

**FACTORS INFLUENCING INTERNATIONALIZATION PROCESS
AT KENYA COMMERCIAL BANK LIMITED**

BY

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DECLARATION

This research project is my original work and has not been presented for examination in any other university.

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This research project has been submitted for examination with my approval as the University supervisor.

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DEDICATION

I dedicate this project to my husband; Mr. Calvins E. Aloo and my daughter Chloe Aloo for providing me with the motivation and moral support when working on this project and also through the entire study period.

ABSTRACT

Internationalization is the process of engaging in production of goods and services beyond national boundaries. Firms may engage in such ventures either incrementally starting with low commitment modes like exporting and licensing and then increase gradually to the high commitment modes of Foreign Direct Investment (FDI); or they may decide to start off with the high commitment modes of FDI directly without going through the incremental stages.

On this basis, the study tried to analyze the reasons that prompt firms to engage in such costly and risky ventures in foreign lands where they are at a disadvantage as compared to the local firms. KCB was chosen as the appropriate firm to bring out this phenomenon since it has used FDI through wholly owned subsidiaries as the only entry mode without engaging in prior low commitment modes.

The OLI theory has been used by many to explain the existence of FDI. This study adopted a case study approach to determine if the theory can explain KCB's preference of wholly owned subsidiaries as the entry mode choice in all its foreign operations and thus determine if the Ownership, Location and Internalization are the factors which influenced the internationalization process at KCB.

The research found that the ownership advantages that KCB has includes, capital strength, technological advancement and management skills. The common location advantage that Tanzania, Sudan, Uganda and Rwanda have is the psychic distance between the four countries and Kenya. This is beneficial because the cultures of the people living in these countries are almost similar and they have traditionally been

trading with each other. The bank in a bid to follow its customers who were trading in the different countries was able to bring in new customers in these markets that it ventured into. The main reason as to why KCB preferred to internalize its operations is the technological platform which it uses to carry out all its processes which is able to provide real time transactions across the national borders of all the countries in which the bank operates.

The study also made a number of recommendations to the firm under study, policy makers and brought up areas for further research. The governments of most of these countries can improve the conditions for inward FDI to attract firms with financial power such as KCB to consider their countries as suitable for setting up operations; this is beneficial to the host country as a source of employment for its people. The recommendation to the bank is that it should have a flexible policy to allow it to utilize other forms of FDI such as acquisitions in more mature markets where there are suitable candidates for acquisition. This will help the firm to penetrate the market faster and gain market share within a short period of time rather than going through the slower route of a greenfield venture in such mature markets. Further research can be carried out on firms in a different sector e. g manufacturing to determine if the Ownership, Location and Internalization are the factors that would make a firm to start foreign operations via FDI instead of going through the incremental stages of internationalization from low commitment modes of exporting to high commitment modes.

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CHAPTER ONE: INTRODUCTION

1.1 Background of the Study

The main aim of any profit making organization is to make profits, in a bid to achieve this objective; firms define their market which they would like to target with their goods or services. This market could include customers in a small market segment within a country or it may sometimes include customers beyond the national boundaries of the firm and thus the firm may look for various ways to reach such international consumers of its products or services. Through the internationalization process, firms gradually spread their business operations and activities beyond their national boundaries (Ahmad and Kitchen, 2008). Prior to an international expansion move, the firm has to make a number of decisions such as the markets to venture into, the timing of entry and the entry mode to use. Among the three, the entry mode choice is considered important for this study.

Researchers have divided entry mode choices into two aspects namely, non-equity and equity modes. Non-equity modes are divided into market oriented modes i.e. direct and indirect exports and contractual modes i.e. turnkey projects, contract manufacturing, management contracts, strategic alliances, licensing and franchising. Equity entry modes include partly owned modes or joint venture and wholly owned subsidiary or sole ownership (Kumar and Subramanian, 1997; Lotayif, 2003). When a firm adopts an equity mode, it has to make the choice between setting up a business from scratch termed as a greenfield investment and buying an existing firm by acquisition, or brownfield which is a combination of both strategies (Hill, 2005). Each entry mode strategy has its benefits

and drawbacks. Firms may follow various criteria in choosing a suitable entry mode but to keep the gist of the opening statement; if a firm needs to meet its profit maximization objective then it may require a high resource commitment in its foreign operations in order to obtain high returns.

Once the foreign commitment decision is made and the firm successfully gains entry into several foreign markets through foreign direct investment (FDI), it ceases to become a national firm and instead becomes a multinational enterprise (MNE). There are many existing definitions of an MNE. The International Labor Organization defines it as a corporation that has its management headquarters in one country known as the home country and operates in several other countries known as host countries; another definition is that it is a firm in which foreign production takes place in a wholly owned foreign subsidiary and lastly; it is a firm having a wholly owned foreign subsidiary in several countries. For this research, the last two definitions will be used as they are applicable to the firm under study.

1.1.1 Foreign Direct Investment Theories

(Hymer, 1976) tried to analyze the MNE based upon industrial organization theory and found out that when a firm establishes in a foreign country it faces disadvantages such as stringent legal systems, language or cultural barriers and government restrictions. He sought to find out how a foreign company can compete successfully in an unfamiliar market, where it must be at a disadvantage compared to local firms. From his findings he concluded that for firms to own and control foreign value-adding activities they must possess some kind of innovatory, cost, financial or marketing advantages specific to their

ownership which is sufficient to outweigh the disadvantages they face in competing with indigenous firms in their country of production. If in spite of these the firm engages in FDI it must have some advantages arising from intangible assets such as brand name, managerial skills and patents; as long as these are transferable to foreign affiliates (Hymer, 1976). This theory, however, assumed that firms are operating in a perfect market which is not the case.

(Buckley and Casson, 1976) introduced the market imperfection factor in their theory of internalization. They suggested that a firm overcomes market imperfections by creating its own market, this is known as internalization. Internalization theory explains that FDI arises to replace market transactions with internal transactions, this may be the reason as to why a firm would want to make use of the ownership advantage by itself such that it is the only one involved in the transfer of the advantages it possesses across national boundaries to its foreign subsidiaries.

Research has proven that even though ownership specific advantages are necessary for FDI to occur, it is still not a sufficient explanation. The internalization theory also fails to explain on its own the existence of FDI. By combining ownership specific advantages, internalization specific advantages and location specific advantages, we get the eclectic approach to FDI by John Dunning also referred to as the OLI theory of international production. The O stands for ownership, L for location and I for Internalization. This theory suggests that the greater the Ownership and Internalization advantages possessed by firms and the more the Location advantages of creating, acquiring and exploiting these advantages from a location outside its home country, the more FDI will be undertaken. Where firms possess substantial Ownership and Internalization advantages but the

Rwanda Stock Exchanges and are widely held by Kenyan and other international investors.

KCB (Tanzania) Limited was incorporated in April 1997, in Dar es Salaam. It was established to provide a wide range of financial products to the emerging economies of that region and to facilitate cross-border trade following the revival of the East African Co-operation. KCB South Sudan was founded in 2005 following the cessation of hostilities between South Sudan and Sudan. It was also at this time that the signing of the Comprehensive Peace Agreement took place in Naivasha, Kenya. KCB Bank Uganda Limited was incorporated in the year 2007, with the first branch being opened at Commercial Plaza, Kampala Road. In December 2008, KCB Rwanda commenced banking services in Kigali, following licensing by the National Bank of Rwanda. It is worth noting that all these subsidiaries are 100% owned by KCB Group based in Nairobi.

KCB is the region's largest bank in terms of total assets at Kshs. 280 billion, most capitalized at Kshs. 38.4 billion and total number of branches at 222 spread in five countries, namely; Kenya has 169 branches, Tanzania has 11 branches, Southern Sudan has 19 branches, Uganda 14 and Rwanda has 9 branches. This is complemented by over 920 ATMs that offers a twenty-four hour services across the region (Kenya Commercial Bank, 2011).

KCB consolidated its operations for 100 years in the Kenyan market before venturing into other foreign markets. In its initial years of operation, the bank reported losses in the three subsidiaries of Uganda, Tanzania and Rwanda. Only the subsidiary in

Southern Sudan reported profits from its first one and a half years of operation. During the release of the 2011 half year results the bank announced a consolidated profit from all the subsidiaries. This presents an interesting scenario in line with the theory being studied as it will help in determining the location advantages that each country offers, the ownership or firm specific advantages that KCB has and the reasons for internalization of its processes; and if these can explain the internationalization process at KCB.

1.2 Research Problem

It has for long been recognized that internationalization is an incremental process in which firms move through stages of development such as export, licensing and joint venture. This is however, not always the case as some firms prefer to begin their internationalization process through high commitment modes by establishing wholly owned subsidiaries in foreign markets. Dunning (1977, 1980 and 1988) in his eclectic paradigm approach known as the OLI theory emphasized that a firms' international expansion and entry strategy depends on its ownership advantages (firm resources), location advantages (host country factors) and internalization advantages (relational factors). Based on this viewpoint, if the home market has a location advantage over the target foreign market, exporting is a suitable entry mode. If the host market has a location advantage, firms look at the contractual mode of entry. If the risk of contract with local partners is high, FDI is the appropriate mode (Dunning, 1980).

Several studies have been carried out in regard to KCB; Kamanda (2006) studied the factors influencing regional growth strategies of KCB and concluded that attractive

regional market, desire to follow competition and customers, growth in market size, inducement by host government, reduction of operating cost, desire to boost cooperate image, tap new opportunities, leverage on regional integration and free trade frontiers are the factors influencing the regional growth strategy of KCB. Kieti (2006) in his study of the entry strategies among Kenyan firms venturing into Southern Sudan found that the strategies are a function of various parameters some of which are in the foreign business environment while others are firm specific.

Mwadime (2010) went further to find out the reasons for the presence of KCB in each of the foreign markets in which it operates. In Rwanda the reasons for opening up a subsidiary was due to presence of few banks, the East African Community agreement, presence of a large unbanked market and lastly in pursuit of strategy or vision. In Uganda the reason for operation was to follow its customers, existence of large trade volumes between Sudan and Uganda and ego to follow other banks which had established a presence in the market. The presence in Southern Sudan was mostly influenced by the Comprehensive Peace Agreement which was signed to start off the peace process and this was also a virgin market since KCB was the first bank in the market with a large unbanked population, and the bank was wooed by the government since it did not have a proper banking system. This study was however, not conclusive since it was not able to establish why KCB used the same entry strategy in the different markets even when it was apparent that these markets offered different incentives. Nyakundi (2010) concluded that a wholly owned subsidiary is the most chosen mode of operation by KCB but he did not establish why this is the case.

The internationalization process at KCB is characterized by FDI through wholly owned subsidiaries; therefore, in trying to determine the factors influencing the internationalization process at KCB this study will establish why the firm has used greenfield ventures as the entry mode in all the different countries it operates in.

1.3 Research Objective

The main objective of this study is to determine the factors influencing the internationalization process at Kenya Commercial Bank Limited.

1.4 Value of the Study

This study will enable KCB to know how to exploit its firm specific advantages in determining the locations of its future foreign operations.

Other firms intending to internationalize will be able to obtain information on how they can apply OLI theory in their own undertakings of opening subsidiaries in foreign markets. By relating theory to real life case, it will enable managers to apply the OLI theory to their everyday strategic decision making process.

The government and policy makers will benefit when formulating policy regarding both outward and inward FDI.

Scholars will find it useful as it will facilitate and increase the general knowledge as well as the relevance of OLI theory to internationalization process of firms within the East African region and it may bring up some areas for future research.

CHAPTER TWO: LITRERATURE REVIEW

2.0 Introduction

This chapter reviews literature relevant to the research by looking at what other authors have written that could add more insight into the topic under study. The main areas to be looked at include a general discussion on internationalization, an overview of theories relating to internationalization through FDI and an in-depth discussion of the OLI theory, this will be followed by a discussion on FDI through wholly owned subsidiaries by looking at the two main forms of FDI i. e Greenfield ventures and acquisitions; a review of scale of entry vis a vis strategic commitment and lastly is a concept of how the OLI theory can be applied as a strategic tool.

2.1 Internationalization

The term internationalization has been used extensively and few real attempts have been made to provide a standard definition of its meaning. (Turnbull, 1985) describe internationalization as the outward movement of a firm's operations. (Welch and Loustarinen, 1988) describe it as the process of increasing involvement in international operations. This definition takes into account both the inward and outward growth of international firms. The internationalization process of firms has been subject to widespread research attention and empirical investigation (Andersen, 1993).

Consequently, internationalization theories have tried to explain how and why the firm engages in overseas activities and in particular, how the dynamic nature of such behavior can be conceptualized. (Welch and Loustarinen, 1988) have comprehensively reviewed

this literature and concluded that there is a wide range of potential paths any firm may take in internationalization. A number of approaches and perspectives have contributed to the contemporary understanding of firm internationalization. Despite such a large interest from scholars, the FDI approach has developed a significant body of literature on the subject of internationalization and for this reason a number of theories try to explain the existence of FDI (Andersen, 1993). In the context of this study three major theories will be discussed; the internalization theory, transaction cost theory and the OLI theory which forms the backdrop that this study will be based on.

2.2 Internalization and Transaction Cost Theories

One important reason for explaining the existence of multinational companies is transaction costs and internalization. According to the internalization approach multinational companies arise because companies tend to internalize transactions for which the transaction cost in the market is high (Caves, 2007). One way to reduce the transaction costs is to carry out these transactions within one and the same company rather than between independent companies (Hill, 2005).

Perfect competition dictates that firms produce homogeneous products and enjoy the same level of access to factors of production (Porter, 1980). However, the reality of the matter is that markets are characterized by imperfect competition. The theory of internalization factors in the market imperfection perspective and was long regarded as sufficient to justify why FDI occurs. By internalizing across national boundaries a firm becomes a multinational (Ekeledo and Sivakumar, 1998). Market imperfections are factors that inhibit markets from working perfectly and with regard to horizontal FDI,

market imperfections arise in two circumstances; when there are impediments to the free flow of products between nations and when there are impediments to the sale of know-how. Barriers to the free flow of products between nations decrease the attractiveness of exporting relative to FDI and licensing, while barriers to the sale of know-how increases the profitability of FDI relative to licensing (Hill, 2005).

Thus the market imperfections explanation predicts that FDI will be preferred whenever there are impediments that make both exporting and sale of know how difficult and / or expensive. This theory centers on the notion that firms aspire to develop their own internal markets whenever transactions can be made at lower cost within the firm (Buckley and Casson, 1976). Thus, internalization involves a form of vertical integration bringing new operations and activities, formerly carried out by intermediate markets, under the ownership and governance of the firm (Hymer, 1976).

Internalization and transaction cost theories are similar in that both try to lower costs of transfer of factors of production across the boundaries of the home and host countries through the price mechanism. In external markets prices are charged between buyers and sellers. In the internal market, on the other hand, prices are charged between related parties within the same organization. The company itself sets the transfer prices of goods and services within the organizational boundaries. This leads to flexibility to help achieve the overall goals of low cost production (Caves, 2007).

This explanation is however not sufficient to explain FDI since firms can transfer these advantages through other avenues such as joint ventures. There are limits in

internalization, particularly in terms of increased costs of communication and control of the separate organizational units.

2.3 The OLI Theory

MNEs are firms that produce goods and services abroad with their own employees as opposed to firms that export to these countries or that license or franchise producers located there. (Dunning, 1988) lists three necessary and sufficient conditions for the existence of MNEs, these are; Ownership advantages, Location advantages and Internalization advantages. Firms operating abroad usually incur higher costs than they do at home because they do not know the local environment as well, are not inserted in local networks and are quite often the victims of discrimination by local authorities. (Hymer, 1976) argued that to make up for these disadvantages, the firms must have compensating advantages.

(Dunning, 1980) refers to these compensating advantages as ownership or firm specific advantages which include new products and processes as well as a strong brand name. He further notes that a firm's possession of ownership advantages is not a sufficient condition for it to own value adding operations abroad. This is because the firm could exploit these advantages by integrating into production at home and exporting the products. A second condition therefore is that the firm must carry out its operations internally or intra-firm without going through the market process.

In addition to the ownership advantages and the internalization advantages which are necessary for a firm to invest internationally, (Dunning, 1977) adds that it must be in the firm's interest to use these in combination with some factor inputs located abroad, also

termed as location-specific advantages. These advantages arise from using resource endowments or assets that are tied to a particular foreign location and that a firm finds valuable to combine with its own unique assets such as the firm's technological, marketing or management know-how. By factoring in the location advantages, the propensity of a firm to initiate foreign production will depend on the specific attractions of its home country compared with resource implications and advantages of locating in another country (Lotayif, 2003). This theory makes it explicit that not only do resource differentials and the advantages of the firm play a part in determining overseas investment activities, but foreign government actions may significantly influence the attractiveness and entry conditions for firms.

Therefore, combining location-specific advantages or resource endowments and the firm's own unique assets often requires the firm to establish production facilities where those foreign assets or resource endowments are located (Dicken, 1992). The firm's unique assets will need to be transferred intra-firm to exploit the location advantages of the foreign market. This is termed the eclectic paradigm or Ownership, Location and Internalization (OLI) Theory.

2.3.1 Ownership Advantages

These firm specific advantages are usually intangible and can be transferred within the multinational enterprise at low cost (e.g., technology, brand name, benefits of economies of scale). The advantage either gives rise to higher revenues and/or lower costs that can offset the costs of operating at a distance in an abroad location. Some firms have a firm specific capital known as knowledge capital or human capital through its managers and

employees with relevant skills (Dicken, 1992). Other advantages include patents, technologies, brand, and reputation. If the markets were perfect then it would be easy to transfer such advantages across national boundaries. A multinational enterprise operating a plant in a foreign country is faced with additional costs paralleled to a local competitor.

The additional costs include:

- i. A failure of knowledge about local market conditions
- ii. Legal, institutional, cultural and language diversities
- iii. Increased costs of communicating and operating at a distance

Consequently, if a foreign firm is to be successful in another country, it must have some kind of an advantage that vanquishes the costs of operating in an abroad market. Either the firm must be able to earn higher revenues, for the same costs, or have lower costs, for the same revenues, than comparable native firms. These firms must have other methods to earn higher revenue to overcome "costs of foreignness".

$\text{Profit} = \text{Total revenues} - \text{Total costs} - \text{Cost of operating at a distance.}$

The multinational enterprise must have some separate advantages with its competitors, if it wants to be profitable abroad. Advantages must be particular to the firm and readily transferable between countries and within the firm (Hymer, 1976). These advantages are called ownership or core competencies or firm specific advantages (FSAs).

The firm has a monopoly over its firm specific advantages and can utilize them abroad, resulting in a higher marginal return or lower marginal cost than its competitors.

According to (Dunning, 1988), there are three basic types of ownership advantages (or Firm Specific Advantages) for that a multinational enterprise can possess. These are:

- i. Monopolistic advantages that receive to the multinational enterprise in the form of privileged access to output and input markets through ownership of scarce natural resources, patent rights, and the like.
- ii. Technology, knowledge broadly defined so as to contain all forms of innovation activities
- iii. Economies of large size (advantages of common governance) such as economies of learning, economies of scale and scope, broader access to financial capital throughout the multinational enterprise organization, and advantages from international diversification of assets and risks.

2.3.2 Location Advantages

(Dunning 1980) defines location-specific factors as "those which are available, on the same terms, to all firms whatever their size and nationality, but which are specific in origin to particular locations and have to be used in those locations.

These advantages can be separated into three classes:

- i. E - Economic advantages which consist of the quantities and qualities of the factors of production, transport and telecommunications costs, scope and size of the market, and etc.

- ii. P - Political Advantages which include the common and specific government policies that influence inward Foreign Direct Investment flows, intra-firm trade and international production.
- iii. S - Social, cultural advantages which include psychic distance between the home and host country, language and cultural diversities, general attitude towards foreigners and the overall position towards free enterprise.

These advantages can also give the firm the benefit of saving on transport costs for those involved in manufacturing for inputs and output, service firms benefit by being able to provide their services directly to the consumer without worrying that quality of service may be compromised. If the location has abundant resources then the firm is able to obtain cheap inputs. A firm can also circumvent barriers to free flow of goods by establishing its operations within the particular country of interest. Other location advantages consist of efficient labor, investment incentives and disincentives, tariff and non-tariff barriers as well as a favorable institutional framework.

2.3.3 Internalization Advantages

Given that ownership advantages are present, it must be in the best interest for the firm to use these on its own rather than sell or license them to other firms (Ekeledo and Sivakumar, 1998). This may arise if the firm possesses some proprietary information which it would not want to reveal or transfer to another firm. Problems could arise if the foreign agent interrupts the contract, and uses the technology to compete with the mother company. In the case of brands or firms that emphasize on reputation, there is the risk of damaging the brand reputation (Lotayif, 2003).

The multinational enterprise has several choices of entry mode, ranking from the market in terms of arm's length transactions to the hierarchy or wholly owned subsidiary (Ekeledo and Sivakumar, 1998). Internalization is preferred where the market does not exist or functions poorly so that external transactions are high. The subsistence of a particular know-how or core ability is an asset that can give rise to economic rents for the firm. These rents can be earned by licensing the firm specific advantages to another firm or exporting products using these firm specific advantages as an input.

According to internalization theory, FDI arises to replace market transactions with internal transactions; this may be the reason as to why a firm would want to make use of the ownership advantage by itself and exploit it in a foreign location.

2.4 Foreign Direct Investment through Wholly Owned Subsidiaries

FDI occurs when a firm invests directly in facilities to produce and / or market a product in a foreign country (Dunning, 1988). FDI takes on two main forms, green-field investment which involves the establishment of a wholly new operation in a foreign country and acquisitions which involves a firm acquiring a stake in a foreign firm. Horizontal foreign direct investment is FDI in the same industry in which a firm operates at home while vertical foreign direct investment is investment in an industry that provide inputs for a firm's domestic operations, or it may be FDI in an industry abroad that sells the outputs of a firm's domestic operations.

In a wholly owned subsidiary the firm owns 100 percent of the stock. Establishing wholly owned subsidiaries in a foreign market can be done in two ways. The firm can either set

up an operation in that country often referred to as a green-field venture or it can acquire an established firm in that host nation or a combination of both termed as a brownfield venture.

2.5 Advantages and Disadvantages of Wholly-Owned Subsidiaries

There are three clear advantages of wholly owned subsidiaries. First, when a firm's competitive advantage is based on technological competence, a wholly owned subsidiary will often be the preferred entry mode because it reduces the risks of losing control over that competence. Many high-tech firms prefer this entry mode for overseas expansion e. g firms in the semiconductor electronics and pharmaceutical industries (Hill, 2005). Second a wholly owned subsidiary gives a firm tight control over operations in different countries. This is necessary for engaging in global strategic coordination i. e using profit from one county to support competitive attack in another. Third, a wholly owned subsidiary may be required if a firm is trying to realize location and experienced curve economies as firms pursuing global and transnational strategies try to do.

Establishing a wholly owned subsidiary has its disadvantages as well since it is generally the most costly of all the entry modes from a capital investment point of view. Firms doing this must bear the full capital cost and risks of setting up overseas operations. The risks associated with learning to do business in a new culture are less if the firm acquires an established host country enterprises, however acquisition raise additional problems including those associated with trying to marry divergent corporate cultures (Ekeledo and Sivakumar, 1998). These problems may more than offset any benefits derived by

acquiring an established operation because the choice between green-field venture and acquisitions is such an important one (Hill, 2005).

2.6 Greenfield Venture vs. Acquisition

The choice between acquisitions and green-field ventures is not an easy one to make. Both modes have their advantages and disadvantages. In general, the choice will depend on the circumstances confronting the firm (Hill, 2005). If the firm is seeking to enter a market where there are already well established incumbent enterprises and where global competitors are also interested in establishing a presence, it may pay the firm to enter via an acquisition. In such circumstances, a green-field venture may be too slow to establish a sizeable presence (Lotayif, 2003). However, if the firm is going to make an acquisition, its management should be cognizant of the risks associated with acquisition such as difficulty in merging two organizational cultures, overvaluation of the firm to be acquired and consider these when determining which firms to purchase. If the risks are too high then it would be better to enter by the slower route of a green-field venture than to make a bad acquisition (Kumar and Subramaniam, 1997).

If the firm is considering making an entry into a country where there are no incumbent competitors to be acquired, then a greenfield venture may be the only mode. Even when incumbents exist, if the competitive advantage of the firm is based on the transfer of organizationally embedded competencies, skills, routines, and culture, it may still be preferable to enter via green field venture. Skills and organizational culture which are difficult to articulate and codify are much easier to embed in a new venture than they are

in an acquired entity, where the firm may have to overcome the established routines and culture of the acquired firm (Kumar and Subramaniam, 1997).

Overall, setting up wholly owned subsidiaries is preferable to joint venture arrangements and to using foreign marketing agents because it gives the firm tight control over marketing that might be required for coordinating a globally dispersed value chain (Hill, 2005). It also gives the firm the ability to use the profits generated in one market to improve its competitive position in another market. In other words, firms pursuing global or transnational strategies tend to prefer establishing wholly owned subsidiaries (Porter, 1980).

2.7 Scale of Entry and Strategic Commitment

Entering a market on a large scale involves the commitment of significant resources and it implies rapid entry (Griffin and Pustay, 2007). Not all firms have the resources necessary to enter on a large scale and even some large firms prefer to enter foreign markets on a small scale and then build slowly as they become more familiar with the market. The decision to do a foreign direct investment in another country leads to increased commitment, greater understanding of the local business environment and the possibility of further investment in the future. The consequences of entering on a significant scale are associated with the value of the resulting strategic commitments (Griffin and Pustay, 2007).

A strategic commitment has a long-term impact and is difficult to reverse. Deciding to enter a foreign market on a significant scale is a major strategic commitment. The scale of entry gives both customers and distributors a reason for believing that the firm will

remain in the market in the long run. The scale of entry may also give other foreign institution considering entry into that particular market to pause since they will now they have to compete not only against indigenous institution in that market but also against an aggressive and successful MNE (Lotayif, 2003). On the negative side by committing itself heavily to one market, it may have fewer resources available to support expansion in other desirable markets. The commitment to one particular market limits the company's strategic flexibility (Hill, 2005).

It is important for a firm to think through the implications of large scale entry into a market and act accordingly. Of particular relevance is trying to identify how actual and potential competitors may react to large scale entry into a market. It is worth noting that, the large-scale entrant is more likely than the small scale entrant to capture first-mover advantages, associated demand, pre-emption scale economies and switching costs (Ekeledo and Sivakumar, 1998).

The value of commitments that flow from rapid large -scale entry into a foreign a market must be balanced against the resulting risks and lack of flexibility associated with significant commitments; on the other hand strategic inflexibility can also have value, by eliminating option of retreat, the firm will have no choice but to perform and succeed in that particular market (Hill, 2005).

Balanced against the value and risks of the commitments associated with large-scale entry are the benefits of a small-scale entry which allow a firm to learn about a foreign market while limiting the firm's exposure to that market. Small-scale entry is a way of gathering information about a foreign market before deciding whether to enter on a

significant scale and how best to enter. This reduces the risks associated with a subsequent large –scale entry. However, a lack of commitment associated with small-scale entry may make it more difficult for the small-scale entrant to build market share and to capture first mover or early-mover advantages (Hill, 2005). The risk averse firm that enters a foreign market on a small scale may limit its potential losses but may also miss the chances to capture first-mover advantages (Ekeledo and Sivakumar, 1998).

2.8 The OLI Theory as a Strategic Tool

The theory can be used as a strategic tool in the formulation of business strategy (Dunning and Gray, 2003). This theory does not only explain past behavior of the firm but can also help in designing a business strategy for operating internationally. Instead of demonstrating that ownership advantages enable a firm to compete, the goal is to use those advantages to develop global corporate strategies. This application of the theory is probably the closest thing to a recipe for global strategy that one can imagine (Dunning and Gray, 2003). The recipe states that a firm must first assess its ownership advantages relative to the key rivals in the market(s) of concern. Then the firm must decide whether production of its products and/ or services should take place in a country where the firm is already producing those outputs or in a new country. And finally the firm has to decide whether to produce the products / services itself or contract them out to be produced by a third party. This perspective is tremendously useful as a strategy tool for framing a firm's decision making in global competition.

CHAPTER THREE: RESEARCH METHODOLOGY

3.0 Introduction

This chapter focuses on the research methodology that was used to meet the objective of this study by looking at the research design, data collection methods adopted for the study and the data analysis procedure.

3.1 Research Design

The research design adopted was a case study. Yin (1994) defines a case study as an empirical enquiry that investigates a contemporary phenomenon within its real life context, especially when the boundaries between phenomenon and context are not clearly defined. Yin (1994) argues that the case study allows an investigation to maintain the holistic and meaningful characteristics of real life events such as individual life cycles, organizational and managerial processes, neighborhood change, international relations and the maturation of industries. Therefore the case study approach is especially useful in situations where contextual conditions of the events being studied are critical and where the researcher has no control over the events as they unfold. In this case the researcher had no control over the internationalization process at KCB but this contextual condition is critical for the study.

Yin (1993) distinguishes three types of case studies; exploratory, causal and descriptive case studies. In an exploratory case study, the collection of data occurs before theories or specific research questions are formulated; it is followed up by analysis of data and leads to more systemic case studies. The first stage in this kind of case study is to define

the issues to be researched. The causal case study will look for cause-and-effect relationships and search for explanatory theories of the phenomena. According to Yin (1993) this situation offers the most suitable conditions for adopting the case study as the research strategy of choice. The descriptive case study will require a theory to guide the collection of data and 'this theory should be openly stated in advance and be the subject of review and debate and later serve as the 'design' for the descriptive case study'.

Given the nature of the research objective which was to establish the factors influencing the internationalization process at KCB, the case study approach was the appropriate research design for this topic.

3.2 Data Collection

The main data collection technique for this study was an interview guide which was self administered. The interview guide had open ended questions which enabled the collection of the views of the two respondents who are senior managers at Kenya Commercial Bank Limited.

The interview guide was divided into four sections. Section A covered the respondent's profile i. e the position in the bank, division and the number of years worked. Section B covered the entry mode choice, section C covered the ownership advantages that KCB has, section D looked at the location advantages in the countries in which KCB operates, section E looked at the reasons for internalization and lastly section F looked at the reasons for preference of greenfield ventures. The interview guide allowed for

flexibility of questions and it also enabled the respondent to give more details when answering the questions. This made it possible to test the respondents' knowledge and to make reliable assessment of their views.

One of the respondents was a senior manager in the International Division of the bank, having 16 years experience in the bank and the second respondent was a senior manager in Strategy and New Business Division with 10 years of service in the bank. They were qualified as respondents since KCB started its active internationalization process 6 years ago by opening subsidiaries in South Sudan and progressing on to other countries. They were already in service by the time the bank started its internationalization process. The two divisions they represent are also actively involved in carrying out research on new foreign market opportunities, strategies to be used in current foreign operations as well as formulating strategies on how best to enter new markets. They were able to provide the information necessary to draw conclusions necessary for this study.

3.3 Data Analysis

Data was analyzed by qualitative analysis which categorizes phrases, describes the logical structure of expressions and ascertains associations in order to interpret the results of the findings. Qualitative data analysis allows the researcher to study selected issues, cases, or events in depth and detail; data collection is also not constrained by predetermined categories of analysis and the researcher does not attempt to manipulate the program or its participants for purposes of the evaluation (Patton, 2002).

Data was classified into various themes for ease of analysis. Through this method, inferences were made by systematically and objectively identifying specified characteristics of information collected.

CHAPTER FOUR: DATA ANALYSIS, RESULTS AND

DISCUSSIONS

4.0 Introduction

This chapter analyses the data findings together with the interpretation of information collected. First is a look at the responses and secondly, the findings on factors influencing internationalization process at KCB are analyzed. Lastly are recommendations on the basis of the findings.

4.1 Responses

The respondents were two senior managers, one from International Division and had been with the bank for 16 years and the one from Strategy and New Business Division had been with the bank for 6 years. This made them suitable as respondents because the bank's internationalization process actively began six years ago.

4.2 Results

The findings were divided into ownership (O) advantages possessed by KCB, location (L) advantages existing in countries in which KCB operates, the reasons why KCB would want to (I) internalize its processes instead of going through the market and lastly is the reasons for its preference of greenfield ventures.

4.2.1 Ownership Advantages

The study found that the ownership or firm specific advantages that KCB has include, capital strength, economies of large size, technology, experience in foreign operations

and product diversification. KCB was the most capitalized bank in the country at Ksh. 38.4 billion as at half year of 2011. The bank also has privileged and broad access to financing from large firms such as the International Finance Corporation (IFC) which is the private lending arm of the World Bank; from which it received USD 105 Million in September, 2011 to support the bank's regional SMEs and mortgage lending business. Through its continuous internationalization process the bank has the advantage of international diversification of assets and risks.

4.2.2 Location Advantages in the Foreign Countries

The economic advantage that was contingent to South Sudan was that it provided a virgin market, since the country did not have many banks at the time when KCB opened its first subsidiary in 2005. This gave the bank first mover advantage and was able to capture 40% market share, the bank was also able to break-even within the first year of operation and reported profits after one and a half years of operation. Presence of few banks in Rwanda presented a large unbanked market. Tanzania and Uganda had a number of banks already present and were considered relatively mature markets.

The general economic advantage that these countries offered was that they were new markets which gave KCB the opportunity to increase its presence in the region and to tap on new customers through its diversified products. The Kenyan market was also becoming competitive with new entrants from West Africa coming into the country such as Ecobank, UBA and Bank of Africa. Thus the bank was also diversifying its portfolio in other markets by following its existing customers who were involved in cross border trade.

There were no political advantages such as favorable government policies in regard to inward FDI in all the four East African countries that KCB is operating in, and even if they existed it was not a driving factor for setting up operations in those particular countries.

There were however, socio-cultural advantages in terms of the psychic distance between Kenya and the four East African countries in which KCB operates in. The language dialects are also nearly similar and most countries speak English or Kiswahili which are widely spoken in Kenya thus language barriers can be circumvented. There are trade patterns among the five countries including Kenya, for example many traders in Kenya export products to Uganda which is land locked and produce from industries to Tanzania; many traders in Kenya also trade in South Sudan and Rwanda since these are 'new countries' thus providing opportunities for new markets. Since many of the business people within the region trade across the national boundaries the bank was following its customers as well when setting up operations in these countries to take care of the transactional part of their trade.

4.2.3 Reasons for Internalization

The reasons that led KCB to internalize its operations rather than use the market is its technological platform. The bank is now on a state-of-art core banking system, T24, which became operational at the end of 2008. This system is able to support transactions across the borders and its implementation has enabled KCB to introduce technology driven products and services such as the new state-of-the-art contact centre, and the KCB Connect, which is one of the country's best mobile telephone banking. This enables the

customers to access their accounts and transact when they are in any of the four East African countries in which KCB operates in. This is a system that the bank boasts of and that none of its local competitors can offer real time banking across the region.

The bank also possesses managerial expertise and this comes out explicitly in the Kenyan staff who have been involved in leading the foreign operations start ups, even though the host countries have insisted on local employees to make up a percentage of the staff in the subsidiaries.

4.2.4 Reasons for Use of Greenfield Ventures

The bank policy is to have 100% ownership of its subsidiaries thus this was the major reason for the use of greenfield ventures. There are also other reasons that justified the use of greenfield. The first subsidiary that was opened by KCB was in Tanzania, in 1997, at that time buying another entity was unlikely with few suitable candidates for acquisition. Secondly, KCB opened its subsidiary in South Sudan in 2005 and at this time the country was recovering from war thus there were no suitable banking institutions as candidates for acquisition. The only entry mode choice available was through greenfield ventures. This is justified because the bank has benefitted from first mover advantage and now has 40% market share.

The bank was also aware of inherent risks of acquisitions such as difficulty in merging KCB culture with that of a new entity. Having a greenfield enables the bank to copy paste its operations from the parent to the host countries, implementation is also faster and gives the parent freedom to determine the number of branches to be set up and their sizes.

There are also legacy issues of the company to be acquired in terms of bad debts and brand reputation; when a company acquires another firm, it takes up all the advantages and the disadvantages the firm had.

4.2.5 Other Factors Influencing the Internationalization Process

Revival of the East African Community played a major role in the bank's penetration of the region. Once the treaty is in place, the bank hopes that this will ease cross-border trade and the bank needed to have its systems in place to facilitate the cross-border transactions. The bank was also pursuing its strategy and vision through which it desires to be the preferred financial solutions provider in Africa with global reach. A third factor was to follow its competitors who had already established a presence in these countries. The bank was also following its customers and wanted to establish and increase its presence in the region.

4.3 Discussion

As per the findings some of the issues discussed in the literature review are applicable to the case of KCB, particularly in light of acquisitions and greenfield ventures. KCB has however, not considered use of acquisitions because of its policy which requires the bank to have 100% ownership of its subsidiaries. The bank got offers from prospective firms in Uganda and Rwanda but the deal was to give away less than one hundred per cent ownership which was against bank policy.

Use of greenfield ventures has been justified in the case of South Sudan and Tanzania but for Uganda and Rwanda, the bank should have considered other entry modes because there were many candidates for acquisition, it would have been cheaper and the payback

period would be shorter. Acquisitions are generally cheaper if the players do not overvalue the firm to be acquired because the foreign firm can spread and gain market share within a short period of time. A major disadvantage of greenfield is that it takes longer to break even and one has to start growing market share of 0%. The greenfield is viable if there are no incumbent competitors to be acquired or the existing companies are not suitable candidates for acquisition; it would be better to go through the slower route of Greenfield rather than to make a bad acquisition.

The ownership advantages that KCB has include its financial strength, being the most capitalized bank in the region. This advantage is very critical in setting up a greenfield venture which is very costly. The bank also has managerial expertise which comes about from experience, the bank operated in Kenya for more than 100 years before venturing into Tanzania, where it opened its first subsidiary. This enabled it to build a skill base of its managers who were sent out to start up operations in South Sudan, Tanzania, Uganda and Rwanda. These are personnel who were well conversant with the bank's policies and procedures thus would be able to implement these in the subsidiaries and also provide training to the local employees in processes and procedures. The parent company also has preferential and broad access to financing from large firms such as the IFC; this is then availed to its subsidiaries which with their own portfolios would not be able to access such funding.

The socio-cultural advantage stands out as the major location advantage that the four countries offered among the economic, political and socio-cultural advantages mentioned in literature review. This comes out in terms of psychic distance, with few language barriers and existing trade patterns among the countries within the region.

The main reason for internalization is the bank's technological platform. First of all, this was an expensive venture and is also able to support the banking operations across the region. With such a system it would not make economic sense to set up a representative office or have another firm operate on its behalf yet it has a technological capability to handle such operations. It would also be risky to entrust a third party with such a system since a slight error could pose operational, legal and reputational risk, this locks out the option of licensing.

Apart from the three major OLI factors, there are other factors which led to the internationalization process of KCB, these include the revival of the EAC, following its customers, pursuit of its strategy and to establish and increase its presence in the region. These can however, still be classified under the three main factors of OLI. The revival of the EAC provides a conducive political environment across the region in terms of investment because the treaty provides for improving trade across the region. Following customers can be looked at as a location advantage since the customers' trading patterns across the region provide for economic advantages.

CHAPTER FIVE: SUMMARY, CONCLUSION AND

RECOMMENDATIONS

5.0 Introduction

This chapter gives a summary of the research conclusions drawn from the study. It also gives some recommendations useful to the bank under study, other banks and policy makers as well as areas for further research.

5.1 SUMMARY

This study sought to find out factors influencing internationalization process at KCB by incorporating the OLI theory. It targeted the senior management at the bank who are involved in decision making and thus would be best suited to give the information necessary for this study. The study used primary data that was collected using interview guide and it revealed that, the bank possesses ownership advantages which include its capital strength, economies of large size, technology, experience in foreign operations and product diversification. Broad access to financing from large firms such as the IFC also gives an advantage to the subsidiaries as compared to their local competitors by virtue of the parent company's capital base. Through its continuous internationalization process the bank has the advantage of international diversification of assets and risks.

These ownership advantages are particular to the firm and are readily transferable between countries and within the firm. In this case the firm has a monopoly over its technological platform which is used across all its subsidiaries. This may lead to lower

marginal cost than its competitors since it does not have to purchase a new system when starting up operations in a foreign market.

Internalization plays a critical role in the bank's operations because in external markets prices are charged between buyers and sellers. In the internal market, on the other hand, prices are charged between related parties within the same organization. The company itself sets the transfer prices of goods and services within the organizational boundaries. This leads to flexibility to help achieve the overall goals of low cost production. This comes out as a compensating advantage which gives rise to lower costs that can offset the costs of operating at a distance in an abroad location as compared to the native firms.

KCB also benefits from internalization by being able to provide its services directly to the consumer without worrying that quality of service may be compromised.

The bank's preference of a wholly owned subsidiary gives it tight control over its operations in the different countries. This, as seen from literature review, is necessary for engaging in global strategic coordination i. e using profit from one county to support competitive attack in another. For instance since South Sudan reported profits in the first one and a half years of operation and the parent company in Kenya was reporting profits, these were used to support the other subsidiaries that were not yet profitable but required capital.

The nature of the banking industry and also the fact that KCB is majorly a retail bank makes it difficult to use other modes such as exporting or licensing, thus the best option was to set up foreign operations through FDI. This decision to engage in foreign direct investment in other countries lead to increased commitment, greater understanding of the

local business environment and the possibility of further investment in the future. This is evident because the bank has been expanding its operations in the four countries through opening new branches. This scale of entry gives both customers and distributors a reason for believing that the firm will remain in the market in the long run. The scale of entry may also give other foreign institution considering entry into that particular market to pause since they will now have to compete not only against indigenous institutions in that market but also against an aggressive and successful MNE. It is worth noting that, through large-scale entry the bank has been able to capture first-mover advantages, associated demand and pre-emption scale economies.

5.2 CONCLUSIONS

KCB has successfully gained entry into four countries in the East African region namely, South Sudan, Tanzania, Uganda and Rwanda. It made some losses during its initial years of operation but now the subsidiaries have turned into profitable ventures.

The ownership and internalization factors give KCB a competitive edge in the foreign markets because its subsidiaries have privileged access to capital from its parent company which is the most capitalized in the country. This capital can be obtained at preferential rates as compared to borrowing from another entity in the external market. The technology used by the bank also provides real time banking which is lacking in other competitor banks thus enabling it to provide efficient services to its customers wherever they are in the five countries in which KCB operates. Internalization of processes enables the bank to move its capital from one country where it is in excess to another subsidiary

where it is in deficit. The technological platform also contributes to internalization because the system supports transactions across the four countries; therefore the bank does not need to purchase a different system when going into a new country. It would also be risky to contract such a system to an agent, a slight error would greatly affect the bank's operations across the region therefore this is entrusted only to its employees who are bound by company policy.

The Location factors did not qualify for the case of KCB because apart from South Sudan, none of the other countries fit in Dunning's definition of location advantages which states that "location-specific advantages are those which are available, on the same terms, to all firms whatever their size and nationality, but which are specific in origin to particular locations and have to be used in those locations". The major advantage that the four countries had was psychic distance which is not sufficient on its own to justify as a location advantage because it would not give the same advantage to a firm with a parent company outside of the East African region. This advantage would also not be applicable if KCB ventured beyond the region.

Therefore, the OLI theory partly explains KCB's internationalization process but not fully, because there are factors other than the Ownership, Location and Internalization factors that led to KCB's internationalization process, these include the revival of the EAC, following its customers, pursuit of its strategy and to establish and increase its presence in the region. These can however, still be classified under the three main factors of OLI. The revival of the EAC provides a conducive political environment across the region in terms of investment because the treaty provides for improving trade across the region. Following customers can be looked at as a location advantage since the

customers' trading patterns across the region provide for economic advantages. The pursuit of strategy and increasing presence in the region are however, not contingent to the OLI factors.

Overall, the OLI theory provides a sound basis on the major factors influencing the internationalization process at KCB, but on its own is not sufficient to justify that the Ownership, Location and Internalization advantages are the factors that influenced the internationalization process at KCB. However, it provides useful insights into the ownership advantages that are possessed by the bank and how it can apply the theory as a strategic tool by first assessing these ownership advantages relative to the key rivals in the market(s) of concern and applying these to gain low cost advantage over its native competitors.

5.3 RECOMMENDATIONS

Being that KCB is majorly a retail bank, the only entry mode suitable for starting up international operations would be through FDI. However, there are different forms of FDI such as Greenfield ventures (the only mode used by the bank), acquisitions and joint ventures.

I would therefore recommend the bank to try and utilize the other modes of FDI such as acquisition. This is because, given its vision which states that "To be the preferred financial solutions provider in Africa with global reach." This implies that the bank is on a journey to be a global bank and will set up foreign operations in other countries beyond the East African region. The bank policy which dictates that it must have 100%

ownership is hindering the bank from looking at other options available for it to gain entry into foreign markets. What the bank can do is to have a majority ownership on its subsidiaries rather than 100% ownership in some markets since this can be a costly avenue. The policy should be in such a way as to allow other entry modes depending on the circumstances facing the firm, without eroding the control of the parent company by ensuring majority shareholding. In countries with mature markets it would be better to penetrate the market via acquisitions because the risks associated with learning to do business in a new culture are less if the parent acquires existing firms. This enables it to establish a sizeable presence within a short period of time and also gain market share from the acquired firm. It would be better if the bank left its options open so that depending on the market in question, for instance a mature market, getting in via greenfield may prove to be slow and more expensive if there are incumbent competitors. The bank may run out of the psychic distance advantage if it ventures further away from the East African region thus it would be better if it considered the other advantages it would gain in other foreign markets and how best to tap this at low cost.

The bank can also use the OLI theory as a strategic tool, by first assessing its ownership advantages relative to the key rivals in the market(s) of concern.

5.3.1 Recommendations to Policy Makers

The governments of most of these countries can improve the conditions for inward FDI to attract with such financial power such as KCB to consider their countries as suitable for setting up operations.

Governments should also have a monitoring mechanism on acquisition transactions so that the local firms do not take advantage of the foreign firms' capital base and charge exorbitant cost of acquisition. This will give a clear way of analyzing the costs of setting up a Greenfield venture relative to an acquisition rather than if the players are left to set their own prices which would distort the actual value of the entity to be acquired.

5.3.2 Recommendations for Further Research

This study only looked at one organization, it would be better if an industry-wide analysis can be done to determine the factors that influence the internationalization process of different banks. It would also be good to have a study carried out on a different industry because the nature of banking makes FDI the only suitable mode of entry. The theory can also be tested in a different sector e. g manufacturing to determine if the Ownership, Location and Internalization factors would lead it to start foreign operations via FDI rather than using incremental modes such as exports and then slowly to higher commitment modes.

5.3.3 Limitations

The study only focused on one organization thus is not sufficient to draw conclusions of whether the OLI theory can explain internationalization of firms. The respondents did not give full information in fear of breaching bank policy thus there may be other factors that this study was not able to establish.

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DATE.....12th OCTOBER, 2011.....

TO WHOM IT MAY CONCERN

The bearer of this letter.....BEATRICE ANNE MAUNDA.....

Registration No.....D61/73484/2009.....

is a bona fide continuing student in the Master of Business Administration (MBA) degree program in this University.

He/she is required to submit as part of his/her coursework assessment a research project report on a management problem. We would like the students to do their projects on real problems affecting firms in Kenya. We would, therefore, appreciate your assistance to enable him/her collect data in your organization.

The results of the report will be used solely for academic purposes and a copy of the same will be availed to the interviewed organizations on request.

Thank you.

UNIVERSITY OF NAIROBI
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 MBA OFFICE
 P.O. Box 30197
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JUSTINE MAGUTU
 ASSISTANT REGISTRAR
 MBA OFFICE, AMBANK HOUSE

APPENDIX II: INTERVIEW GUIDE

SECTION A: RESPONDENTS PROFILE

1. Which department are you working in?
2. What position do you hold in the bank?
3. How many years have you been working for KCB?

SECTION B: ENTRY MODE CHOICE

4. Is there an entry mode preferred by KCB and why?

SECTION C: OWNERSHIP ADVANTAGES

The following are ownership advantages that lead companies to start up successful wholly owned subsidiaries in foreign markets. Are these some of the ownership advantages possessed by KCB?

5. Capital
6. Technological Know- how
7. Foreign market experience
8. Management Skills

9. Patented Information

10. Monopolistic Advantages

SECTION D: LOCATION ADVANTAGES

11. Are there some location advantages unique to each country that KCB is operating in?

YES

NO

12. If the answer to the question above is a Yes, what are the specific location advantages unique to each country?

i. Tanzania

ii. South Sudan

iii. Uganda

iv. Rwanda

SECTION E: INTERNALIZATION ADVANTAGES

13. What factors lead to preference to internalize processes rather than using an external agent?

SECTION F: GREENFIELD VENTURES

14. What are the reasons for the bank's preference of Greenfield ventures?