DIVERSIFICATION STRATEGY USED BY COMMERCIAL BANKS IN REAL ESTATE TO GAIN COMPETITIVE ADVANTAGE IN KENYA

BY

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DECLARATION

This research project is my original work and has not been presented for a degree 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

This project is dedicated to my lovely and caring wife Maureen Ndulu Kinyua, my son Ethan Koome Kinyua and my daughter Ethel Mwendwa Kinyua for their love, care and comfort that gave me all the strength to undertake this project.

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ABBREVIATIONS AND ACRONYMS

KCB : Kenya Commercial Bank

BBK : Barclays Bank of Kenya

CBA : Commercial Bank of Africa

CBK : Central Bank of Kenya

DTB : Diamond Trust Bank

HFCK : Housing Finance Corporation of Kenya

GDP: Gross Domestic Product

I & M : Investment and Mortgage Bank

IO : Industrial Organization Theory

NBK : National Bank of Kenya

NHC : National Housing Corporation

NIC : National Industrial Credit

ROI : Return on Investment

SCB : Standard Chartered Bank

SCP : Structure Conduct Performance

S & L: Savings and Loan

ABSTRACT

The role of the commercial banks in Kenya cannot be over emphasized as the banking industry is known for its role in the development of the nation. Banks have continued to support businesses and individuals by offering loans and accepting deposits. The banking industry is estimated to control about 30-40% of the country's GDP. Competition within the banking sector has been very stiff and banks have gone full throttle in this competition. Anchored on game theory and industry organization theory, the study established that to remain competitive, banks have employed the use of diversification in real estate to remain ahead of their peers. Diversification in real estate is a new concept in banking as banks attempt to keep pace with innovation. This study sought to establish the impact of real estate diversification in an attempt to see whether diversification in real estate will keep the commercial banks competitive. The study found out that there exist structured real estate diversification and that few banks have remained innovative enough in this sector. These banks have captured the market and are reaping the fruits of being the front runners. The study finds that real estate has been a key driver in banking sectors especially in collateral support when lowering the banks risks but with the new innovations in this sector, banks which have embraced real estate and diversified their products in this area remain competitive as reflected in their performance. Some limitations were encountered in the process of carrying out this study since not all real estate players were involved. Organizations like housing finance, national Housing Corporation, Shelter Afrique could have been involved since they contribute a lot in this industry. There is the need to carry out a similar study on all key real estate players to ascertain the level of diversification used by these players to gain competitive advantage

CHAPTER ONE

INTRODUCTION

1.1 Background of the Study

Organizations resort to diversification in an attempt to improve their attractiveness and enhance their performance in the industry with the aim of gaining competitive advantage. Diversification helps an organization to boost its performance by initiating actions which leverage in the existing internal as well as external resources to support other venture which complement overall performance of the organization and help build on the shareholder value. The motivation to diversify is built on the need of improving shareholders value by using existing resources (Thomson et al., 2012). Diversification refers to a change in the characteristics of an organization's product line or its market. Diversification is manifested through market penetration, market development, and product development, which represent other types of change in product-market structure (Ansoff 1957).

Anchored on the industrial organization theory and the game theory, diversification emphasizes the need to get the structure-conduct-performance of the organization right so as to gain competitive advantage in an industry. Porter (1985) emphasized the need of a firm to position as well as differentiates itself in the industry through the five forces model. SCP paradigm in addition calls for a firm to formulate competitive strategies to remain competitive in the industry (Hoskinsson et al, 1999). The game theory makes use of mathematical models to craft strategic decision which benefit the organization by ensuring that the decisions made support the ultimate objectives of the organization. Game theory emphasizes the fact that there are decisions to be made in an organization and these choices are driven by a myriad of uncertainties in the environment and the need to make the right decisions relying managerial experience (Stinchcombe, 2002). The game theory calls for the need of an organization to apply strategies which ultimately guarantee success based on the players in the industry, the actions these industries take in comparison to the decisions (actions) the firm takes based on the prevailing information in the market.

Competition in the banking industry is very stiff forcing banks to bring out all the tricks in their reach to remain afloat. The number of banks in Kenya is large but the nature and type of products on offer in the banking industry are similar and diverse. This makes movement from one bank to another by customers to be fluid since the products are more or less homogeneous. To have a head start, banks must remain on top of their game competitively so as to cut a niche for themselves. Real estate is a field that banks make use of especially when security (collateral) is required. The players in real estate lending are few in the banking sector due to long term nature of the repayment as well as the risk involvement. Banks have resorted to diversify their real estate product offering to sustain the quest for profits. Diversification has been employed by banks to ensure that real.

1.1.1 Diversification Strategy

Stern and Henderson (2002) indicate that diversification will occur when firms wish to extend their existing product or service range from their current traditional ones by embracing new products or services. Diversification aims at maximizing the resource utilization of an organization as well as extending its market reach so that a variety of product or services are availed to meet the perceived expanded taste of customers. Matsusaka (2001) acknowledges that an organization which uses diversification can maximize value in its strategy. This is attributed to the fact that the firm will make use of the existing resources shared around the entire projects or products of the organization without the need to invest wholesome on the same product as it happens with any new venture. This way, diversification benefits the firm by spreading thin, the resources of the firm hence resulting into perfect resource utilization. In addition, diversification assist the firm to reduce the risks by enabling the firm have a number of products/services running hence should any of these projects fail, the loss factor is highly reduced.

The driving force in diversification is the quest of firms to make use of their organizational capabilities appropriately by maximizing existing resource use therefore making the firm more profitable. The use of diversification is therefore aimed at maximizing the organization’s offering by ensuring that all the tastes of different client base is catered for using the same resources thereby stretching the resource offering and yet still improve shareholders’ wealth.

1.1.2 Competitive Advantage

Competitive advantage as viewed by strategists entail that quest to remain at the helm where your piers admire your position but they are in no way capable of achieving your success Christensen (2001). Most firms consider the need to remain focused, while others look at economies of scale or integration as a source of competitive advantage. The need to understand what make firms competitive has been a source of research by strategic management scholar. The question that lingers in the minds of such scholars is *why do some firms perform better than others?* The need to create economic value to the organization is in the center of the drive of competitive advantage. Consequently, competitive advantage is enshrined in the need to improve performance of the organization. And the economic rent derived from such initiatives must be above normal performance. This means that a firm must do its best with the existing resources to ensure it generates a higher than expected return from the resources it utilizes (Barney, 2002).

Porter (1985) noted that to achieve competitive advantage, there are three main strategic options that available to organizations to pursue these include; cost leadership, differentiation and focus strategies. He emphasized the need for firms to put competitive advantage in the fore front of their quest to succeed by entrenching it at the heart of an organization's performance in any competitive market.

1.1.3 The Banking Industry in Kenya

As the back-bone of the economy, the banking sector is one very important constituent of the economic pillars of the nation. The industry boasts of impressive profits year in year out with the top tier banks posting double digit profits in the past five years. It is agreeable that the banking industry is the cornerstone of the economy. Individuals as well as companies go to banks for loans which are used for growth. It would be unimaginable to develop without the banking sector. This makes the industry a very important part of our lives.

Central Bank of Kenya (CBK) reports the existence of 44 Commercial Banks in Kenya today (see appendix 1). The banks are divided into Tiers (I, II & II). Tier I being the largest banks by asset base and is made up of Kenya Commercial Bank (KCB), Barclays Bank of Kenya (BBK), Equity Bank of Kenya, Standard Chartered Bank (SCB), Cooperative Bank of Kenya. In the last five years, Tier I banks have been competing for dominance with cut throat competition and each bank attempting to be the industry leader. For instance, KCB and Equity have in the last two years exchange leadership in profitability with KCB taking over from Equity. In addition, KCB was the first bank to go regional into Tanzania, Rwanda, Uganda, Burundi, South Sudan with Equity following closely.

Tier II is made up of Diamond Trust Bank (DTB), CFC Stanbic, Citibank, National Bank of Kenya (NBK), I and M bank, Commercial Bank of Africa (CBA) and National Industrial Credit (NIC). The rest of the banks form Tier III banks. The grouping of banks is based on each bank’s customer base as well as their asset base. There has been an attempt in the banking sector to rank banks by profitability so that the most profitable bank become Tier I followed by Tier II and finally least profitable to be ranked at Tier III. According to CBK (2012), the country is over banked as CBK thinks of a way in which it will force the Tier III banks to merge into larger entity. The comparison is made where Nigeria with over 100 M in population has less than 30 bunks while Kenya with a population of 40 M has more banks than Nigeria.

Table 1.1: Top Ten Banks in Kenya

	TOP TEN BANKS IN KENYA
1	KENYA COMMERCIAL BANK
2	EQUITY BANK
3	COOPERATIVE BANK
4	STANDARD CHARTERED BANK
5	BARCLAYS BANK
6	CFC STANBIC
7	NIC BANK
8	DIAMOND TRUST BANK
9	COMMERCIAL BANK OF AFRICA
10	CITIBANK

Source: CBK (2013)

1.1.4 Commercial Banks and Real Estate in Kenya

Real estate is an important securitization component of the banking sector. As a safeguard for collaterals, real estate has acted as a source of exchange or security for money borrowed by customers. More often than not, businesses find it difficult to get bank lending when they lack security most of which is in form of real estate title deeds. Banks charge these securities (real estate) to offer loans to customers. These loans are in form of hard cash, guarantees, letters of credit, bid bonds, among other banks offerings.

The bulk of loans in Kenya are secured through title deeds of land making land the number one collateral in the country. Banks which offer mortgages are countable in Kenya as the capital tied to these assets are vast. Among the top tier banks, the competition for market share is cut throat and the game is played on the interest rate area as well as the fixed vis-a-vis floating loan offering.

As a frontier in banking, real estate has become a game changer in the profitability of most banks. Some banks who offer real estate loans rake so much profit at the envy of those who do not have the adequate risk appetite for loans. The real estate sector is well differentiated and banks have used the differentiated products to capitalize on the market weakness at the benefit of the banks.

1.2 Research Problem

Diversification has proved to be a key strategy used by organizations to reduce risk as well as expand a business empire by making use of existing resources hence improving the performance of the organization. At the heart of diversification strategy, is the need to increase market size and at the same time make maximum utilization of the resources. On the other hand, competitive strategy aims at empowering and equipping an organization to remain at the helm of its peers by ensuring the firm pursues actions and products/services which set them apart from the competition.

The cut throat competition by commercial banks has forced the banks to convert real estate into a battlefield for diversification in an attempt to remain competitive. Banks employ all the tricks of the game to achieve their objectives. As an important component of securitization by banks, real estate has and continues to be a major component of banking security. However, most banks are beginning to look at real estate not only as a security but as a business strategy for diversification. Few banks have in the recent past ventured into real estate mortgages something which has been a preserve of real estate companies such as Housing Finance, National Housing Corporation and other private real estate ventures. As a very important component of banking product offering, real estate is an area which ties up capital over a long period of time as the loans for real estate have long repayment duration. However real estate has its share of risks as some title deeds in Kenya are not acquired rightfully and hence may make the bank loose its capital. In addition, the long term nature of real estate poses the risk of some borrowers defaulting on the loan advanced hence putting the bank's loans at risk of loss.

The study sought to establish how banks can make use of real estate as a diversification strategy to gain competitive advantage. The underlying challenge is how banks use diversification strategy in real estate to remain competitive in the industry. Studies have been conducted in real estate with the following contribution; Lind and Nystrom (2012) carried a study titled Within Real Estate Diversification and Investment Strategies. They discovered that there is not benefit in diversifying in real estate as the real estate sector is inefficient. Wilson and Zurbruegg (2003) researched on a topic -does it pay to diversify real estate assets? The outcome of the study was that there is a mixed outcome. Shediac et al. (2005) looked at the economic diversification in the road to sustainable development and discovered that there is a clear link between diversification and sustainable growth.

Locally, studies have been conducted with Mwangi (2011) studying the behavioral factors influencing investment decisions in Kenyan property market. The study found that property sellers peg their prices on the behavior of the market players in addition; Wasike (2010) conducted a study on competitive strategies adopted by Barclays bank of Kenya in counteracting industry competition and Wambui (2010) the existence of real estate investment trusts needs by institutional investors at the NSE. The study discovered that there is lack of real estate investment trusts to spearhead real estate growth at the burse. None of the above studies has looked at real estate specifically as a source of diversification for competitive advantage hence this study is well on course to establish this relationship. How do commercial banks use real estate diversification for competitive advantage?

1.5 Research Objective

The study sought to establish how commercial banks in Kenya use real estate to gain competitive advantage.

1.6 Value of the study

To the policy makers, this study assists in empowering the players by equipping them with the latest happenings in the industry. This will help them come up with better policies to the benefit of the banks and country at large. Better policies will open up the banking sector by allowing products and services to compete favorably. These policies will aid in adding value to the industry players.

To the scholars, the study contributes to existing literature thereby growing scholarly materials in the field of diversification, competitive advantage and banking sector. Real estate literature will also be aligned to the banking sector something which will expand the use of real estate beyond the current value attached to as collateral. The study contributes to the literature by emphasizing the application of industry organization theory as well as game theory in real life situation something which enables banks to appreciate the role of literature in daily running of business. In addition, the study can assist scholars in appreciating and applying game theory as well as structure-conduct-performance in the daily running of existing businesses. Scholars are in a position to relate the two theories in the daily running of organizations especially in banking. Lastly, to the practitioners in real estate, the study empowers them on how to engage banks as well as other real estate players when they are seeking loans. This will support the practitioners in their daily interaction with banks when it comes to real estate issues. Practitioners will in addition have the know-how to compete favorably especially when it comes to diversification of real estate products.

CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

This chapter reviews theoretical and empirical literature on diversification strategy used by banks in Kenya to gain competitive advantage in real estate. The chapter will explore the theoretical anchorage of the research topic and attempt to relate the contribution of diversification in real estate within the banking industry in Kenya. In addition, the chapter will attempt to bring out the understanding of diversification as well as competitive advantage and their manifestations in banking in line relation to real estate.

2.2 Theoretical Anchorage

The two main theories which form the basis for this study are industry organization theory and the game theory.

2.2.1 Industrial Organization Theory

The industry organization (IO) theory considers the structural aspect of an industry where firms consider industry structure and competitive position. Bain, (1956) and Mason, (1939) Industry organization (IO), is the study of a firm behavior in imperfectly competitive markets. IO relies on the structural aspect of an industry which emphasizes on the strategic groups in the industry with emphasis on the firm behavior and market structure. The empirical analysis of IO is better reflected by structure-conduct-performance (SCP) which describes how key market structures relate to each other.

SCP explains that the visible (observable) structural characteristics of the market determine the behaviour of the firm in the market in which it operates. The behaviour of the firm in this market further determines the performance of the firm in the market (Mason and Bain, 1956). Porter (1980) noted that SCP helps us understand the structure of an industry. He explains that structural analysis focuses on competition beyond a firm's internal environment to include external environment.

Porter (1980) came up with five forces which better brings a complement to IO by more specifically the various industry structures thereby making it simpler to analyze and understand a firm's attractiveness. The five forces dwell on competition as a means of gauging the industry attractiveness (Porter, 1985). The five forces include; threat of new entrants, bargaining power of buyers, threat of substitute products and services, bargaining power of supplier and rivalry among existing competitors.

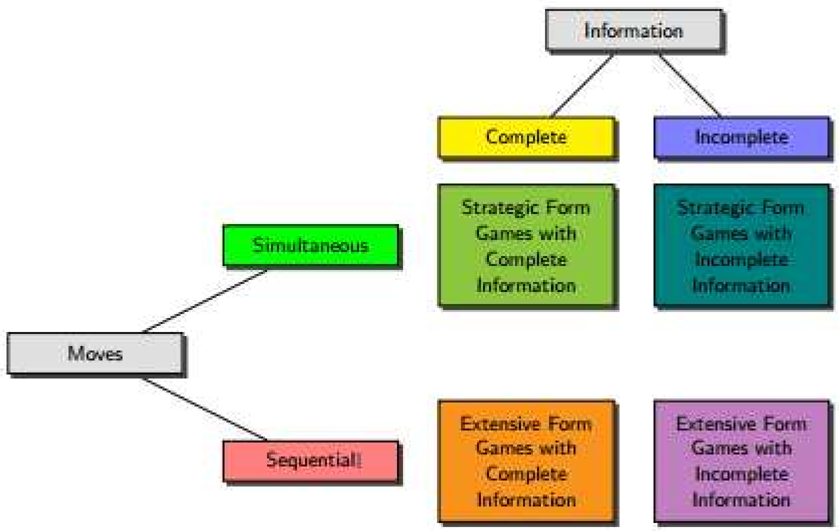
2.2.2 Game Theory

Ogot (2011) define game theory as part of a large body of theory(ies) which aim at providing a formal language to describe conscious, goal-oriented, decision making processes involving one or more players. Shubik (1972) observe that the solution concepts derived from game-theory may be thought of as normative or descriptive views of multi-person decision-making. Camerer (1991) posit that game theory as the analysis of rational behaviour in situations involving interdependence of outcomes.

Game theory studies strategic interactions within a group of individuals. The theory believes that actions of each individual firm have effects on the outcome of other firms.

Each firm is therefore aware of that fact that their competition are also rational and have well defined objectives over the set of possible outcomes and are therefore ready to pursue the best available strategy to counter their competitors (Kockesen, 2011).

Figure 1: Game theory diagram



Source: Kockesen (2011)

2.3 The Concept of Diversification

Johnson et al. (2004) define diversification as a growth strategy employed by organizations to move the organizations into new products or services or into new markets. Diversification is applied by organizations to extend their market dominance by opening new frontiers in business. In addition, diversification seeks to increase profitability of a firm through greater sales volume as a result of new markets and products introduced. Wernerfelt (1984) acknowledge that any diversification should happen when the bundled resources in an organization is increased by the diversification itself.

Markowitz (1952) considers diversification to refer to the minimization of risks by not putting all the eggs in the same basket. There are various ways of diversifying in real estate as a result of the fact that real estate is highly heterogeneous (it varies by size, property type, geographic and economic region, and proximity to a metropolitan area). The benefit of diversification is found in the reduction of risks as diversified firms have less risk exposure unlike none diversified organizations which can collapse upon failure of the single venture.

According to Hermalin and Katz (2000) diversification is the process of entering different lines of business so as to reduce the risks existing in the current business. Decisions related to diversification are two fold; one, they relate to whether the industry to be entered is more attractive than the firm's existing business or whether the firm can establish a competitive advantage within the industry to be entered. In other words does synergy exist between the core business and the new business?

Stern and Henderson, (2002) observe that diversification occurs when a firm extends its existing product or service line from the current traditional offering by embracing new products or services. The aim of diversification is to maximize resource utilization of a firm as well as extend the market reach in terms of product offering to enable a variety of product or services to be availed to meet the perceived expanded taste of customers.

Organizations which employ the use of diversification can maximize value in their strategy as the central idea is that firms are made up of organizational capabilities that can be profitable in multiple businesses and that diversification is a search processes by which firms seek a business which is a good match for the organization's existing capabilities. Maximizing the organization's offering is the man motive of diversification (Matsusaka, 2001).

Thomson et al. (2012) acknowledge that there exist three types of diversification notably; vertical integration (related diversification) which calls for the integration along the same business line by simply adding value within the value chain of the firm. Horizontal integration (unrelated diversification) entails diversifying into more than one business line besides the current one. Lastly is geographical integration where a firm opens up new frontiers in other regions by leaving the home turf to pursue additional business outside ones territory for growth reasons. Geographical integration is a strategy of diversification applied when the structure is adequate to support the strategy (Chandler, 1962)

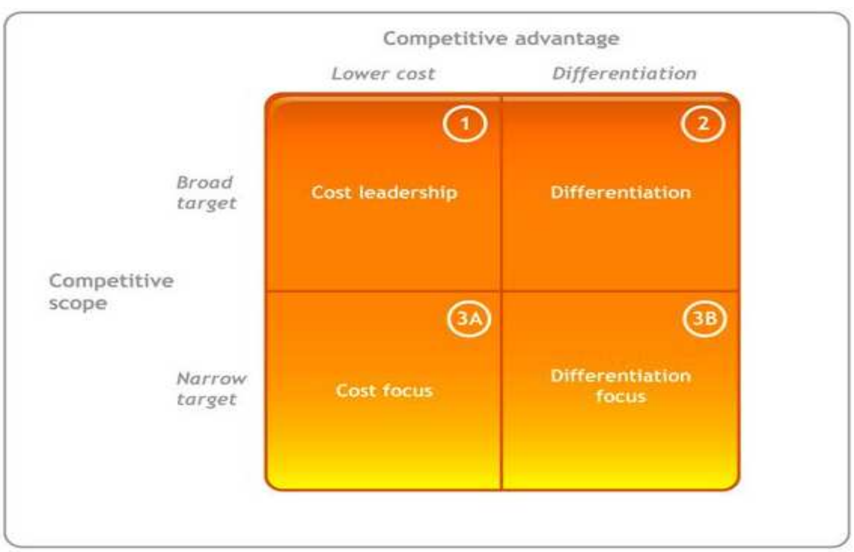
2.4 Competitive Advantage

A firm will boast of having a competitive advantage when its actions in the industry create economic value to the organization. Competitive advantage is tied to the performance of the organization when a firm obtains above normal performance by generating higher than expected value or return from the resources it employs (Barney, 2002).

Porter (1985) noted that firms must build competitive advantage into their strategies to be able to make a difference. He emphasized the need for competitive advantage to be at the heart of a firm's performance in any competitive market hence firms must create competitive advantage in an industry to remain profitable. Porter believes that to achieve competitive advantage, there are three main strategic options that are open to organizations to pursue these are cost leadership, differentiation and focus strategies.

Peteraf (1993) perceive competitive advantage to entail sustainability on the company returns resulting from an organization's resources. Competitive advantage here entails generating rent from resources of an organization. Barney (2002) noted that a firm will experience competitive advantage when its actions in the industry create economic value to the firm. He further stresses that for a firm to be competitive, it must obtains above average performance in which it generates greater than expected value from the employed resources.

Figure 2: Competitive Advantage



Source: Porter (1985) Competitive advantage

Porter argues that competitive advantage means having low costs, differentiation advantage, or a successful focus strategy. In addition, he claims that competitive advantage grows fundamentally out of value a firm is able to create for its buyers that exceeds the firm's cost of creating it. Porter argues that competitive advantage means having low costs, differentiation advantage, or a successful focus strategy. In addition, he claims that competitive advantage grows fundamentally out of value a firm is able to create for its buyers that exceeds the firm's cost of creating it. The rate at which a bank is capable of employing its resources dictates the ROI it places on its shareholders as such an organization can reap better output as opposed to a firm which does not deploy its resources well leading to wastage.

Organizations need to determine how they compete in a way that can result into advantages that are sustainable in the long term. The long term sustainability requires that the resources employed by these firms are unique and not easily imitated by competition. This means that such firms must be focusing on two fundamental questions; one, how should they compete in order to create competitive advantages in the market place (for instance, leaders need to determine if the organization should position itself as the low-cost producer, or develop products and services that are unique which will enable the company to charge premium prices - differentiated or some combination of the two?, secondly, leaders must also ask themselves how they will make the above advantages sustainable, so that they can maintain competitiveness in the long run (Porter, 1987).

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Introduction

This chapter explains the way in which data was collected and analyzed. It provides the choice of research design used, why the choice of the design, how data was collected and analyzed.

3.2 Research Design

A research design provides a guide for selecting sources and types of information as well as providing a framework for specifying the relationships existing among study variables. Kothari (2004) states the function of the research design is to provide means of the collection of relevant evidence with least effort, time and money. In other words the research design is the general plan of how to go about answering the research questions.

The study employed the use of cross sectional survey design to establish diversification strategy used by banks in Kenya to gain competitive advantage in real estate sector. A survey was the most appropriate design to make this investigation as it takes place at one point in time. The banking industry has 44 banks studying such a large group is better done through a survey design. The choice of survey as a design is appropriate in that it provides an avenue for establishing comparison within the banking sector and relating the implications of real estate in the banking.

Nachmias and Nachmias (1996) recommends the use of survey design when looking at a number of players in an industry such as the entire banking industry in this case as this makes generalization easy. Similar studies have been carried out using survey design with satisfactory results. Mwangi (2011), Muthike (2012) and Wanemba (2010) used similar designs and their results were successful.

3.3 Population of the Study

The study sought to get responses from all the 44 commercial banks of which one senior person per bank needs to respond. In total 44 respondents are required to respond. The study seeks to gather data from key people of the banks. Target respondents are the people in charge of strategy of the organizations. The study therefore expects to receive responses from 44 respondents in total. It is not possible to receive feedback from all the 44 commercial banks so this study will work with a 60% success rate on the respondents. This way, the analysis carried out will be representative of a larger population of the banking industry.

3.4 Data Collection

The study targeted key units of the banks for data collection (strategic unit which is synonymous with corporate strategy). The reason for targeting strategic units of the bank is based on the assumption that diversification and competitive advantage are better handled within the strategic unite or departments of the banks. Use of primary data (Questionnaires-Appendix 2) was employed. At least one strategy manager from each bank as expected to respond. Questionnaires were administered through drop and pick method as well as delivered by email where applicable.

The questionnaires had both closed and open-ended questions. The questionnaire mainly relied on Likert Scale type of 1 (strongly disagree or strongly negative) to 5 (strongly agree or strongly positive impact) to rank the respondents opinion on various statements as well as open ended questions. The years under review was pegged at 2008 to 2012 (5 years).

3.5 Data Analysis

Data analysis involves the drawing of inferences from raw data (Saunders, Lewis, and Thornhill, 2009). An analysis of quantitative data captured in the questionnaire was thereafter done. The data gathered was coded, analyzed and organized according to the themes and patterns that emerge (phenomena). Major themes and patterns identified were related to the research questions or objective of the study.

Results of the collated data were reported in narrative and tabular/graphic formats (Use of tables and graphs was employed to ensure that report is easy to understand). Data analysis was done using Microsoft office (in tables, and graphs) to get the relationship between independent and dependent variables. The application of content analysis was done in the open ended section of the questionnaire and the results were relayed on continuous prose as stipulated in the report.

CHAPTER FOUR

DATA ANALYSIS AND RESULTS

4.1 Introduction

This chapter presented the findings of the study based on the data collected. The study relied much on content analysis. The analysis of this study relied on data collected from respondents with emphasis devoted to addressing the objective of the study.

4.2 The Respondents

Respondents to the study came from managers especially those responsible for strategy. In situations where a bank lacks strategy managers, the study chose to issue questionnaires to marketing managers. It was assumed that these people will be knowledgeable enough to address the bank's strategic moves.

A total of 44 questionnaires were sent out with 36 fully completed questionnaires returned. The responses were analyzed using content analysis. This represented 81% success rate something which was very welcome as the data gathered was very representative of the population of study.

4.2.1 The Market

The banking industry is renowned for specific "vanilla" products with some serious diversified products finding their way into the market monthly. The stiff competition occasionally leads to the banks having streams of products and services which they churn out regularly to assume the market leadership role. A wide number of products and services find themselves in the market. These range from banccassurance, personal accounts, corporate accounts, children accounts, lending, chama affiliated accounts, deposit taking products, cash management, online banking services, custody services, agent banking services, business advisory services, investments services, institutional banking, business incubation services, mortgages among many others.

The banks basically attempt to gain competitive advantage and by so doing they capture the market and keep their customers. Since the banking industry boasts of driving the economy of the country, product diversification is seen as the ultimate driver and deliverer of competitive advantage. The banking industry controls about 40% of the economy currently and is therefore a very important component of the economy. Banks offer loans which is used to support businesses, individuals also burrow from banks for personal development such as mortgages, asset financing, insurance premium financing as well as personal loans for general upkeep and support of financial obligations by individuals such as school fees payments among others.

4.2.2 The Banking Environmental

The banking industry is made up of 44 banks. The banks are in constant competition as each of them tries to elbow the other in fight for population. Housing has been considered a number one priority for the citizen yet it is the number one product which is not doing very well in the banking sector. The demand for housing is thought to be 150,000 households in a year and banks have been tasked with the role of ensuring that they fund the growth of real estate. This demand has made banks to seek ways of satisfying the market.

Despite the shortfall in supply, banks have been wanting in this area as most of them do not get motivated to lock large sums of money in real estate for over 10 years. Mortgage business therefore remains a special league for banks and financial institutions with the appetite for long term investment. Many banks have used the services of international lenders like IFC and World Bank to seek cheap deposits which when locked into real estate for a longer period, do not hurt the bank's asset base and liquidity.

4.2.3 Banks Offering Real Estate

There are many people who wish they could own their own houses. This has remained a pipedream for so any households as there are many impediments to owning a home. The bulk of the banks showed that the need for a 10-20 % down payment is a big turn off to home ownership as so many of the bank customers could not raise these deposit. Some respondents indicated that the need to raise this deposit has contributed to many defaults as some borrowers would go to SACCOS or go to other banks to borrow the down payment before they come to a different banks to seek mortgage financing. This makes the cost of home ownership very high leaving the borrower with very little to live on.

Table 4.2: Showing the type of real estate loans offered by banks

	Real Estate Loan Type					
Bank/Institution	**Construction Loans**	**Fixed Interest**	**Variable Interest**	**Secured Loans**	**Company Arranged**	**Total**
KCB	10%	45%	2%	38%	5%	**100%**
BBK	8%	52%	5%	32%	10%	**100%**
HFCK	20%	60%	0	15%	5%	**100%**
NHC	5%	70%	0	10%	15%	**100%**
SCB	9%	40%	6%	35%	10%	**100%**
CFC Stanbic	6%	55%	4%	25%	10%	**100%**

From table 4.2, out of the 44 banks in the country, the study found out that only 10 banks take part in real estate lending with only 4 banks offering diversified products in real estate. The banks gave credence to the role played by HFCK and NHC in the real estate as they are key contributors in the real estate business.

4.3 Diversification Strategies used by Banks in Real Estate

The following is the findings related to the use of real estate as a means of gaining competitive advantage by the banks. The table above has considered nonbanking institutions due to the impact they have in the real estate business. However, analysis of this study will avoid including these two institutions as the study is set to look at real estate diversification in banks.

4.3.1 Fixed Interest Mortgage Lending

This is the most popular real estate loan by banks which support real estate lending. The reason for the popularity of this type of loan is due to low risk appetite banks have and the quest to make high profits from loans. A fixed deposit loan on mortgage is easy to manage as banks have very limited effort required to invest in changes in interest rates.

Fixed interest is pegged on a mortgage repayment period where a borrower is required to make repayment over 5 or 10 or 20 years until the loan is fully settled (paid up). As a diversification strategy, fixed deposit lending contributes to the highest profit returns for the banks. Conversely, it is very expensive to the borrowers especially in situations where real estate interest rate comes down.

4.3.2 Secured Mortgage Lending

This is another product in the mortgage business which is very popular by banks. It is attractive in that it reduces the banks risk of default as there is some security on top of the property just in case the loan goes bad; there is recourse for the bank to fall back on. The security for the property in most cases is in other properties as well as cash secured lending. It is the most popular security used by banks to extend lending.

Most banks makes use of collateral requirement as it is a sure way of ensuring that funds borrowed are adequately covered by the pledged security. This in essence makes secured mortgage the most preferred by banks as it is a sure way of ensuring that the risk of lending is mitigated as at any time, there is a fall back claim in case of a default.

4.3.3 Company Arranged Real Estate Loans

This is another way in which banks diversify their loan portfolio. They in essence allow companies to place guarantees or cash secure the loans given to the staff of these companies. This way the interest rates charged on such real estate assume a remarked reduction in the rate. The market prevailing rate might be reduced by half or quarter without the bank losing their revenue as they are allow to extend the cash security to recoup on the reduced interest rate.

Companies also make use of the facility to make their own office blocks for rental or occupancy. This way, the companies benefit a great deal from the relationship with the bank as they support the bank's liabilities quest as well as the bank reciprocating on the reduced interest rate.

4.3.4 Construction Loans

The Kenyan market is attempting to revolutionize the real estate sector by introducing new angles through diversification into the market. Banks are continuously allowing people with land to seek construction loans to put up their own structures. This concept is becoming popular especially for borrowers who know what they want and have the resilience to wait and the capacity to monitor their property growth. This concept is a bit involving and challenging to the banks but since banks are looking forward to meeting the needs of various customers, they are ready to invest in architectures, engineers and other players who have the expertise to enable the banks lower their risk.

4.4 How Commercial Banks Evaluate Real Estate Loans

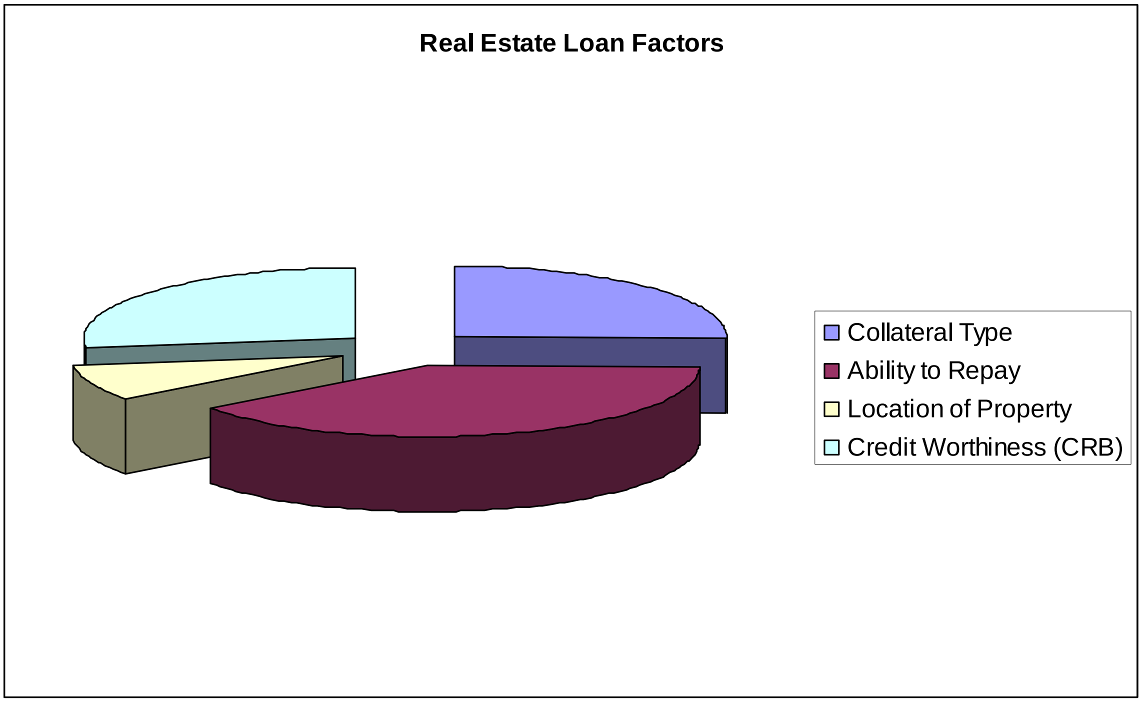
Real estate borrowing is as old as banking despite the proliferation of new diversified concepts in the industry as portrayed above. This paper sought to establish what banks consider before they issues loans and the following was the finding;

Table 4.3: Factors to consider when Issuing Real Estate Loans

Factor	**Response**	**Percentage**
Collateral Type	9	25%
Ability to Repay	14	39%
Location of Property	3	8%
Credit Worthiness (CRB)	10	27%
Total	**36**	**100%**

The table above shows how banks consider the risk of defaulting as the number one factor to be guaranteed before a loan is issued. At 39%, it means that bank's ratings first checks whether you have the capacity to repay the loan. This is followed by a borrower's creditworthiness and banks check this by going to credit reference bureau to ascertain if one is listed or not. If the listing is not negative, then the banks consider the type of collateral at 25%. Lastly, the banks consider location of premise and this is in relation to nearness to town centers meaning the value of land which the property is sitting on is also of priority.

Figure 3: Loan Factors for Real Estate



CHAPTER FIVE

SUMMARY, DISCUSSION AND CONCLUSION

5.1 Introduction

This chapter summarized the findings based on the objective of the study. The purpose of the study was to establish how commercial banks in Kenya use real estate diversification for competitive advantage.

5.2 Summary

The study has positively supported the need for bank to diversify their real estate as this is shown in the continuous improvement in performance of key banks which are aggressively pursuing real estate. The study demonstrated that diversification as a strategy is important in the continuous growth of the banks especially in real estate. As supported by Johnson et al. (2004), diversification as a growth strategy by organizations to enables players in real estate to move the banks who take part in it into new products or services or into new markets. This has shown that diversification strategy if well applied by banks in real estate, can extend their market dominance by opening new frontiers in business, which can keep the brand of these banks relevant and hence leading to competitive advantage.

Competition in the commercial banks has proved to be very competitive and banks have shown that real estate diversification has proved that banks can maintain their edge in the competition. Leading banks are using a number of ways to diversify their products and services.

The use of fixed interest of awarding loans has proved critical for people with fixed income as they have used it to lock in real estate mortgage for about five years before the loan is opened up to variable interest rate. There are customers who have benefited by locking in fixed interest rates for five years and managed to conclusively pay up the outstanding mortgage amount within the five years before they result to taking another loan. This way, such customers have been smart enough to use the interest rates difference to their benefit.

Banks have also incorporated company arranged loans which works perfectly for company employees. The way this real estate financing has been used has shown that banks are willing to retain their clientele as most banks engaged in company arranged mortgages has liabilities at the banks which they use to manage their liquidity. This way, the banks attempt to use the deposits in their books as security for their staff loans such that the banks lower the loan interest in a way which is manageable for the employees of these companies as the loans are now offered at below market interest rate.

The use of construction loans has also shown that banks have opened up new frontiers and are more than willing to try up new things for the sake of remaining competitive. The need to venture in new lines of business has made these banks forge strategic partnerships with specialist in real estate such as constructors, architects, engineers, surveyors and property valuers just to mention but a few. These players have cushioned the banks and stakeholders against possible losses as banks attempt to balance professionalism.

5.3 Conclusion

The innovations in real estate by commercial banks in Kenya is commendable and banks need to be lauded for the impressive work put so far in real estate by opening up new opportunities and ventures which has not only enabled the market to expand but has as well guaranteed the banks competitiveness hence improving profits of the banks and ultimately benefiting the shareholders.

So far, this study would wish to commend banks for a work well done when it comes to real estate diversification. The performance of the bank has shown a lot of due diligent put in place before extending loans to different borrowers as the risk appetite for different stakeholders is taken into account. Banks have also shown that adequate credit risk policies are in place to guide the process of real estate lending. This has led the bank to operate on rules rather than on whims. The banks have demonstrated that it is possible to diversify in real estate and this is to the benefit of the banks themselves. Diversification has enabled the banking industry even strengthen its resolve to be a leader in innovation and ultimately profitability.

The use of Game theory as advocated by Camerer (1991) shows that banks need to analyze rational behaviour in very diverse situations involving interdependence of outcomes. This is what the banks have done in order to innovate in real estate business. The study further shows that there is a delicate balance required in this sectors hence the reason not all banks operate in the diversification of real estate leaving such banks to only rely on the “vanilla” products of real estate which may not offer competitive advantage.

The competitive advantage which banks embracing real estate enjoy is likely to last longer as the banks are regularly reviewing their risk policies as well as reinforcing their innovative ventures with other strategies in marketing and strategic partnerships. With this in place, banks will continuously drive their real estate business which will propel the industry for higher productively and ultimate profitability.

5.4 Discussion

The study shows that not all banks are specializing in real estate business. Most banks use real estate only as a means of reducing the risk of loans they offer. These banks make use of real estate as collateral just to ensure the banks' funds are not lost. Conversely, about 10 banks are found to be relying on real estate heavily as a business initiative (strategy). In addition, about 4 banks (KCB, BBK, and CFC Stanbic) are found to be using real estate diversification as a means of maintaining competitive advantage. KCB has historically used its subsidiary – Savings and Loan (S&L) to offer real estate business.

On the other hand, CFC Stanbic is a market leader when it comes to offering 100% financing of real estate loans. This has made the bank cut a niche in the real estate business as most banks require that the borrower foot the bill for legal fee, 4% land rates as well as contribute 10-30% down payment something which makes the cost of real estate so high hence locking would be borrowers. CFC Stanbic has therefore diversified and is becoming a market leader in 100% financing. Other banks are attempting to copy what CFC Stanbic is doing.

5.5. Recommendation

Going by the findings of this study, it is evident that Barclays bank has made a name for itself in the field of real estate. The bank prides itself in being a lead player in real estate as it offers the lowest interest rate in the real estate business. This has attracted so many civil servants as well as high net worth clients who are capable of making additional payments such as 10-30% down payments, legal fee as well as land rates. With a healthy asset base, Barclays bank is capable of lending to the masses hence their strength in the real estate lending. The study recommends that the bank considers diversifying into low cost housing to meet the untapped demand in the country.

The banking industry uses real estate to remain competitive; the study recommends that commercial banks should keep innovating in real estate realm to ensure that it maintain the competitive advantage. The banking industry should not shy away from designing new real estate products but do so in a pace which resonates with expectations of the market and clients.

There is also need for commercial banks that rely on real estate to remain competitive to enlist and work closely with essential real estate service providers. This way, the banks and key stakeholders in real estate will forge a way forward something which will work towards the betterment of the real estate offering by banks. It is necessary for the banks to ensure the partnerships with these key stakeholders in real estate do not contribute into increasing the cost of rendering the services to final beneficiaries by increasing transactional cost.

5.5 Limitations of the Study

A good study would have come off this research if it had been conducted on the entire real estate players including nonfinancial institutions such as housing finance, National Housing Corporation, Shelter Afrique among others as these can contribute in various ways in the results of the study.

It was also very difficult to believe that the staff of the banks gave factual information as most banks put their staff on oath of secrecy not to disclose bank sensitive information especially that which is related to market intelligence. It is our belief that some of the staff did not offer genuine information for fear of exposing their bank ideas to competition.

5.6 Suggestions for Further Reading

This study suggests that a similar study be carried out on all the key real estate players extending the study beyond commercial banks. This will ensure the findings are compared to see if the outcome is similar. This will give a good read and will cover grounds which this study might have omitted.

Also there is the need to carry out the proper analysis on the partnerships that exists between other real estate players on all other aspects of real estate developments.

5.7 Implication on Policy, Theory and Practice

The study established that real estate borrowers are hard pressed when it comes to paying the initial charges such as 4% stamp duty, land rates which is payable to the government, as well as legal fee, valuation, down payment and transfer fees.

The study finds that these prerequisite costs contribute to almost 40-50% of the cost of mortgage. This study tasks the policy makers to consider waiving the 4% stamp duty as well as assist home buyers to make use of their retirement benefit contribution to be used for the rest of the prerequisite charges/fees. The study will assist policy makers to understand the real estate market hence make policy matters which is beneficial to the real estate sector.

This study has made positive contributions theory. The study has shown that diversification can lead to competitive advantage as used in the real estate lending business by KCB, CFC Stanbic, SCB and BBK. In addition the study has discovered that structure follows strategy as advocated by four banks above. These banks have developed the real estate departments and they are so established that the banks can now roll out diversified products for the benefit of the banks (competitive advantage) Bain and Mason (1956).

The study has shown that for banks to reap from the study, they must ensure they employ the concept of SCP to rollout real estate business. This is reflected by only 4 banks having got their act together hence the reason they managed to rollout real estate business and reap success out of the business. In conclusion, the study has established that game theory must be put into use when launching a diversified strategy as used in real estate. Rational behavior must be analyzed as actions from various stakeholders affect the actions of other groups (Kockesen, 2011).

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APPENDICES

Appendix 1: Commercial Banks in Kenya

1	African Banking Corporation, Nairobi
2	Bank of Africa Kenya, Nairobi
3	Bank of Baroda, Nairobi
4	Bank of India, Nairobi
5	Barclays Bank of Kenya, Nairobi
6	CFC Stanbic Bank, Nairobi
7	Chase Bank Ltd, Nairobi
8	Citibank, Nairobi
9	Credit Bank, Nairobi
10	Co-operative Bank of Kenya, Nairobi
11	Commercial Bank of Africa, Nairobi
12	Consolidated Bank of Kenya Ltd, Nairobi
13	Credit Bank Ltd, Nairobi
14	Development Bank of Kenya, Nairobi
15	Diamond Trust Bank, Nairobi
16	Dubai Bank Kenya Ltd, Nairobi
17	Equatorial Commercial Bank Ltd, Nairobi
18	Equity Bank, Nairobi
19	Family Bank, Nairobi
20	Fidelity (Commercial) Bank Ltd, Nairobi
21	Fina Bank Ltd, Nairobi
22	First Community Bank Ltd, Nairobi
23	Giro Commercial Bank Ltd, Nairobi
24	Guardian Bank, Nairobi

25	Gulf African Bank Ltd, Nairobi
26	Habib Bank A.G. Zurich, Nairobi
27	Habib Bank Ltd, Nairobi
28	Housing Finance Co. Ltd, Nairobi
29	Imperial Bank, Nairobi
30	I&M Bank Ltd (former Investment & Mortgages Bank Ltd), Nairobi
31	K-Rep Bank Ltd, Nairobi
32	Kenya Commercial Bank Ltd, Nairobi
33	Middle East Bank, Nairobi
34	National Bank of Kenya, Nairobi
35	National Industrial Credit Bank Ltd (NIC Bank), Nairobi
36	Oriental Commercial Bank Ltd, Nairobi
37	Paramount Universal Bank Ltd, Nairobi
38	Prime Bank Ltd, Nairobi
39	Southern Credit Banking Corp. Ltd, Nairobi
40	Standard Chartered Bank , Nairobi
41	Trans-National Bank Ltd, Nairobi
42	UBA Kenya Bank Ltd., Nairobi
43	Victoria Commercial Bank LTD, Nairobi
44.	Jamii Bora Bank

Source CBK (2013)

APPENDIX 2: QUESTIONNAIRES

LETTER OF INTRODUCTION

UNIVERSITY OF NAIROBI

School of Business

Telephone: +254-2-318262 Pius Kinyua

Telegrams: "Varsity", Nairobi P.O. Box 30711 00100

Telex: 22095 Varsity Nairobi, Kenya

Dear Sir/Madam,

RE: REQUEST OF PARTICIPATION IN MBA RESEARCH PROJECT

The bearer of this letter, Pius Kinyua is a Postgraduate student undertaking a Master of Business Administration (MBA) degree at the School of Business, University of Nairobi. He is Majoring in Strategic Management. As part of his course work assessment, he's required to submit a research project report on the diversification strategy used by commercial banks in real estate to gain competitive advantage in Kenya. Kindly assist him by completing the attached questionnaire. We assure you that the information provided is purely for academic purpose only and will be treated with utmost confidentiality.

Should you be interested in the findings of the research, a copy will be availed to you on request by the student. In addition a copy will also be availed at the University of Nairobi Library.

Thanks you for your cooperation.

Dr. Z. B.Awino Pius Kinyua

Senior Lecturer, UoN MBA Student

Introduction:

There is growing concern by Banks in Kenya and world over on how to remain competitive. Banks have relied on traditional ways and means of retaining competitiveness without success. Consequently, the banks have resorted to diversification strategy to push the competitive agenda.

This study looks at how banks can use diversification in real estate to drive the competitive push and improve their performance.

To achieve the above, we wish to request that you complete the questionnaire below. Information provided here will be treated as confidential. Should you require feedback related to the outcome of the study, feel free to contact the researcher for the final report.

Section A. Introduction – Information about the Bank

i.) Kindly provide the name of your bank (**Optional**)………………………………

ii.) What is your role at the Bank?...

iii.) How would you rate your bank? a.) [] Tier 1 b.) [ ] Tier 2 c.) [ ] Tier 3

iv.) Do you offer real estate lending in your bank? [ ] Yes [ ] No.

Section B: Diversification Strategy and competitive advantage

1.) Which of the following below represent the predominant type of product offering by your bank?

Mark all that apply;

1. [ ] Asset Finance Lending
2. [ ] Corporate Lending
3. [ ] Trade related lending
4. [ ] Group lending
5. [ ] Personal Lending
6. [ ] Real estate lending

Any other, please specify____

2.) Which of the below clearly relate to the nature of lending that the bank engages in?

1. [ ] Unsecured Lending 2. [ ] Secured lending 3. [ ] Other, please specify____

3.) To what extent do you agree or disagree with the statement below?

"The hope of this bank in lending is best taken care of by secured lending as opposed to non secured lending"

Not at all 1. ☐ 2. ☐ 3. ☐ 4. ☐ 5. ☐ A great extent

4.) In terms of percentage contribution of lending to the bottom line of the bank, how would you rate the contribution of lending business to the profits of the banks?

1. ☐ 10%-30% 2. ☐ 31%-50% 3. ☐ 51%-70% 4. ☐Over 71%

5.) To what extent would you say your bank diversify the following products/services?

Please Circle one for each row.	**Not at all**		**To a great extent**			
i.) Asset Financing		1	2	3	4	5
ii.) Mortgage Lending/Real estate	1	2	3	4	5	
iii.) Cash Management		1	2	3	4	5
iv.) Hire purchase	1	2	3	4	5	
v.) Premium Financing		1	2	3	4	5
vi.) Accounts offering		1	2	3	4	5

Other, Please include and rate____

6.) What factors lead to diversification in your bank?____

____

____

7.) To improve your competitiveness, kindly indicate what your bank does to ensure it is in the lead.____________________________________

____

____

8.) Please indicate what your bank maintains competitive advantage.

Please, Circle one for each row.	Not at all		To a great extent			
i.) Producing new products/services	1	2	3	4	5	
ii.) Offering superior customer service	1	2	3	4	5	
iii.) Diversifying real estate products		1	2	3	4	5
iv.) Through market dominance (presence all over)	1	2	3	4	5	
v.) Using Agency Banking	1	2	3	4	5	
vi.) Other, Please specify______________________	12	3	4	5		

9.) Please indicate what your bank looks at when deciding to diversify its products/services?

Please, Circle one for each row.	Not at all		To a great extent			
i.) The profit capability	1	2	3	4	5	
ii.) The impact on other products	1	2	3	4	5	
iii.) Return on investment is the deciding factor	1	2	3	4	5	
iv.) Competitive nature of the product/service		1	2	3	4	5
v.) Other, Please specify______________________	1 2	3	4	5		

Section C: Role of Real Estate in diversification

1. What is your understanding of Diversification in real estate?

____

____

____

2. In your view, do you consider real estate to be subject of diversification by your bank ?

[ ] Yes [ ] No.

If yes above, please clarify why and how____

____

____

3. To what extent does your bank use the following categories of real estate diversification?

Please Circle one for each row.		Not at all			To a great extent	
i.) Offering Variable mortgages	1	2	3	4	5	
ii.) Offering Fixed Mortgages		1	2	3	4	5
iii.) Offering construction loans	1	2	3	4	5	
iv.) Offering partner lending		1	2	3	4	5
v.) Facilitating take over mortgages	1	2	3	4	5	
vi.) Availing secured mortgages	1	2	3	4	5	
vii.) Offering unsecured real estate lending	1	2	3	4	5	
viii.) Any other,____________________	1	2	3	4	5	

4. Please indicate the extent to which you agree or disagree with the following information;

“Real estate lending is a sure way of diversification by banks”

Strongly agree 1. ☐ 2. ☐ 3. ☐ 4. ☐ 5. ☐ Strongly disagree

5. How effective would the following types of real estate lending in a bank lead to competitive advantage in real estate?

Please Circle one for each row.						
	Least effective			Very effective		
i.) Use of collaterals		1	2	3	4	5
ii.) Use of bank guarantee	1	2	3	4	5	
iii.) Partnership lending	1	2	3	4	5	
iv.) Use of Credit Reference Bureau		1	2	3	4	5
v.) Facilitating construction loans	1	2	3	4	5	
vi.) Any other,____________________	1	2	3	4	5	

6. In your view, what is the role of Real estate in banking especially in ensuring that a bank remains competitive?

____

____

____

7. What are the benefits of real estate lending in banking?

____

____

____

8. What measures would you recommend that can improve a bank's Real estate offering to guarantee competitive advantage?________________

____

____

9. How do you consider the impact of real estate diversification would be in an attempt to gain competitive advantage?

____

____

____

10. Kindly provide any other information which you think can contribute to diversification strategy in real estate so as to guarantee a bank in being ahead of its competition

____

____

____

____

11. Who are the key competitors in real estate lending?

____

____

____

~Thank you ~