Value of Small Banks - Part 1

Details
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Wafula cheerfully waltzed into his bank at Garden City in Nairobi. He greeted the teller and looked admirably around at the glittering modern furnishings of the new branch. He appreciated that he now could visit a branch closer to his home.

However, while Wafula waited on his transaction to finish, he stared through the glass out at a neighbouring bank branch as mall workers removed its sign replacing it with another bank sign. He could see frustrated customers of the former bank look helplessly in despair that their former bank had collapsed and they lost their savings.

Unnerved by his observations, Wafula wondered whether his own savings remained safe in his bank. Unanswered questions punctuated his mind. Should he move his money elsewhere? What would he do if his financial institution collapsed too? How could he determine which bank to utilise? He simultaneously noticed the Government's proposed assault against smaller banks and pondered whether bigger banks were truly better.

Many of us throughout East Africa held the same thoughts as Wafula over the past calendar quarters. Many pundits demonized everything from small banks to the Central Bank of Kenya to Treasury to governance procedures. Finger pointing aside, as customers, Kenyan consumers must possess tools to decipher appropriate financial institutions.

First, the Government of Kenya's battering, like several other authorities in Sub Saharan Africa, against small banks stands as unfounded. The correlation between bank failures as a result of capital requirements in absolute terms lacks credible evidence.

If banks must increase capital from 250 million Kenyan Shillings to 1 billion in 2012 and then again to 5 billion by 2018 under current proposals, expect lower competition, higher costs to consumers, slower response times for approvals, and lethargic solutions to bank errors. Thankfully, Central Bank of Kenya Governor Dr. Patrick Njoroge opposed the Treasury’s plans.

Increasing bank capital requirements gives the voting public the feeling that regulators look out for them and strengthen the sector, but it only covers up a lack of oversight and provides no meaningful protection enhancement. A comparative scenario might juxtapose a silly situation whereby in order to stop terrorists from entering Kenya, immigration authorities increase the size of passports. Yes, bigger
passports would represent an action step, but the causality towards making Kenya safer would equal nil. As silly as the latter example seems, the public is fed with such meaningless solutions against bank failures. When big banks and their paid researchers and associations represent the loudest voices clamoring for the change, then consumers and businesses should take notice and watch out.

Are big banks inherently bad? No. However, consumers should arguably maintain freedom of choice so that poor service by one bank or category of bank may meet with punishment from fleeing consumer funds to competitors.

Proponents of forced bigger banks argue first that cost savings from greater economies of scale helps consumers. However, banks traditionally fail to transfer merger cost savings down to customers and instead benefit themselves from greater profits. Supporters often measure return on equity for banks as successful indicators for capital requirement mandates. However, logical consumers know that higher return on equity for banks often means the burden transfers onto borrowers and savers in already one of the highest interest rate environments in the world.

Secondly, proponents argue about the stability that large banks bring. Never mind that the world’s largest banks caused the financial crisis of 2008. From New York to Reykjavik to Dublin to Nairobi, the world holds a strong history of large banks once deemed too big to fail requiring substantial bailout assistance from their respective governments to stay afloat. Both Kenya’s largest bank by assets and the nationalized bank enjoyed urgent Government assistance in their histories.

On the other side, some argue that larger banks lead to poorer service and higher prices commensurate with the reduction in supply of financial institutions. Unfortunately for those few wealthy Kenyans who benefit from bank mergers that create mega banks, smaller banks around the world often offer the lowest interest rates and small fees for loans. Further, a reduction in competition lowers bank responsiveness and competitiveness.

Ever applied for a loan with one of the large banks in Kenya? Sometimes the process goes smoothly with banks holding sufficient processes and policies. However, often times, big does not equal better processes and policies. Some of the largest banks habitually send consumers in endless hopeless service loops. Apply for a loan, wait for a decision, one department loses your documents, you reproduce documents, a different department claims not to receive them, you receive approval confirmation, but loan funds never hit your bank account, no one at the big bank can explain why funds never came. Sound familiar? Such experiences often send consumers to small banks where processes are streamlined and decision authorities held accountable more transparently in their eyes.

Conversely, if a borrower falls behind in payments due to a major life event, then he or she stands a higher chance of falling into the machinery of big banking. Multiple collections officers calling and
Creating stories in order to get your funds and making false promises. In small banks it is easier to speak to decision makers and make modification agreements.

Still months after the prominent bank failure in Kenya and the proposed debates in Parliament, Kenyan consumers linger nervously with decisions over which type of bank to choose. Next week Business Talk delves into how to select a financial institution and what to watch out for in the process. Discuss bank horror stories and triumphs with other readers through #KenyaBanks on Twitter.

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In the next edition of Business Talk, we explore "How to Select a Bank". Read current and prior Business Talk articles on the USIU-Africa website.