research</td>
<td>220</td>
<td>41</td>
<td>90</td>
</tr>
<tr>
<td>Development</td>
<td>200</td>
<td>30</td>
<td>60</td>
</tr>
<tr>
<td>TOTAL</td>
<td>680</td>
<td>35</td>
<td>240</td>
</tr>
</tbody>
</table>

Source: own compilation, 2005

3.4 Data Collection Methods

The collection instrument used in the research was mainly the structured questionnaire, having both closed and open-ended questions was administered to the respondents. This instrument was used as they are popular and a relatively inexpensive way of getting people to provide information. In addition questionnaires are frequently used with sample survey strategies to answer descriptive and normative audit or evaluation questions. They are more versatile and can be used to collect more types of information and can be used for a large number of respondents in widely separated locations (Chelimsky, 1993). An interview was conducted with the respective bank personnel mainly in the strategic
management, information technology, marketing and research and development divisions when the questionnaire proved not to be sufficient.

3.5 Research Procedures

The research was conducted for a period of three months. The first month was for proposal development. The second month for data collection and the last month for data analysis, documentation and finalization of the entire report. After the development of the questionnaire, a pilot test was done in two banks (Barclays Bank and Citibank) to check the reliability of the questions. A total of 16 respondents comprising one manager and one supervisor in each of the four divisions of strategic management, information technology, marketing and research and development were given the questionnaires for the pilot test. After the results were analysed the questionnaire was modified as per the pilot testing report. Actual data collection then commenced with the aid of two research assistants. Each assistant was allocated five banks from which to collect data from. These research assistants were undergraduates with business background. The implementation schedule is shown in the Appendix 1.

3.6 Data Analysis Methods

The Excel program and Statistical program for Social Scientists (SPSS) was used as a tool to analyse data. A quantitative approach of data analysis was employed where descriptive statistics (frequencies, category percentages) were used and the data presented in frequency distribution tables, bar graphs and pie charts.

3.7 Chapter Summary

The chapter focused on the research methodology and comprised the introduction, research design, population and sampling design, data collection methods, research procedures and data analysis methods.

The findings of this research are presented in the next chapter.
CHAPTER FOUR

4.0 RESULTS AND FINDINGS

4.1 Introduction

The previous chapter presented the methodology of research employed for this study. This chapter presents the findings arising out of this work. It is organized as follows. Section 4.1 addresses the introduction. Section 4.2 presents the factors influencing bank competition. Section 4.3 examines benefits of Information Technology in banking competition, while Section 4.4 the role of the size of a bank in formulating competitive strategies. Section 4.5 addresses the competitive strategies in Banks resulting from ATM Market and section 4.6 presents the summary.

4.2 Key Factors influencing Bank Competition

Several factors including geographical location influenced competition in banks. These are presented below in various categories beginning with communication means.

4.2.1 Communication Means

Table 2: Communication means used by banks

<table>
<thead>
<tr>
<th>Means</th>
<th>Distribution</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Frequency</td>
</tr>
<tr>
<td>Telephone</td>
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<tr>
<td>Email</td>
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<tr>
<td>Fax</td>
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</tr>
<tr>
<td>Extranets</td>
<td>4</td>
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<tr>
<td>Websites</td>
<td>6</td>
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<tr>
<td>Video conferencing</td>
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<tr>
<td>Chat</td>
<td>5</td>
</tr>
<tr>
<td>Bulletin board</td>
<td>5</td>
</tr>
<tr>
<td>Dial up</td>
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</tr>
<tr>
<td>Mobile phone</td>
<td>9</td>
</tr>
<tr>
<td>Satellite</td>
<td>5</td>
</tr>
<tr>
<td>Two way radio</td>
<td>2</td>
</tr>
<tr>
<td>Virtual Private Network (VPN)</td>
<td>5</td>
</tr>
</tbody>
</table>

Source: survey data
Banks cited the following as their means of communication with their stakeholders.

Telephone, email, fax, extranets, websites, video conferencing, chat, bulletin board, dial up, mobile phone, satellite, two way radio and Virtual Private Network (VPN).

Table 2 above shows the frequency counts and category percentages from the different communication means used by banks.

![Means of communication in banks](image)

**Figure 1: Communication means**

As shown in the table 2 and figure 1 above, telephone, and fax were the high-cited communication means used by banks as shown by 100% of the respondents. Emails and mobile phones communication had 90% response while websites and dial up means had 60% response of the responses. These results show that banks place a premium on their communication modes, and the more easily available and accessible means are utilized to enable effective communication. Both telephone and fax are affordable and available communication means in Nairobi.
4.2.2 Connection type used

The connection type used was also of significance in the banks’ communication logistics. The chart below in figure 2 shows connection types used by banks when communication to their clients and counterparts. Banks used various communication types including dial ups, leased lines, satellite, VPN, WAN and wireless means.

![Type of connection used by banks](chart)

**Figure 2: Connection type used**

Dial up and Leased line were cited as the mostly used connections types with 27% response. Satellite and VPN had 19% response respectively. Information was said to take less than an hour to reach the head office from branches by all banks sampled in the study using the leased lines and dial up connections.

The faster connection speeds favoured by banks using dial ups and leased lines show the need for banks to have faster communication between branches and the head office, to better analyse and interpret data and information to enable them provide quicker responses.
4.3 Information Technology in Banking Competition

The internet played a significant role in communication between banks and their customers.

4.3.1 Customers' access to Internet

The pie chart shown in figure 3 below shows the percentage of bank customers who accessed bank services via the Internet out of the total.

![Internet access by customers](image)

**Figure 3: Customers' access to internet**

Sixty percent (60%) responded as having access to the services via the Internet while the rest (40%) of the customers had no access to bank services through the Internet. By having access to banking services and information on products and services on the internet more customers would be able to access information faster and at less inconvenience. As the results indicated above, 60 % of the customers were able to access their banks and this enabled them obtain faster banking information on request.
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![Pie chart showing internet access by customers](image)

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4.3.2 Bank services via internet

Bank services via the internet were cited as a significant factor in motivating customers make their choice of banks, and the services they required from them.

![Bank services via internet chart]

**Figure 4: Bank services via Internet**

From the bar chart in figure 4 above the following bank services were cited by respondents to be available online or via the Internet. Product information had the highest response with 80% response. Bank rates, account balances and money transfer had 60% response. Deposits and help desk services had 50% response.

By using the internet, banks were better able to advertise and provide their services and product information to customers who had access to the internet.
4.3.3 Benefits of computerized systems

Computerization in banks has significantly impacted competition. The figure below shows the benefits of having computerized systems in banks.

![Benefits of computerised systems](image)

**Figure 5: Benefits of computerized systems**

The bar graph shown in figure 5 above shows the benefits that accrue to a bank when it adopts computerized systems. Better services provision was cited as the most accruing benefit as cited by 100% of the respondents. Reduction in waiting time had a 90% response. Other benefits received (50-70) % response from the banks.

From the results shown above computerized systems in banks enabled them provide better services and reduced the waiting time taken to serve both customers and respond to branch queries.
4.3.4 E-commerce technologies

E-commerce has become an important factor in banks competition in recent years. The figure below presents basic information on this.

![E-commerce technologies](image)

**Figure 6: E-commerce technologies**

As shown above in figure 6, website and fax technologies are the most utilized E-commerce technologies as shown by 100% of the respondents. Telephone, Email and electronic money transfer were the second in the rank for they received a response of 90%. ATM was third with 80% response. Other technologies cited by banks included: Credit cards, Visa cards, VPN, Intranet and clearing by use of bank connect technology.

The results above show that banks have utilized E-commerce technologies in their efforts to have a competitive edge in the industry. By utilizing the more available technologies of telephone, fax and websites they are able to access a wider reach of customers.
4.4 The Role of the Size of a Bank in Formulating Competitive Strategies

The size of a bank was an important consideration in determining what competitive strategies could be addressed to make it more competitive.

4.4.1 Number of customers per branch

The figure below provides information on the number of customers per branch.

<table>
<thead>
<tr>
<th>Number</th>
<th>Distribution</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Frequency</td>
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<tr>
<td>0-100</td>
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<td>100-500</td>
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<td>1000-5000</td>
<td>6</td>
</tr>
<tr>
<td>Over 5000</td>
<td>4</td>
</tr>
<tr>
<td>Totals</td>
<td>10</td>
</tr>
</tbody>
</table>

Source: survey data

Table 3 above shows the number of customers per branch in the sampled banks. The majority of banks had customers in a branch ranging from 1000-5000 as shown by 60% of the responses. In addition 40% of the branches had over 5000 customers.

A large percentage of the branches in banks have between 1000 to 5000 customers. This information should be able to provide managers and planners with better methods of service provision and access to their customers. By knowing the number of customers in their branches and their banking preferences Kenyan banks can better tailor their services.

4.4.2 Value of International Business

Many banks have substantial international business. The pie chart shown below shows the value of international business undertaken by the sample banks.
Figure 7: Value of International Business

Most (67%) banks responded by citing to have over 30% of international business. Other banks had their value of international business below 30% as indicated by 11% of respondents in each category.

To be able to compete on a global level banks must have some value of international business. In this study at least 30% of a bank’s business should be international. For Kenyan banks to be more competitive on the local and global arena, they will require to take on more international business.

4.5 Competitive Strategies in Banks resulting from the Evolution of the ATM Market

4.5.1 ATMs Ownership

Banks were increasingly installing and adding more ATMs in their branches. The pie chart below shows the availability of ATMS by banks.
Figure 8: Availability of ATMS

The pie chart in figure 8 above shows the percentage of ATM ownership by banks. 70% of the respondents were said to have had the ATM services available to their customer. Thirty percent (30%) of the respondents had no ATM services.

The availability of ATMs to customers was found to be essential for banks’ services. In addition they are an expected feature of today’s banking scene.

4.5.2 Advantages of technology

ATM Technology played a significant role in banks’ service provision. The bar chart shown in figure 9 shows the advantages of utilizing information technology in banking sector. The following advantages came up from the research: 24-hour business, time saving, cost effective, customer satisfaction, increased profits, reduced backlog, global market place, company image and attracting quality staff.
Figure 9: Advantages of technology

Time saving, cost effectiveness, customer satisfaction and company image were the highly cited advantages as shown by 100% of the respondents. Reduced backlog was second with 80% response.

The provision of ATMs and information technology have enabled banks become more cost effective and provide improved customer satisfaction.

4.5.3 Benefits of centralized system

Centralized systems had certain benefits. The figure below presents information on benefits of having a centralized system.
Figure 10: Benefits of centralized system

The research revealed that 90% of the respondents (banks) used centralized system and only 10% of the respondents use decentralized system. For the banks using the centralized system, they following reasons were cited for its use: efficiency and customer satisfaction, specialization & off service, internal control, cost effective & headcount, reduction and efficiency and communication.

From figure 10 above, efficiency, customer satisfaction and communication were the highly cited reasons with 100% response as shown by 33.33% of the banks. The other three benefits had each a 11.11% response respectively.

Efficiency, communication and customer satisfaction were found to be crucial components of having centralized systems in banks.
4.5.4 Availability of Technical Staff

Technical staff with requisite competencies were very much required to operate and manage the information technology and centralized systems in banks.

![Pie Chart: Availability of technical staff]

**Figure 11: Availability of technical staff**

The figure 11 above shows the availability of technical staffs in the banks. Eighty percent (80%) of the banks said they had technical staff in their banks. While 20% of the banks, which did not have technical staff were said to have executed technical duties by outsourcing the staff.

Managing information technology and the technical know how of their centralized systems required banks to employ their own in house technical staff.

4.6 Chapter Summary

This chapter presented and analyzed the research findings on the basis of the research questions as completed by respondents. Findings were presented in frequency tables, category percentages and pie charts.
The major findings were that in the determination of what key factors influenced bank competition all banks used telephones and fax to communicate with their stakeholders as shown by 100 % of the responses. Regarding what were the benefits of information technology in banking competition 60 % of bank customers accessed banking services via internet and cited better service provision (100 %) and reduced waiting time (90 %) as the benefits of computerization. It was found that in the determination of what role the size of a bank had in formulating competitive strategies 50 % of the bank branches had 1000 – 1500 customers and 67 % of the banks had over 30 % of international business. In the determination of what competitive strategies in banks resulted from the evolution of the ATM Market, 70% of banks had ATMs available to their customers.

The next chapter is on the discussion, conclusion, and the recommendations of the study.
CHAPTER FIVE

5.0 DISCUSSION, CONCLUSIONS AND RECOMMENDATIONS

5.1 Introduction

The chapter includes is organized as follows: Section 5.1 is on the introduction. The summary to this work is presented on section 5.2, the discussion on section 5.3, the conclusions in section 5.4 and the recommendations in section 5.5.

5.2 Summary

The purpose of the research was to evaluate the competitive strategies adopted by banks to compete effectively in the industry. The research questions addressed were, What were the key factors influencing bank competition, What were the benefits of information technology in banking competition, What was the role of the size of a bank in formulating competitive strategies in the industry and Specifically what were the competitive strategies in banks resulting from the evolution of the ATM market?

The descriptive study approach was used as it describes phenomena systematically to reveal patterns and connections that might otherwise go unnoticed. Ten banks were identified to form a representative sample of commercial banks in Nairobi. From these, staff from four divisions of these banks namely the strategic management, information technology, marketing and research and the development divisions comprised the sample of 240 respondents. Data was collected using structured questionnaires and analyzed using the Statistical Package for Social Sciences (SPSS) and presented through frequency tables supported by pie charts and bar graphs.

The major findings in the determination of the key factors influencing bank competition were that all banks used telephones and fax to communicate with their stakeholders. On the issue of connectivity, dial up and leased lines were the most common types with the highest responses.

Regarding the benefits of information technology in banking competition over half of bank customers sampled accessed banking services via internet. Interestingly also less than half had no access to bank services through the internet.

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On the availability of bank products over the internet most respondents rated product information as the highest response. Respondents also cited better service provision and reduced waiting time as the benefits of computerization. The use of E-commerce was also on the rise and was used to give banks a competitive edge. It was found that under what role the size of a bank had in formulating competitive strategies more than half of the bank branches had 1000 – 1500 customers, in addition most of the banks had over a third of international business.

In the determination of what competitive strategies in banks resulted from the evolution of the ATM Market most banks had ATMs available to their customers. Information technology and the development of ATMs had enabled time saving, cost effectiveness, customer satisfaction and improved the bank’s image as shown by respondents. A large number of the banks had their own in house technical staff to manage the ATM system.

5.3 Discussion

5.3.1 Key Factors influencing Bank Competition

From the study findings all banks used telephones and fax to communicate with their stakeholders and faster connection modes were utilized for better and faster data interpretation. Both Osuagwu (2003) and Abraham (1999) concur with this when they state that technology in banking has resulted in the changing strategic market behaviour of banks. In addition Abraham (1999) reported that changes in technological, deregulation attitudes to shareholders value and demographics trends had been the underlying forces for change in European banking.

In Kenya, innovation in the banking industry was cited by the Economic Intelligence (2004) as the smart response by banks to the heightening competition for a thinning market that was steadily taking its toll on them. As Berger and DeYoung (2001) pointed out, banks competed for customers in many more ways than simply through the prices they charged for services and the internet they offered on deposits. The convenience of a bank’s location, the services and personal attention it offered and the location and number
of ATMs it provided, the networks the bank’s ATM card could access, the interest on deposit and the speed of response, were all factors in a consumer’s decision of where to open a bank account.

The implication of the findings above on the factors influencing bank competition show that Kenyan banks must place a stronger emphasis on technology use and especially on their communication modes as they enhance access to their branches and customers. In addition, information must be relayed and received in real time to enable effective and efficient communication. On regulatory measures, the Economic Intelligence (2004) states that following the awakening of the Central Bank Amendment Bill 2000 (Donde Bill) by the Minister for Finance in which he pronounced a number of extensive reforms for the financial sector, Kenyan banks have been forced to embark on building their non-interest income portfolios with the immediate solace being fees and commissions charged for services rendered.

5.3.2 Benefits of Information Technology in Banking Competition

The findings of the study showed that over half of bank customers accessed banking services via internet and better service provision and reduced waiting time were the benefits of computerization. These findings were supported by Adam Messner in the Economic Intelligence (2004) who stated that technology provided two crucial components i.e. efficiency and security. In addition, successful banking demanded secure, reliable and efficient data communication which could propel faster information flow and quicker decision making.

According to The Standard Limited (2004) the Co-operative Bank of Kenya Limited’s introduction of new products that provided customers with convenience in accessing their accounts and greater control over their money was expected to sharpen the bank’s competitive edge and bring additional depositors and revenue to keep the bottom line growing. This strategy would enable them attract more customers and ensure profitability.

Hunter (2001) concurs with the findings too, when he states that the internet distribution channel extends the large bank retail strategy and fits well with commercial bank business practices as found in the United States. He adds that internet transaction costs are cheaper than transactions made at branches and banks could substantially reduce their costs by
encouraging their retail and business customers to migrate from branch banking to internet banking.

The implication of information technology on banking competition shows that faster speeds are a prerequisite for efficient customer service as technology is seen as a key in the delivery of services to banks. If banks are linked by broadband technology clients will see more rapid service delivery for items such as account queries and information transfer. As a result decisions will get made faster. The Economic Intelligence (2004) concurs by saying that technology is a core component in transaction monitoring, allowing the bank to check on the validity of transactions or compliance with regulations.

5.3.3 *The Role of the Size of a Bank in Formulating Competitive Strategies*

According to the research findings more than half of the bank branches had 1000 – 1500 customers and at least a third of their business was of international nature. This opinion is supported by the Economic Intelligence (2004) who state that the size of a bank should be determined by the number and size of deposits, total assets and total banking and secondly by the quality and selectivity of clients, products and positioning.

According to a study by the Federal Deposit Insurance Corporation (2004) Internet primary banks were institutions that delivered banking services mainly online. By eliminating physical branches and employing fewer employees, they could potentially provide banking services at lower cost. In reality, however, internet banks underperformed ‘brick-and-mortar’ banks.

Increase in branch banking had seen phenomenal growth in Kenya due to suburbanization according to the Economic Intelligence (2003). However by phasing out some of their branch networks due to centralization of banking services, banks were losing out on the customer relations game.

Mergers according to Milbourn et al. (1998) between small banks appeared to increase lending to small businesses, but mergers between larger banks generally decreased this type of lending or left it unaffected, in addition according to De Young (2000) banks had a variety of motivations for making acquisitions. Benefits from increased scale were the
most obvious, including but not limited to: reduced unit costs; higher per unit revenues; improved access to capital markets; the ability to make larger loans or offer broader product lines; the ability to attract and retain high quality managers; reduced portfolio risk from diversifying into new geographic markets; and network benefits from integrating systems of branches and ATMs that cover different geographic areas.

It can be shown that a direct implication of the size of a bank in formulating competitive strategies is determined by the value of its assets as compared to other competitor banks. Having more international business will also provide better leverage for international decisions and expansion. In ranking the largest banks in Kenya, Central Bank of Kenya (2004) and Economic Intelligence (2004) both concur that the size of a bank is determined from its value of deposits and assets.

5.3.4 Competitive Strategies in Banks resulting from the Evolution of the ATM Market

Study findings showed that information technology and the development of ATMs had enabled time saving, cost effectiveness, customer satisfaction and improved the bank’s image as shown by respondents. The Consolidated Bank of Kenya Limited (2003) supported this finding when they stated that formerly banks in Kenya only had ATMS whose main function was cash dispensing. However, due to the fierce competition for customers, pressure on profit margins, burgeoning customer expectations on service and convenience, they had to shift to the full implementation of modern full function ATMs with wider capabilities for their customers’ convenience and services.

The Standard Limited (2004, July 27) reported that during the year 1999, that the banking sector in Kenya had embraced the changes occurring in information technology. The larger banks had already achieved branchless banking and were expanding their networks of ATMs while the small and medium size banks were exploring the possibility of sharing ATMs. However the lack of modernization of the telecommunications sector has been a hamper to the growth of internet banking. D’souza (2003) concurs when he stated that the Kenswitch project in Kenya was a strategic move to enable smaller banks access ATMs, by enabling them to enjoy reduced transaction costs and increase efficiency that was only previously enjoyed by a few big banks.
The implications were that better reach of bank services were evident to customers of the Kenyan Banks surveyed with ATM accessibility. However in rural and peri-urban areas not served by ATMs pooling of resources with players such as Pesapoint and Kenswitch will enable eventual access to better banking services and products. It must be noted that ATMs continue to be considered as very basic requirements in the array of financial services that a bank offers.

5.4 Conclusions

5.4.1 Factors influencing Bank Competition

As liberalization and globalization of world markets become more apparent, communication is more crucial in today’s global banking environment. Connectivity and ease of reach to customers and other sectors has become more significant. Policymakers around the world frequently express concern about whether their countries’ bank competition policies are appropriately designed to produce well-functioning and stable banks. Authorities want to know what indicators they should use to gauge the degree of competitiveness of their banking industries.

5.4.2 Information Technology in Banking Competition

Information Technology and the resulting increased range of products have given many banks a competitive edge in business. Competition policies in banking may involve difficult trade-offs. While greater competition may enhance the efficiency of banks with positive implications for economic growth, greater competition may also destabilize banks with costly repercussions for the economy. Similarly, while greater competition may produce banks that give small firms the ability to exercise their entrepreneurial energies, this competition may yield less stable banks that are prone to devastating crises.

5.4.3 The Role of the Size of a Bank in Formulating Competitive Strategies

Smaller banks had to explore consolidations and merger in order to survive the threat of competition from larger banks and serve a wider range of customers. Furthermore authorities seek guidance on how pro-actively they should influence the size distribution of banks and whether there are adverse implications from increasing bank competition.
Globalization and the resulting consolidation in banking have further spurred interest in this issue, leading to an active public policy debate.

5.4.4 Competitive Strategies in Banks resulting from the evolution of the ATM Market

Information technology and the ATM network were widely used by most of the banks. Not having an ATM network or a well served and maintained severely hampers banking and growth potential in today’s market. Well-functioning banks promote national economic growth, improve the efficiency with which credit is allocated, and boost the growth prospects of small and medium enterprises. Thus, information on which policies enhance the operation of banks is relevant for developing national strategies to promote overall economic development and alleviate poverty.

5.5 Recommendations

5.5.1 Recommendations for Improvement

5.5.1.1 Factors influencing Bank Competition

Commercial banks should endeavour to have better leased line facilities with faster speeds and more capabilities of serving a wider network range with better communication and coverage. These banks especially with the growing regional dynamism should seek to expand to the East African Community and Comesa region.

5.5.1.2 Information Technology in Banking Competition

Information technology is crucial for banking services and the commercial banks should seek to partner with ISP providers to ensure more bank branches are covered and hence a wider customer base.
5.5.1.3 The Role of the Size of a Bank in Formulating Competitive Strategies

More banks are closing their upcountry branches but these should be reconsidered especially with the increase in entrepreneurial capital and personal loans available and the increased need for banking services throughout the country. The need for mergers and consolidation may provide a basis for continued growth with expanded product availability.

5.5.1.4 Competitive Strategies in Banks resulting from the Evolution of the ATM market

ATMs are vital in providing faster less stressful banking. Banks should consider ATM internetworking between other banks at a small fee to provide access to those branches or banks that have fewer ATM services.

5.5.2 Recommendations for Further Study

There were areas that this research did not cover because of limitations inherent in its breadth. These areas would however contribute to knowledge in competitive strategies that banks can use to compete in the banking industry. This is an area that has become increasingly important because of the global and competitive nature of the banking industry.

Further research in the following areas would therefore add to knowledge in this vital area.

- To investigate the impact of Kenswitch ATM system adapted by small banks in Kenya.
- To investigate customers perception of the banking strategies being used to have a competitive advantage in the banks.
- To investigate the banking competitive strategies in the changing environment of information technology.
- To investigate customer service management strategies in banking industry.
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APPENDICES

APPENDIX 1: IMPLEMENTATION SCHEDULE

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<td>Feb - 04</td>
<td>1 Month</td>
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<tr>
<td>2</td>
<td>Data collection</td>
<td>Feb - 04</td>
<td>Mar - 04</td>
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</tr>
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<td>3</td>
<td>Data analysis and Report writing</td>
<td>Mar - 04</td>
<td>Apr - 04</td>
<td>1 Month</td>
</tr>
</tbody>
</table>
APPENDIX 2: QUESTIONNAIRE

I. BANK INFORMATION

1.1. Name of the bank

1.2. Name (optional)

1.3. Division

1.4. Telephone/email

II. BUSINESS AND INFRASTRUCTURE

1.0. Key Factors influencing Bank Competition

1.1. How do you communicate with your counterparts?

☐ Telephone

☐ Email

☐ Fax

☐ Extranets

☐ Websites

☐ Video conferencing

☐ Chat

☐ Bulletin board

☐ Dial up
☐ Mobile phone
☐ Satellite
☐ Two way radio
☐ Virtual Private Network (VPN)
☐ Any other specify ________________________________

1.2. Are the branches networked?
☐ Yes ☐ No

1.3. If yes what types of connection do you use?
☐ Dial up
☐ Leased wire
☐ Satellite
☐ Virtual Private Network (VPN)
☐ Other ________________________________

1.4. How long does information take to reach the head office?
☐ Less than an hour
☐ 0-5 hours
2.0 Benefits of Information Technology in Banking Competition

2.1. Do your customers have access to your bank services through the Internet?

☐ Yes ☐ No

2.2. If yes what proportion of customers?

☐ 0-5%

☐ 5-10%

☐ 10-15%

☐ 15-20%

☐ Over 20%

2.3. If yes what services can the customer get through the Internet or electronically?

☐ Deposits

☐ Withdrawals

☐ Bank balances

☐ Money transfer
2.4 What are some of the benefits that the bank has realized from computerized systems?

☐ Increase in profits

☐ Increase in sales

☐ Decrease in bad debts

☐ Increase in customers

☐ Reduction of staff

☐ Increased staff morale

☐ Better services

☐ Reduction in waiting time

☐ Others (specify) ________________________________
2.5 Which e-commerce technologies has the bank deployed?

☐ ATM

☐ CREDIT CARDS

☐ VISA CARDS

☐ ELECTRONIC MONEY TRANSFER

☐ E-MAIL

☐ FAX

☐ TELEPHONE

☐ WEBSITE

☐ Virtual Private Network (VPN)

☐ Any Other (specify)______________________________

2.6 What is the customer turnover per day in your bank?

☐ 0 -2000 customers

☐ 2001 - 10000

☐ 10001 - 50000

☐ 50001 - 100000

☐ Over 100000
3.0  The Role of the Size of a Bank in Formulating Competitive Strategies

3.1  How many branches does your bank have countrywide?

3.2.  Approximate number of customers per branch

☐  0-100
☐  100-500
☐  500-1000
☐  1000-5000
☐  Over 5000

3.3.  What value of your business is:

International?  Local?

☐  0-10%  ☐  0-10%
☐  10-20%  ☐  10-20%
☐  20-30%  ☐  20-30%
☐  Over 30%  ☐  Over 30%

4.0  Competitive Strategies in Banks resulting from the Evolution of the ATM Market

4.1.  Does your bank have ATM services?

☐  Yes    ☐  No
4.2 How many ATMs does your bank have?

<table>
<thead>
<tr>
<th>In Nairobi</th>
<th>Other parts of the country</th>
</tr>
</thead>
<tbody>
<tr>
<td>0-10</td>
<td></td>
</tr>
<tr>
<td>10-20</td>
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<tr>
<td>30-40</td>
<td></td>
</tr>
<tr>
<td>40-50</td>
<td></td>
</tr>
<tr>
<td>Over 50</td>
<td></td>
</tr>
</tbody>
</table>

4.3 What is the advantage of new technology innovations?

- [ ] 24-hour business
- [ ] Time saving
- [ ] Cost effective
- [ ] Customer satisfaction
- [ ] Increased profits
- [ ] Reduced backlog
- [ ] Global market place
- [ ] Company image
- [ ] Any Other (specify)__________________________
4.4 What decision making system has your bank adopted?

☐ Centralized system

☐ Decentralized system

☐ Combination of both

4.5 What benefits does the bank benefit from:

Centralized system (Explain in detail)


Decentralized system (Explain in detail)


4.6 Does your bank have all the technical experts required in the banking operations?

Yes ☐ No ☐

4.7 If no then how do you ensure that the bank duties are executed?


4.8 Explain in outline form what competitive strategies your bank has adopted to counter competition.


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4.9 Has your bank been subject to mergers/acquisitions? Please explain.


4.10 How would you describe your bank’s size? Please explain.

☐ Small  ☐ Medium  ☐ Large


4.11 How has the size of your bank influenced how you compete? Explain in detail.


4.12 What would you say are the key success factors in Bank Competition today?


4.13 How has IT influenced the evolution of Bank competition in recent years?


APPENDIX 3: LIST OF COMMERCIAL BANKS, NON BANKING FINANCIAL INSTITUTIONS, MORTGAGE INSTITUTIONS, MICRO FINANCE INSTITUTIONS AND FOREX BUREAUS.

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### BUILDING SOCIETIES

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### MICRO FINANCE INSTITUTIONS

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# APPENDIX 4: TEN LARGEST COMMERCIAL BANKS

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