RESPONSES OF BANKS OFFERING CUSTODIAN BANKING SERVICES TO ENVIRONMENTAL CHANGES AFFECTING THE BANKING INDUSTRY IN KENYA

BY

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A management research project submitted in partial fulfillment of the requirements for the award of the Degree of Master of Business Administration, School of Business, and University of Nairobi

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DECLARATION

This project is my original work and has not been submitted for a degree in any other University.

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This project has been submitted for examination with my approval as the University Supervisor

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DEDICATION

This project is dedicated to my family: My mother Regina Pola Juma, my wife Agnes Mashaka Oliko, my daughter Angela Lulu Juma, my Son’s Athanas Amani Juma and Mathew Fahari Lugho.

Special dedication goes to my late uncle Honorable Mathias Benedict Keah for his deep love, foresight and encouragement that made me what iam today.

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I wish to thank my wife for her love, guidance, patience, understanding and support. Without her material support, residential consultations and encouragement this work would not have been accomplished. I salute our children Angela, Athanas and Mathew for their understanding and encouragement. I am grateful to my late uncle, Honorable Mathias Benedict Keah for laying the foundation of my academic pursuits through his fatherly guidance, wise counsel and material support.

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Above all, Glory and Honour be to God the Father, Son and Holy Spirit. This is the work of their hands.

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LIST OF ABBREVIATIONS

CEO'S	CHIEF EXECUTIVE OFFICER'S
CMA	CAPITAL MARKETS AUTHORITY
KCB	KENYA COMMERCIAL BANK
RBA	RETIREMENT BENEFITS AUTHORITY

ABSTRACT

Chapter one contains the background information and purpose of the study. The purpose of this study was to determine responses of custodian banks to environmental changes affecting the banking industry in Kenya. The objectives were two fold, namely:(i) To analyze the changes in the banking environment that affected custodian banking services and the challenges posed by these changes, and (ii) To identify the strategic and operational responses being employed by the custodian banks in response to the changes in the banking environment.

In Chapter two we see the study of environment of organizations and organizations responses to the environment. The study clearly indicates the environmental dependence nature of an organization and that the organization strategy has to be changed in order to adapt to the changing environmental conditions which is only possible through organizational capability changes. Further, the literature review also puts forward the strategic and operational responses employed by organizations to changing environmental conditions, including diversification, restructuring, collaborative, generic, marketing, product, price, place, promotion, operation and technology, financial, human resource and procurement strategies. Some of these responses are also employed by custodian banks in response to changes in the banking industry.

In Chapter three, the procedures for conducting the research are discussed. The study employed a census survey design. A census survey was used in the study. This was found suitable because the population of custodian banks licenced with retirement benefits authority and capital markets authority consisted of 8 banks as at 30.06.2007. Data analysis was conducted using descriptive statistics. These included measures of central tendency, like the mean, frequency distribution tables and charts.

The research first, concludes that economic growth, legislative and regulatory and technological advancement changes affected custodian banking services in Kenya. This correlated well with the observation carried out in the literature review by

Hoskisson et al (1997) who pointed out that external environment plays a significant role in the growth and profitability of firms. The high percentage scores on the changes means that changes in the banking industry to a greater extent affected custodian banking services. Also the research concludes that most custodian banks in Kenya face various challenges imposed by both the external and internal environments. High ranking of these challenges are in the areas of service demand, customer expectations, increased competition, legislative compliances, income distribution and saving culture. The high standard deviations on some of the challenges demonstrated dispersion of the scores across the different respondents for these variables.

The responses employed by custodian banks to the changes and challenges in the banking industry were in the areas of corporate restructuring, business process re-engineering, down sizing, outsourcing of non core services, diversification, pricing and embracing information technology systems. Bearing in mind that the custodian banks are varied in size, this again agrees with the literature review that organizations are environment serving and dependent Hunger and Wheeler (1990) and that they have to respond either strategically or operational to environmental changes in order to survive Barton and Martin (1990) .The strategic responses practices will vary with the size of the organizations; that small banks are limited by the scarcity of resources to respond to some of the changes in the banking industry hence explaining why there are only 8 out of 52 commercial banks offering custodian banking services in Kenya as at 30th June ,2007.

CHAPTER ONE: INTRODUCTION

1.1 Background

Organizations do not exist in a vacuum, they exist in an environment in which they have to relate with for their survival. Organization's environment consists of all the conditions and forces that affect its strategic options and defines its competitive situation. Contemporary business environments are characterized by ever increasing uncertainty due to business challenges from the environment. The success and survival of organizations depends on how well they relate with these challenges and how they position themselves in the environment. With this realization, continuous analysis of the impact of the complex and dynamic existing environmental considerations ensures organizations success in the future (Pearce and Robinson, 1997). Because of the dynamic nature of the environment, organizations need not only notice changes in their environment, but are also required to formulate strategies which match these changes in order to create a "fit".

Strategic response require a firm to change its strategy to match the environment and also to transform its internal capability to match the strategy. Internal capabilities are part of the modern executives responsibilities, as managers they must also respond to challenges posed by the firm's immediate and remote external environment (Pearce and Robinson, 2000). The immediate external environment includes competitors, suppliers, scarce resources, government agencies and regulations and customers whose taste and preferences keeps on shifting. The remote external environment consists of political, economic, social and technology. Successful environment serving organizations are open systems and use strategies that ensures continued organizational survival in the ever turbulent environment in which they exist (Ansoff and Mc Donnell, 1990)

There exists a mismatch between the internal characteristics of an organization and its external environment which is solved by creating a "fit" between the internal characteristics of the organization and the external environment (Aosa, 1988). It is therefore important that organizations shift their strategies with changes in the environment and match their capabilities to the selected strategy in order to survive and remain relevant (Porter, 1985).

The Kenyan business environment has been changing over the years. The changes have been in the areas of liberalization of the economy, globalization, price decontrols and introduction of new government regulations. These changes have affected the business operating environment regardless of the sector in which they operate. It is now imperative for organizations to continuously adapt their activities in order to survive in the current turbulent environment that is constantly changing, (Mittra, 2001).

1.1.1 Organizational responses to environmental changes

Available knowledge reveals that changes in the environment will require new strategies, which in turn call for reformed organizational capabilities. Organizations must adapt their strategies to new environment (Ansoff and Mc Donnell, 1990). According to Thompson and Strickland (1993), it is necessary for organizations to use scanning techniques so as to predict environmental changes. Such scanning techniques involve studying and interpreting the social, political, economic and technological events so as to identify trends that could affect the industry. Environmental scanning enables managers to become aware of new developments that could pose new opportunities and threats to the organization. This is because organizations are open systems that are interdependent with the environment, hence the strategy employed needs to take into account the environment within which they are operating (Mwanthi, 2003)

The scholarly work of Kotler addressed the aspect of strategic planning process. He argues that marketing plays a critical role in the company's strategic planning process and that it is the most significant contributor to the process of defining the business mission and analyzing the environment competitive and business situations. The marketing functions include developing objectives, goals, strategies, defining product markets and distribution. The involvement of marketing extends to development of programs and operating plans that are linked with the strategic plan. In view of this fact that strategic planning have to do with strategic responses, the marketing components articulated form an integral part of the strategic responses (Kotler, 1998).

Each industry has an underlying set of fundamentals e.g. economic or technological characteristics that give rise to competitive forces. For an organization to implement strategic responses three components are essential, they are the right climate (will to respond), competence (ability to respond) and capacity (volume to respond) (Ansoff and Mc Donnell, 1990). These three components are the responsibility of the general management who should also ensure that the organization engages in behaviour which optimizes the organization long term objectives. Climate setting determines the original culture and it involves the mental and power position of the managers. Competence determines the organizations structures, systems and shared knowledge's and involves talent, skills and knowledge of the management. Capacity on the other hand involves personal capabilities to accommodate the various management challenges that may arise over time.

In a study on how large manufacturing corporations in America were affected when the external environment became turbulent, Hall (1980) observed that the "success formulas" which brought prosperity when the environment was stable were no longer working and were being replaced with strategic choices, which were essential for the survival of the organizations in a hostile environment. Consequently when there are changes in the external environment, organizations need to re-direct attention to redefining their businesses as a crucial step to formulation of survival strategies. Organization must also look beyond competitors of today and those that may become competitors tomorrow and exploit new markets.

Environmental changes have inspired various studies to identify organizations responses to challenges posed by the environment. A study in the dairy industry in Kenya concluded that due to the on going economic reforms in the country, firms in the industry made certain adjustments in their marketing mix components of producer prices, promotion and place in order to adapt to changes and remain competitive in a liberalized industry (Bett, 1995). He also observed that firms adopted market driven strategies by engaging in market segmentation and market planning so as to cope with the competitive entity challenges. The firms were also flexible and adaptive as they focused on their competitor's activities and undertook to know what was happening in their industry and the markets.

A past study carried our in the aviation industry confirmed that organizations are environment dependent and hence have to constantly adapt their activities and internal configuration to reflect new external realties, failure to do this, may jeopardize firms future success (Aosa, 1998). In response to the environmental turbulence that characterized the aviation industry in recent years, all the airlines that survived had in one way or another adapted strategies that enabled them to cope with the turbulent environmental conditions at that time. Most of them had formed alliances and partnership so as to quickly globalize their route network thus giving them a competitive edge (Thiga, 2002). Firms operating in the oil industry laid more emphasis on strategic planning. Many of the firms also redesigned their original structures in a bid to make the organization more efficient. The firms also formed strategic alliances and engaged in merging in an effort to reduce costs and be more competitive (Chepkwony, 2001). Most firms also adjusted to their ever changing customers needs, put more emphasis on research and development aimed at establishing needs of their customers and also try to keep abreast of the competitor's activities.

1.1.2 Custodian banking services

In order to increase investor's confidence and facilitate smooth transactions at the stock exchange it has become internationally accepted practice to separate the functions of the parties who may transact business through the stock exchange. As such, it is common to have investment manager's, stockbrokers and custodian, each providing the investors with different services (Ojiambo, 1998,).

Custodian banking services provides a means by which customers assets are held in trust and in turn are invested in accordance with the customer's or their appointed agent's instructions. Assets in this case, refers to the cash balance in the customers accounts and title documents representing investments. The resulting benefits being comfort to the customers that their assets are secure and that the customers will not have to personal undergo the rigorous investment processes as this will be done on their behalf by professional custodian banks. In turn the customer pays the custodian a fee based on the fund value of the assets or number of transactions (2002, Custodian Benchmarks)

Custodian banking services falls under the Kenyan financial sector specifically the commercial banks, which are regulated under the banking act, retirement benefit act and the capital markets act. A custodian must be licensed as a commercial bank by the central bank of Kenya, registered as a custodian with the retirement benefits authority and also registered with capital markets authority as an authorized depository. According to the retirement benefits act, 1997, a custodian means a company whose business includes taking the responsibility for the safe custody of the funds, securities, financial instrument and documents of title of the assets of scheme funds. The capital market act *(Cap. 488) defines a "*Custodian" as a bank licensed under the banking act or a financial institution approved by the capital market authority to hold in custody funds, securities, financial instruments or documents of title to assets registered in the name of local investors, east african investors, foreign investors or of an investment portfolio.

The retirement benefits act and capital markets act recognizes custodian banks as one of the key government strategy in mobilization of huge deposits which when invested will propel the economy by injecting professionalism, transparency and accountability in the management of the retirement's benefits schemes and collective investment schemes in Kenya. The key services offered by custodian banks are to receive funds, deliver securities, verify securities, account for the investor's portfolio through a reporting system and efficiently carry out instructions of the customers or their appointed agents in an efficient manner (2002, Custodian Benchmarks)

The ability to gather assets effectively, employ technology and efficiently process huge volumes of transactions is essential the drive for the growth of custodian banking services today in Kenya. With the mandatory regulatory requirement that all retirement benefits schemes and collective investment schemes appoint a custodian, the level of assets under custody has grown significantly. Currently, the retirement benefits scheme assets are estimated at kshs 172 billion while the collective investment scheme are estimated at kshs 10 billion, (2004/2005, RBA Annual Accounts)

The creation of custodian banking services has elicited interest among the users of the services, which include institutional investors, money managers, brokers and dealers who rely on custodians and other market participants for the efficient handling of their worldwide securities portfolios. (Onyewuchi , 2000). There are eight commercial banks registered with the retirement benefits authority (RBA newsletter February 2007) and eight commercial banks registered with the capital markets authority as authorized depository, CMA Legal notice (2005) banks offering custodian banking services in Kenya.

1.1.3 Banking industry in Kenya

Kenya's financial system is among the largest and more developed in sub Saharan Africa, with a large banking sector. According to the CBK February 2007 monthly economic review, the banking sector is composed of one non-bank financial institution (NBFIs), 2 mortgage financial companies, 2 building societies, 15 micro finance institutions, 3800 savings and credit cooperatives, 89 foreign exchange bureaus and 45 commercial banks, with the six largest banks accounting for about two-thirds of all assets, loans and deposits of the banking system. Other participants in the financial sector include, 4 hire purchase companies, 48 insurance companies, National Social Security Fund and Kenya Postal Office service s Bank.

The banking sector has had to deal with high interest rates which have caused an increase in non performing loan approximated at 36% of the total advances. In addition to this, the period between 1998 to 2001 saw the collapse of five banks. This sent shockwaves in the banking industry. The government had to intervene to avoid an occurrence of the same. The government measures being undertaken to bring down the interest is expected to reverse this trend and stimulate economic growth (Mwangi, 2001). With this realization the banking sector has had to compliment its products portfolio from interest related products to non-interest related products to cushion themselves. Custodian banking services provide one such opportunity for the banks to earn non interest income based on the number of transaction and total size of the asset portfolio.

Numerous efforts have been made by scholars to try and analyze changes affecting banking industry in Kenya. According to Mwamba, (2003) the changes which have impacted on investment banking services include exceptional pace of technology advancement across the industry amongst other . From the era of manual processing of transactions to full automated environment, today we can talk of straight through processing of transactions without any human intervention. A case study of KCB by Kiptugen (2003) established that changes in the business environment has come about due to economic decline, liberalization, increasing level of education and technological changes .He argues that, Kenya commercial bank has addressed its changing competitive situation through restructuring, marketing, information technology and cultural changes among other responses. He further states that the management of these changes in the banking industry has been made more difficult by the presence of five forces that influence competitive situation in an industry. These forces are, barriers to entry, rivalry within the industry, threat of substitutes, powers of buyers and powers of supplies (Porter, 1980).

1.2 Research problem

The banking industry is facing challenges because of changes in the environment. Some of the changes are in the areas of legislation, technology and customer focus, political and economic dimensions. These changes have led to product and service redesigning and development. One of the new product is custodian banking services which involves processing of investment instructions and safe custody of assets. This is a unique and specialized service different from the traditional retail and corporate products offered by commercial banks of lending and deposit taking. In view of this uniqueness it is important to find out how the banks offering custodian banking services are coping with the changes affecting the banking industry. Unfortunately there has been no research done to assess how custodian banks are responding to the changes in the banking industry. Hence little is known about this product.

Several studies have been done in the banking industry where different scholars have made several analyses on how banks are responding to various changes in the environment. The closest study which relate to custodian banking services was done by (Mwamba, 2003) on challenges facing investment banking in Kenya .He concluded that challenges facing investing banking include technological changes, demographic factors, lack of active trading market and globalization. None of the foregoing studies have undertaken to assess how custodian banks are responding to the changes in the banking industry in Kenya, consequently a knowledge gaps exists

The proposed study therefore seeks to provide answers to the research question on what responses are being undertaken by custodian banks in relation to environmental changes in the banking industry.

1.3 Research Objectives

The study seeks to determine the responses of custodian banks to environmental changes affecting the banking industry in Kenya.

The specific objectives of the study were as follows: -

i) To determine the changes in the banking environment that have affected custodian banking services and the challenges posed by these changes

ii) To identify the strategic and operational responses being employed by the custodian banks in response to the changes in the banking environment.

1.4 Importance of study

This study will be of importance to the management of custodian banks in helping them understand the environment and therefore develop appropriate responses to the challenges posed by the dynamic nature of the environment. It will also be useful to the stakeholders of the custodian sub sector, potential investors will gain a greater appreciation of the opportunities and challenges facing the custody services sub sector while the public will gain new insights in the industry. The finding of the study will be an important source of recommendations to the policy makers to implement policies that favour growth of custody service industry. The study will also contribute to the wider body of knowledge in strategic management and in the area of custodian banking services.

CHAPTER TWO: LITERATURE REVIEW

2.1 Introduction

This chapter will look at the review of literature on environment of organizations, organizations responses to the environment, strategic and operational responses employed by organizations to changing environmental conditions.

2.2 Environment of organizations

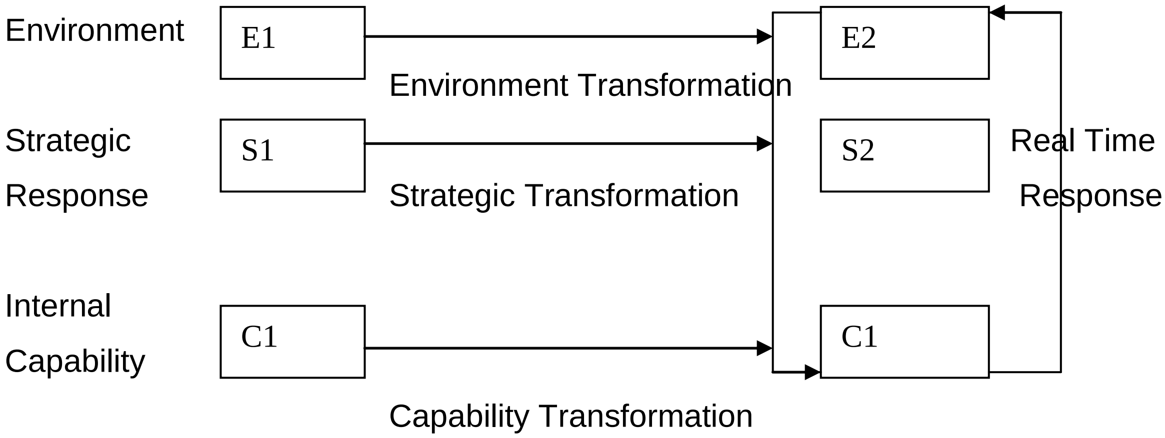
The environment consists of variables that form the context within which firms exist Environmental conditions affect and influence strategies developed by organizations for their survival and success. The environment in which organizations exists is constantly changing and organizations have to respond to these changes. This is because all organizations are environment serving or dependant (Hunger and Wheeler, 1999).

A host of external factors influence organizations choice of direction, action, structure and internal processes. The environment of a firm can be divided into two main subsets: the internal and external environment. The internal environment comprises of factors such as the organization own competitive capabilities and resources both tangible and intangible that affects the organization’s ability to meet its objectives. The internal environment is within the control of the organization while the external is not, making it of great interest to organizations for their survival (Pearce and Robinson, 2000). Hoskisson et al (1997), concludes that the external environment plays a significant role in the growth and profitability of firms.

The external environment can be divided into three interrelated subcategories: the remote, the industry and the operating environment. The remote environment comprises of factors that originate beyond and is usually independent of any single firms operating situation. They are economic, social, political, technological and ecological factors. The environment presents the firms with opportunities and threat but rarely does a single firm exert any meaningfully reciprocal influence. The operating environment comprises of factors in the competitive situation that affect a firm's success in acquiring needed resources or the profitability of marketing of its good and services. These factors include the firm's competitive position, composition of its customers, its reputation among suppliers and creditors and its ability to attract capable employees (Pearce and Robinson, 2000).

Changes in the organization behaviours are necessary if success in the transformation of the future environment is to be assured (Ansoff and Mc Donnell, 1990). They noted that such changes which touch on the organizations strategy and capability will need to be systematically identified through the strategic diagnosis approach. This approach is derived from a strategic success hypothesis, which states that a firm's performance potential is optimum when aggressiveness of the firm's strategic behavior matches the turbulence of its environment and that the responsiveness of the firm capability matches the aggressiveness of its strategy and components of the firm's capability are supportive of one another. When any one of the three aspects is lacking, then the firm's performance potential will be less than optimum. The real time response is the specific action that is chosen and implemented in order to realign the organization's strategic aggressiveness to the environmental turbulent nature.

Figure : Environment of organizations



Key

E1 Current Environment E2 Future Environment

S1 Current Strategy S2 Future Strategy

C1 Current internal capabilities C2 Future internal capability

(Source: Ansoff and Mc Donnel, 1990 pp 40)

The above diagram clearly indicates the environmental dependence of an organization. Where there is environmental shift from E1 to E2, the organization strategy has to be changed from S1 to S2 in order to adapt to the changing environmental conditions. However, it is only possible when organizational capability changes from C1 to C2. Therefore, an organization has to monitor its environment continuously so that it can identify any shifts that require it to adjust its strategies in response to such changes. This requires that the firms capabilities be constantly updated to ensure that they support the chosen strategy.

2.3 Organizations responses to the environment

A response is a move taken to counter the effects of environmental changes, it relates to the action taken by a firm to cope with the shift in the environment. (Hoskisson et al, 1997). Responses are actions and decisions which result in the formation and implementation of plans designed to achieve organizations objectives. Responses are part of the competitive strategies that an organization develops in defining their goals and policies. A change in competitive position requires organizations to decide what strategies to adopt.

There are two types of responses to environmental changes: strategic and operational (Barton and Martin, 1998). Strategic responses represent a significant commitment to specific and distinctive organization resources. They are difficult to implement and to reverse, for example, the introduction of an innovative product into the market. Strategic responses require the organization to change their strategy to match the environment and also to transform or redesign their internal capabilities to match its strategy. Strategic responses are focused on the effectiveness while on the other hand operational responses are taken to fine tune a strategy. They are short term in nature, they involve fewer and more generalization of the organization resources and are relatively easy to implement and reverse. These responses have more immediate impact, for example price reduction could increase demand in the short run. Operation responses involve changes in standard operating procedures and are founded on efficiency.

Organizations should respond in some way as early as possible by developing early warning systems to help them make timely responses. The nature of response is critical in ensuring the impact of threats does not adversely affect an organization or make it miss an opportunity (Porter, 1985). Managers have three options while responding to environmental influences. These are, adapting to environmental influences or elements, attempting to influence the environment favourably or shifting the domain of operations away from the threatening environmental elements and towards more beneficial ones (Barton and Martin, 1998).

The adaptation approach involves changing internal operation activities to make organizations more competitive to its environment. It is essentially to accept the existing environment as given and seek to develop more rational process for adjusting to it. The firm could do this through buffering, smoothing, forecasting and rationing. Influencing the environment favourably involves attempting to alter environmental elements in order to make them more compatible to the needs of the organization. The organization could do this by advertising and public relations. It can also take to contracts, political activities and trade associations. The firm could change the mix of products and services so that it interfaces them with favourable environment influences in an attempt to shift the domain .It could do this through diversification or by moving out of the current product and services.

The period we are living in is one with profound transition ever and changes are more radical than those experienced during the second revolution and depression. There are five social and potential certainties that will shape businesses; the collapsing birth rate, shift in the distribution of income, global competitiveness owing to incongruence between political and economic realties, discrepancies between the pace of changes in the industry environment and the pace of change in the internal environment is the daunting tasks of organization transformation. The organization transformation agenda typical includes downsizing, overhead reduction, employee empowerment, and process redesign and portfolio rationalization (Drucker, 2001). As important as these initiatives are, their accomplishments cannot restore a company to industry leadership, nor can they ensure that it intercepts with the future (Hammer, 1996)

2.3.1 Strategic responses

Strategic response is the matching of activities of an organization to the environment in which the organization operates. Strategic responses affect long term direction of an organization and requires large resources aimed at achieving advantage for the organization (Johnson and Scholes, 1999). According to Pearce and Robinson (1991), a strategic response is a set of decisions and actions that result in the formulation and implementation of plans desired to achieve an organization objectives. Porter (1998) points out that knowledge of the underlying sources of competitive pressure provides groundwork for strategic agenda in action. The following action, which constitutes strategic responses should be considered to better understand how firms behave when their environment changes: -

2.3.1.1 Diversification

This is the process of adding new business to the company that is distinct from its established operations. According to Hill and Jones (2004), in Gluek and Juach, (1990), define diversification as changes in products, markets or functions that can be done internally or externally, horizontally or vertically and can involve related and un-related changes. Diversification occurs when a company decides to make new products for new markets. A firm can pursue either related or un-related diversification depending on the scope of activities. Related diversification is the development beyond the company present market, but still within the broad confines of the industry**.** It therefore builds on assets or activities that the firm has developed (Johnson and Scholes, 1999). It takes the form of vertical or horizontal integration. When a business grows by becoming its own supplier the process is known as backward integration and when organization growth encompasses a role previously fulfilled by a customer then the process is known as forward integration (Barton and Martin, 1998). Horizontal integration is competitive with or complimentary to a company’s present products.

Unrelated diversification is the development beyond the present industry into products or markets in which the face value may bear no close relations to the present product or market. Barton and Martin (1980), contends that unrelated diversification entails diversification affecting growth through development of new areas that are clearly distinct from the current business. This helps them reduces the risk associated with single products or operations. Companies pursuing this strategy lack the ability to transfer leverages competencies and to realize economies of scope (Hill and Jones, 2004).

2.3.1.2 Restructuring

This is based on the notion that some activities in a business value chain are more critical to the success of its strategy than others (Pearce and Robinson, 1998). Managers need to make the strategically critical activities the central building blocks for designing the organization structure. Restructuring includes both the process and structural re-organization such as Business Process Re-engineering (BPR), Total Quality Management (TQM), downsizing and outsourcing.
Re-engineering is the fundamental re-thinking and radical redesigning of the business processes to achieve dramatic improvement in critical contemporary measures of performances such as costs, quality, service and speed (Hammer and Champy, 1993). Total Quality Management stresses that all company's operations should be oriented towards improving reliability of the company’s product offering (Dean and Bowen, 1994) in services offered. Instead of focusing on how a company function operates, strategic managers make business processes the focus of attention.

Re-engineering and TQM are highly interrelated and complimentary in nature. After re- engineering has taken place and the value chain activities have been altered to speed the product to the consumer, TQM takes over with its focus on how to continue, how to improve the new process and find better ways of managing tasks and roles (Hill and Jones, 2004) Firms consider outsourcing when they want to concentrate on their core business. Downsizing is about reducing the number of employees. Downsizing made firms to lower overheads, speed up response time and eliminate red tap (King (1997) in Mugambi, (2003).

2.3.1.3 Collaborative Strategies

Firms may enter into collaborative arrangement with other players in the industry, either local or foreign, such collaboration take the form of strategic alliances, mergers, acquisition, licencing and franchising. According to Schollei (1999), in order to fortify a firm position against predators from abroad, it is important to collaborate. Increased forces towards collaboration with other firms in foreign countries offers market opportunities since some opportunities are too massive for a single firm to exploit. Collaboration also reduces the differentiation and enhances competitive advantage (Monson and Lee, (1990) in Shollei, 1999).

2.3.1.4 Generic Strategies

Porter, (1998) reformulated the three generic strategies. This strategy must be taken into account when firms have to change their strategies. The strategic response reflects the firm’s competitive position in the industry. To overcome the competitive forces and succeed in the long term, management can select from several competitive strategies: Cost Leadership can be achieved by a firm adopting functional policies and resort to aggressive construction of efficient facilities. It can also be done through rehabilitation of the plants and machinery if necessary to achieve efficiency and cost reduction. Cost cutting strategies minimize wastage and necessary expenditures (Willington, 1989) in Mugambi 2003). Differentiation can be achieved by creating the perception of uniqueness about products or services (Barman, (2002) in Mugambi (2003). In a study conducted by Barman, (2002), she identified differentiation as a strategy used by non-profit organization when they were faced with a crowded market. Differentiation can also be created through aggressive marketing campaigns. Rivalry between firms drives them to avoid following what others have done and to state out their own option (Barman, (200) in Mugambi 2003).

A focus strategy is about identification of a particular customer segment geographical and coming up with products suitable for that segment. Willington, (1989) in Mugambi 2003, observed that this could involve focusing specific market segment that provides a profitable share of higher margins. Firms should narrow their operation to target specific markets so as to develop a competitive edge. The generic strategies are mutually exclusive as firms can combine strategies. Each of the competitive forces have a likelyhood of affecting the selection of strategy. First, high level buyer power will limit the firm's ability to achieve high prices as more powerful buyers are able to demand concession from their suppliers (Scherer and Ross, (1990) in Soil et al, 2002). The firm must seek to reduce costs in order to earn above average profits if buyer power is high. Secondly, a high threat of substitution implies that an alternative product type offers a price or performance benefits and limit industry profitability. The firm can earn satisfactory profits while undercutting any potential competition price by pursuing a cost leadership strategy. Thus by reducing the alternative product type, the firms is protecting itself from attack in the long term (Scherer and Ross, (1990); in Song et al, 2002)

The threat by new firms is highest during the high growth phase of the products life .As demand increases, new markets segments emerge and new entrants stake a claim in emerging markets. At this point, the competitive forces shifts from primary to selective demand and firms make a differentiation on their products on attributes deemed important by certain consumer segment (Utter beck and Abernathy, (1975);Manfiled, (1993) in Song el tel, 2002) argues that competitive intensity is likely to be highest during maturity stages of the product lifecycles, as competition selective demand intensified and increasing products innovation are made, firms seek to differentiate their offering of focus on protected profitable niches in order to achieve this, competitive strategy a firm needs to focus on unique activities (Porter ,1996)

The interest in strategic management has inspired various studies in the field of strategic responses used by organizations to face challenges posed by the environment. In a study of strategic responses undertaken by (Njau 2000), he concluded that, a change in the competitive position requires organizations top management decision on which strategies to adopt. (Kombo, 1997) noted that firms in the motor vehicle industry made adjustments by introducing new technologies in product development, differentiations, segmentation and targeting their customers with improved customer services.

Another study was carried out on Reinsurance Company in Kenya. According to Mwarania (2003), on responses by Reinsurance Company in Kenya (Kenya Reinsurance) included marketing local and international, staff training programs, retrenchment, investment in technology and spread of financial investments between short and long term strategies. (Kiptugen, 2003) concluded that Kenya Commercial Bank has addressed its changing competitive situation through, restructuring, marketing, information technology and cultural changes among other responses.

2.3.2 Operational responses

2.3.2.1 Marketing Strategies

Kotler (1998) contends that marketing plays a crucial role in the company's strategy planning. He stated that marketing is a significant contributor to the strategic planning process. Marketing is seen to be a more durable alternative to increased volume instead of continuously cutting profit margins (Morine (1980), in Mugambi, 2003). Marketing policies need to be redefined in line with customers shifts for more value adding products or services (Slatter, 1992) in Mugambi 2003). A firm needs to be constantly in touch with its existing customer base, quickly introduce adjustments to its portfolio as necessary and refocus customer's needs. Attention should be given to enable after sale service and authentic features of the product to be provided (Morine, (1980) in Mugambi 2003). Marketing responses can be in any of the 4 P's of marketing that is product, price, promotion and place (distribution).

2.3.2.2 Product Strategy

Kotler and Keller (2005), define a product as anything that can be offered to a market to satisfy a need or a want. It is a bundle of different attributes. From the firm's point of view, the product element of the market mix is what is being sold whether it is a service or product. From the customer's point of view, a product is a solution to a problem or a package of benefits. This offering may include a physical good, a service or a blend of both (McCarthy and Perreault, (1993) in Mwangi, 2002). Product strategy could involve issues such as design (Size and Shape) features, quality and reliability.

A new product development strategy may be either reactive or proactive, According to Boy and Walker, (1990) in Mwangi, (2002) reactive strategies include a defensive strategy; where existing products are adjusted in such a way that they may effectively compete against recently introduced competitive goods and services or an initiative strategy; involve quickly copying the attribute of a competitor's new product. Proactive strategy is one where the firms goes ahead of competition and introduces a new product through innovation.

2.3.2.3 Price Strategy

It is the only element of the marketing mix that generates revenues. The price set depends on the customer assessment of the unique product features (Perceived quality), competitors, substitutes prices and actual costs (Kotler, 1999). Kibera (1998) observes that from a marketing point of view, price is value placed on a good or service by a customer at the same point in time. Pricing strategies are complex and difficult. Pricing must be consistent with the firms overall strategy, target markets and brand positioning. (Kotler and Keller, 2005) pricing strategies include costs plus pricing, demand plus pricing, competition oriented pricing, penetration pricing, skimming, odd pricing, geographical pricing and suggested retain pricing strategies.

2.3.2.4 Place Strategy

This strategy deals with how the product is distributed and how it reaches its customers. Successful value creation needs successful value delivery. Marketers are increasingly taking a value network view of the business. Instead of limiting the focus to their immediate suppliers, distributors and customers, they are examining the whole supply chain that links its raw materials, components and manufactured goods and show how they move toward the final consumers. Companies are looking at their suppliers; supplier's upstream and their distributor's customers downstream (Kotler and Keller, 2005)

Place strategy helps in selection of suitable branch location and other channels through which to distribute the product and service to customers. It overcomes the time, place and possession gaps that separate goods and services from those who need or want them (Kotler 1998). The channels to be used and the speed of delivery are important consideration at this point. A firm can distribute the product at this point. A firm could either use pull or push strategy. A push strategy involves the use of sales force and trade promotion money by a manufacturer to induce intermediaries to carry, promote and sell products to end users. It is appropriate where there is low brand loyalty, the product is an impulse item and products benefits are well known. A pull strategy involves the manufacturer using advertising and promotion to persuade customers to ask intermediaries for the product thus introducing intermediaries to order it. It is appropriate where there is a huge brand loyalty and high involvement product category or when people perceive differences between brands or when people choose the brands before they go to the store (Kotler and Keller, 2005).

2.3.2.5 Promotion Strategy

This is the element of the marketing mix that the organization has the most control ever. Modern marketing calls for more than developing a good product, pricing it attractively and marking it accessible (Kotler and Keller, 2005). Promotion includes all the marketing communication effort to let the public know of the product or service. Kotler (1998) summarizes the promotion decisions areas as sales promotions, advertising, sales force, and public relations and direct marketing. The aims of promotion are, arousing attention, generating interest, inspiring desire and initiating action. Marketing communications allow companies to link the brands, experiences, feelings and things. It can contribute to brand equity by establishing the brand in memory and crafting brand image (Kotler and Keller, 2005).

2.3.2.6 Operation and Technology Strategy

According to Pearce and Robinson (2005), the production and operation management is the core function of any organization. The operation strategy is the game plan for the production of goods and services for the organization. Its aim is to achieve efficiency and effectiveness in manufacturing and service operations. Production and operations management decisions usually determine if operations will be demand oriented or inventory oriented or outsourcing oriented to take a balance of the two.

Operations strategies include decisions on such issues as what new products must be developed and when they must be introduced into production, what new production facilities are needed, what new production technologies and processes must be developed and when they are needed and what production schemes will be followed to produce products or service. The elements of the operations strategy include; positioning the production systems; focus of production; product/service plans; production process and technology plans; allocation of resources to strategic alternatives and facility plans i.e. capacity, location and layout (Gaither, 1996)

A technology strategy is one of the central functions for achieving competitive advantage because of the fast paced transformations being witnessed today. Technology intelligence is a must in order to gather information on the dynamism of the technological markets (Hax and Majluf, 1996). The interplay between computers and rapid technology development has made flexible manufacturing systems a major consideration in operations.

2.3.2.7 Financial Strategy

Finance is the most centralized functional in an organization. The final accountability unavoidably resides with the Chief Executive Officer. Financial strategy involves decisions such as obtaining and allocating funds, management of working capital, capital budgeting and financial intelligence. Its strategic decisions are in the sphere of corporate decisions making and its performance measures are closely watched by external audiences and embody the economic results of the firm as a whole (Has and Majluf, 1996). The financial strategies direct the use of financial resources in support of business strategy, long-term goals and annual goals and objectives (Pearce and Robinson, 2005)

2.3.2.8 Human Resource Strategy

The human resource function is the most decentralized and pervasive of the managerial functions. The strategic decision cannot be realized without the full participation and responsibility of managers and supervisors, at all hierarchical levels. The human resources management tactics aid long term success in the development of managerial talent and competent employees; the creation of systems to manage compensation or regulatory concerns, and guiding effective utilization of human resources to achievement of both the firm's short term objectives and employees satisfaction and development.

The human resources management "paradigm shift" involves looking at the people expense as an investment in human resources capital. It involves looking at the business value chain and the value of human resources components along various links in that chain (Pearce and Robinson, 2005). The major categories of decisions linked to their strategy are recruitment, selection, promotion, placement, rewards, manager and employee development, appraisal and labour relations (Hax and Majluf, 1996)

2.3.2.9 Procurement strategies

Procurement strategies help in the supply of all the raw materials, supplies and services needed for the smooth operations of the firms business at minimum cost and achieve huge level of service quality. This requires the creation of a special base of suppliers, developing relationship with suppliers, participating in the design of the products and contributing to the resolution of the make versus buy decisions (Hax and Malof, 1996). Sourcing strategies provide guidelines about questions such as; Are the cost advantage of using a few suppliers outweigh by the risk of over dependence? What criteria should be used in selecting vendors? How will volumes and delivery requirements of purchases support operations? (Pearce and Robinson, 2005). The procurement strategy chosen will depend on the answers given to these questions.

CHAPTER THREE: RESEARCH METHODOLOGY

3.1 Research design

A census survey was used in the study, this was found suitable because the population is small consisting of 8 commercial banks offering custodian banking services in Kenya as at 30th June 2007 .

3.2 Population of study

The population of the study was limited to those banks offering custodian banking services in Kenya which are licenced by the Central Bank of Kenya, registered by the Retirement Benefits Authority and registered by the Capital Markets Authority as at 30th June 2007 (Appendix I). There were total of 8 banks offering custodian banking services.

3.3 Data collection

Primary data was collected using structured and semi structured questionnaires containing both open ended and ended questions (Appendix 2). The questionnaire was divided into three parts; part one dealt with the bio data of the organizations; part two addressed the changes and challenges that affected the organizations and part three dealt with responses to the environmental changes and challenges.

The questionnaires was sent through the chief executive officers of the custodian's banks and were answered by the senior managers in charge of the custody services business units who are fully conversant with the strategic issues of the study areas. The questionnaires were dropped and picked later with follow up being done via personal visits, telephone calls and emails which facilitated the response rates. There was one respondent from each of the bank offering custodian banking services.

3.4 Data analysis

The data collected was screened for completeness and accuracy. The consistency in responses to the various questions was examined. The completed responses were coded and translated into specific categories in line with the objectives of the study and guided by the research questions formulated. Data collected was analyzed using descriptive methods, which included the use of frequency distributions and mean score to determine the most important environmental changes that affected custodian banking services and also to determine the most important strategies that was used by the custodian banks. Mean score was calculated to indicate what judgment has been adopted in the strategic variables in response to environmental changes. Content analysis was done to analyze qualitative questions while factor analysis was done to analyze critical factors. The data was summarized and presented in tables, charts, percentages, mean score and frequencies from the population which responded.

Previous studies using qualitative approach to firm's responses to environmental challenges have mainly relied on content analysis Bett (1995); Migunde (2003) and Njau, (2000).

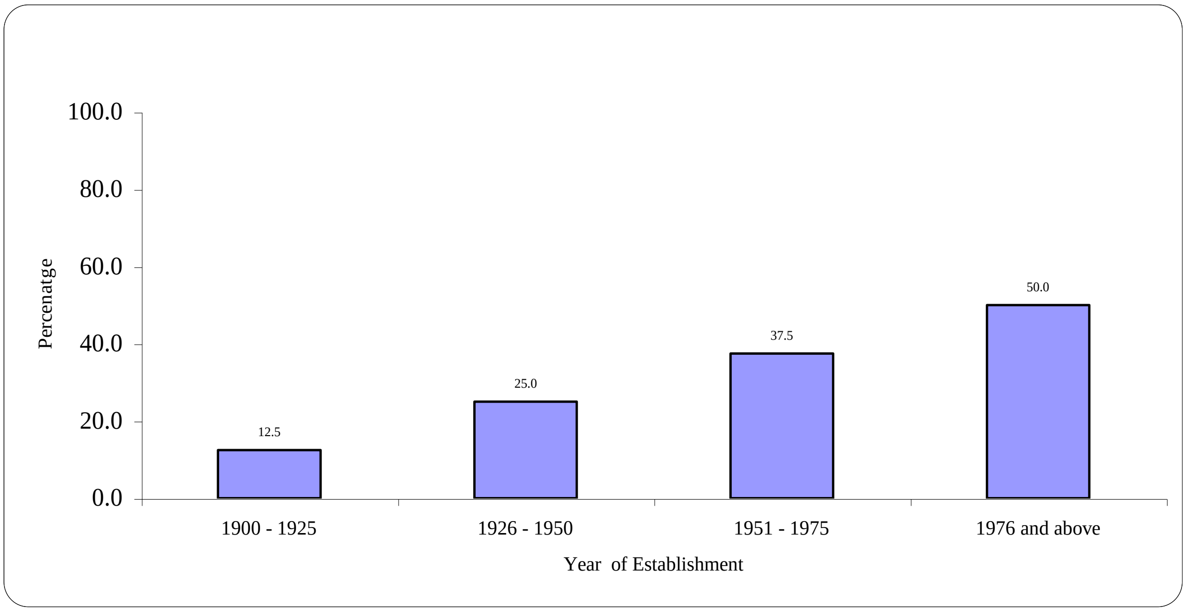
CHAPTER FOUR: DATA ANALYSIS AND PRESENTATION

4.1 Introduction

This chapter presents the results of the data analysis. In this section, the data from the completed questionnaires was summarized and tabulated in the form of percentages, frequencies and mean scores. Standard deviations were computed for selected data to enhance comparison and interpretation. Out of the 8 Custodian Banks registered with the Retirement Benefits Authority and Capital Markets Authority as at 30th June 2007, eight (8) institutions responded which constituted the entire population. The response rate of 100 % is considered sufficient to yield meaningful statistical analysis. Further the response rate of 100% of the respondents indicated that they were eager for their views to be known on the responses of custodian banks to environmental changes affecting the banking industry in Kenya.

4.2 General information about the company

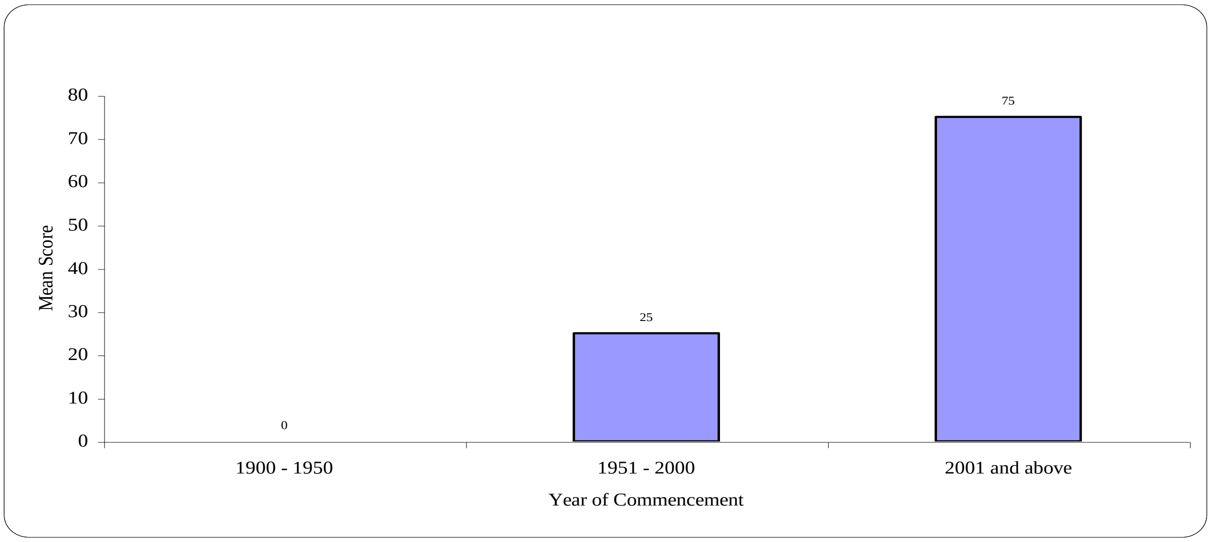
Figure 4.2.1 Period of establishment



From Figure 4.2.1 above it can be seen that 12.5 % of the banks offering custodian banking services in Kenya were established between the period 1900 to 1925,25 %

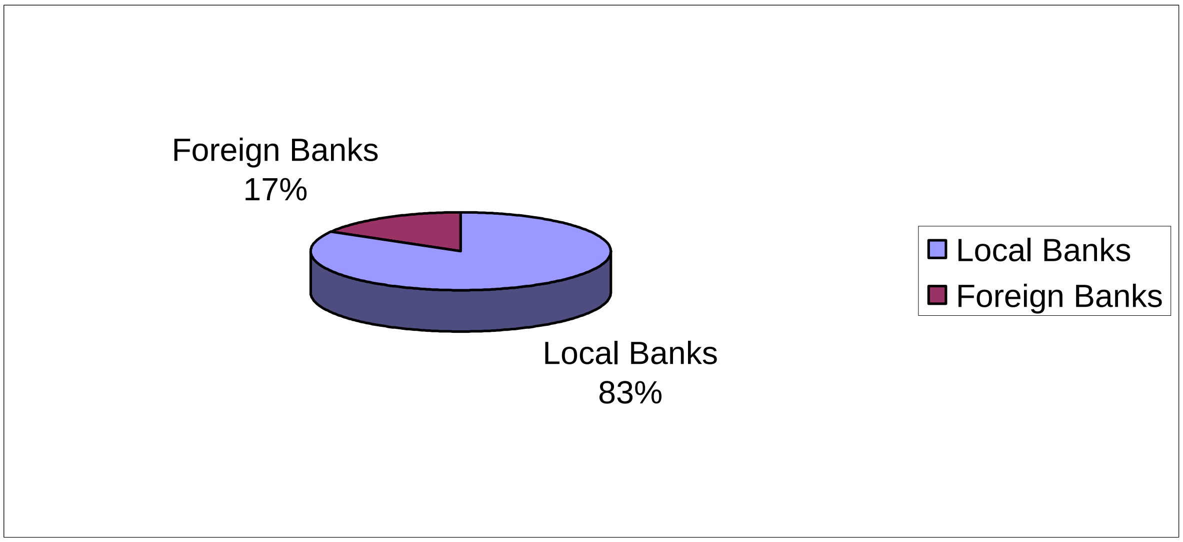
between the period 1926 to 1950,37.5 % between the period 1951 to 1975 and the majority 50 % above the year 1976.

Figure 4.2.2 Period commenced provision of custodian banking services



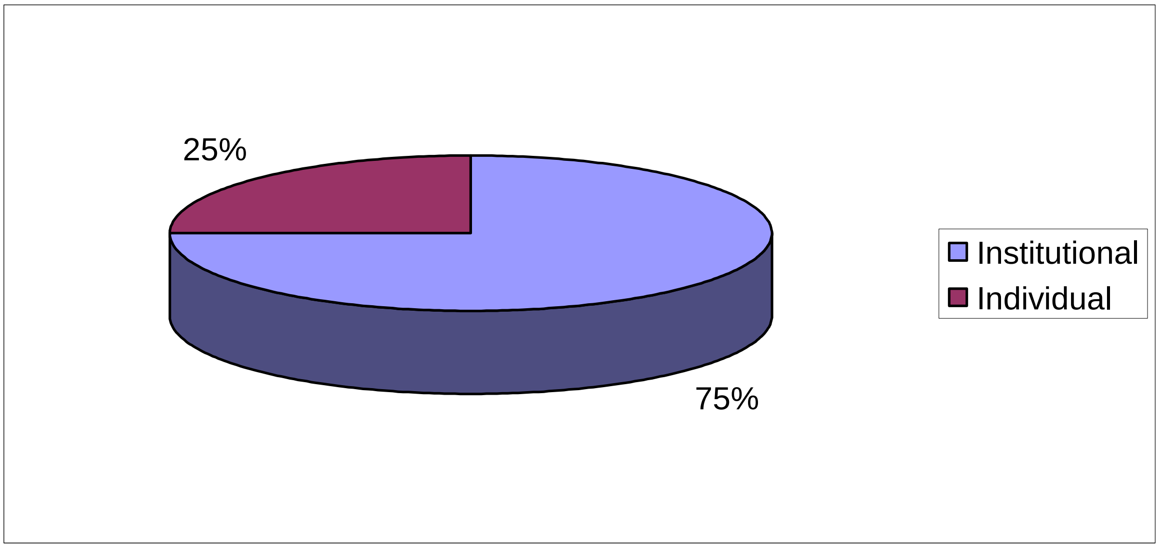
From Figure 4.2.2 above it can be seen that 25 % of the banks commenced the provision of custodian banking services between the periods 1951 to 2000 while 75 % of banks commenced the provision of custodian banking services from the year 2001.

Figure 4.2.3 Ownership composition of the company



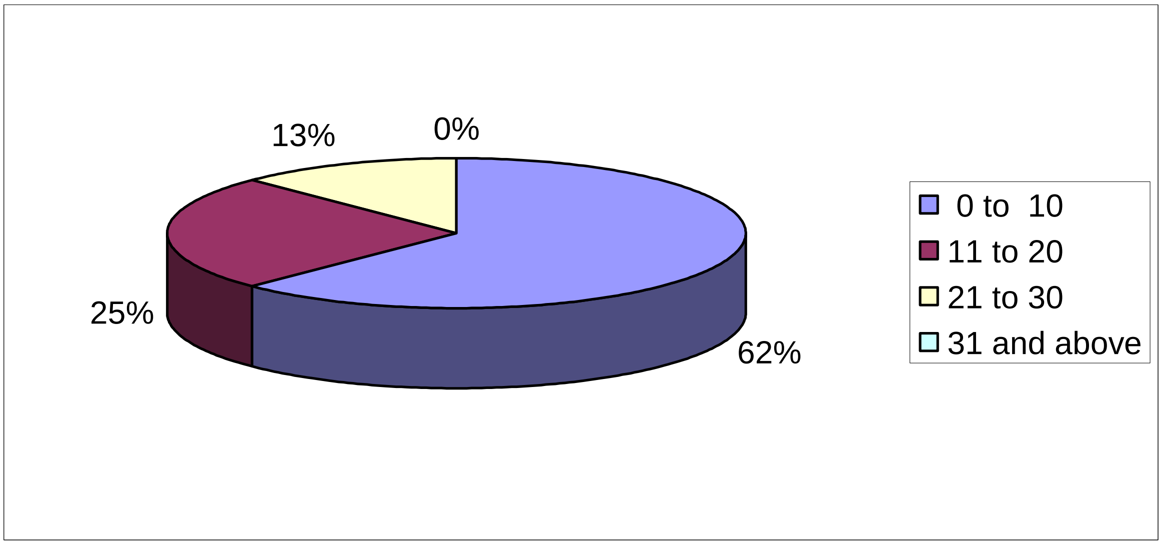
From Figure 4.2.3 above it can be seen that of the 8 banks offering custodian banking services in Kenya 83 % were locally owned while 17 % were foreign owned.

Figure 4.2.4 Principle shareholders



In Figure 4.2.4 above shows that 75 % of the shareholding of the custodian banks is owned by   institutions while 25 of the shareholding is owned by individuals.

Figure 4.2.5 Custody Business Unit Structure



In Figure 4.2.5 above shows that 13 % of the custodian banks employed staff ranging between 0 to 10, 25% of the custodian banks employed staff ranging between 11 to 20 while majority of the custodian banks 62 % employed staff ranging between 21 to 30

4.3 Changes and Challenges posed to the custodian banking services

Table 4.3 .1 Changes in the banking industry that affected custodian banking services

Changes	N	Positively		Negatively	
		Frequency	%	Frequency	%
Economic Changes					
Economic growth	8	8	100	0	0
Liberalization and privatization	8	6	75	2	25
Political Changes					
Legislative & Regulations Changes					
Enactment of the RBA and CMA Collective Investment Scheme Regulations	8	8	100	0	0
High costs of service and regulatory fee	8	2	25	6	75
Duplication in complying to many regulatory bodies	8	0	25	6	75
Social & Demographic Changes					
Information Technology Changes					
Growth of the internet banking and custody systems	8	6	75	2	25
High costs of IT systems and dynamism	8	2	25	6	75

From Table 4.3.1 above shows that respondents identified three major macro-environmental changes in the banking industry that affected custodian banking services in Kenya. They are economic, legislative and regulatory and technological advancement. Under economic changes, 100 % and 75 % of the respondents affirmed that economic growth, liberalization and privatization changes positively contributed to the provision of custodian banking services.

Under Legislative & Regulations Changes, 100 % of the respondents said that the enactment of the Retirement Benefits Act, Capital Markets Act and the introduction of the Collective Investment Scheme Regulations positively affected custodian banking services while 75 % of the respondents said payment of fees to many service providers, regulatory bodies and the compliance obligations to this regulatory bodies negatively affected custodian banking services.

Under Information Technology Changes, 75 % of the respondents said the growth of the internet banking positively affected custodian banking services while 75 % of the respondent said high costs of information technology systems and dynamism nature of the systems negatively affected custodian banking services

Figure 4.3.2 Changes and Challenges posed to custodian banking services

Challenges	**N**	**Mean**	**Std.Dev**
Economic challenges			
Service demand	8	4.750	0.46
Customer expectation	8	4.625	0.51
Inflation	8	2.625	0.51
Unemployment	8	3.750	0.87
Disposable income	8	4.500	0.92
Average		4.050	
Political challenges			
Instability	8	1.375	0.51
Taxation Policy	8	2.125	0.83
Pending bills in parliament	8	1.125	0.35
Political influence	8	1.375	0.51
Constitution	8	1.125	0.35
Average		1.425	

Legislative & Regulations Challenges			
Banking Act	8	3.500	0.53
Retirement Benefits Act	8	4.875	0.35
Capital Markets Act	8	4.875	0.34
Finance Bill 2005/6	8	2.625	1.15
Labour laws	8	1.750	0.46
Average		3.525	
Social & Demographic Challenges			
Population growth rate	8	1.125	0.35
Income distribution	8	1.375	0.51
Saving Culture	8	2.625	0.82
Levels of education	8	1.500	0.76
Lifestyle changes	8	1.375	0.51
Average		1.600	
Information Technology Challenges			
It development pace	8	4.625	0.52
Costs of custody systems	8	4.875	0.35
Availability of custody systems	8	3.125	0.97
Straight through processing of transactions	8	4.125	0.81
Available of real time custody systems	8	5.000	0.83
Average		4.350	
Other Challenges			
Availability of specialized custody staff	8	2.500	0.76

From table 4.3.2 above shows the various challenges represented by economic, Legislative & Regulations and Information Technology were the prominent challenges with high means averaging 4.00. Availability of specialized custody Staff had mean approximating 3.00. Political, Social and Demographic challenges had mean approximating 1.00.Unemployment, disposable income, availability of custody systems, straight through processing and availability of real time custody systems all had standard deviations approximating 1.00 indicating high variability nature of the responses.

4.4 Strategic and Operational Responses

4.4.1 Strategic responses

Table 4.4.1.1 Any new business acquisition distinct from custody services business for the last 10 years

	Frequency	Percentage (%)
Yes	0	0
No	8	100
Total	8	100

From Table 4.4.1.1 above shows that 100 % of the respondents said they did not acquire new business distinct from custody services. It can be interpreted therefore that custody services is a very specialized area operating as stand alone with few synergies from the other products offered by the banks.

Table 4.4.1.2 Corporate Restructuring

	Frequency	Percentage (%)
Yes	0	0
No	8	100
Total	8	100

From Table 4.4.1.2 above shows that 100 % of the respondents said they did undertake corporate restructuring of the custody services business unit.

Table 4.4.1.3 Extent to which objective of the restructuring were met

	Frequency	Percentage
Very Small Extent	0	0
Small Extent	1	12.5
Medium Extent	2	25
Large Extent	4	50
Very Large Extent	1	12.5
Total	8	100

From Table 4.4.1.3 above shows that 12.5 % of the respondents said to a small extent, 25 % of the respondents said to a medium extent, majority of the of the respondents 50 % said to a large extent while 12.5 % of the respondents said to a very large extent. It can be interpreted therefore that corporate restructuring achieved the desired objectives

Table 4.4.1.4 Other strategies undertaken custodian banks for the last 10 years

	YES		NO	
	Freq	**%**	**Freq**	**%**
Business Process Reengineering	8	100	0	0
Reduced Staff (Downsized)	6	75	2	25
Dropped products (Investment Management and Scheme Administration)	6	75	2	25
Entered Strategic Alliance	0	0	8	100
Entered into a Merger	0	0	8	100
Entered into Licensing and franchising	0	0	8	100

From Table 4.4.1.4 above shows that 100 % of the respondents said they undertook Business Process Re-engineering, 75 % of the respondents said they downsized while 75% of the respondents said they dropped some products and none undertook strategic alliances, mergers or licensing and franchising. It can be interpreted therefore that organizational restructuring should be done strategically to benefit the organization.

Table 4.4.1.5 Strategy that best describe the institution that provide custodian banking services

	Frequency	**Percentage**
Cost leadership	**0**	**0**
Market uniqueness about products and services	**0**	**0**
Focus on a market segment of retirement benefits	**2**	**25**

schemes and collective investment schemes		
Focus on both the retails and corporate segments	**6**	**75**
Total	**8**	**100**

From Table 4.4.1.5 above shows that 75% of the respondents said their strategy is to focus on retail and corporate market segments while 25 % of the respondents said their strategy is to focus on retirement benefits schemes and collective investment schemes. It can be interpreted therefore that there is market for custodian banking services for both the retail and institutional customers.

4.4.2 Operational responses

Table 4.4.2.1: Whether custodian banks have introduced new custody related products within the last three years

	Frequency	%
YES	**6**	**75**
NO	**2**	**25**
TOTAL	**8**	**100**

From Table 4.4.2.1 above shows that 75% of the respondents said yes while 25 % said they have not introduced new custody related products

Table 4.4.2.2 Pricing scenario for custodian banking services

	Frequency	Percentage
Monopoly	**1**	**12.5**
Oligopoly	**1**	**12.5**
Perfect Competition	**6**	**75**
Total	**8**	**100**

From Table 4.4.2.2 above shows that 12.5 % of the respondents said that there is monopoly, while another 12.5 % of the respondents said there is oligopoly and majority of the respondents 75% said there is perfect competition. This can be interpreted that there is price undercutting among the service providers which impacts on their revenue.

Table 4.4.2.3 Is pricing a critical factor in the acquisition of custody services business

	Frequency	Percentage
Yes	6	75
No	2	25
Total	8	100

From Table 4.4.2.3 above shows that 75 % of the respondents said yes while 25 % of the respondents said no. It can be interpreted that consumers of custodian banking services are very sensitive to pricing.

Table 4.4.2.4 Whether institution offers custodian banking services outside Kenya or have sub custodian arrangements

	YES		NO	
	Freq.	%	Freq.	%
Offers custodian banking services outside Kenya	2	25	6	75
Have sub custodian arrangement outside Kenya	1	12	7	88

From Table 4.4.2.4 shows that 25 % of the respondents said they offer custodian banking services outside Kenya while the majority of the respondents 75 % said no. On sub custodian arrangements, 12 % of the respondents said they have sub custodian arrangements while 88 %of the respondents said no. It can be interpreted that the institutions have to market themselves and go beyond their geographical locations.

Table 4.4.2.5 Whether custodian banks conducts promotional activities

	Frequency	%
YES	2	25
NO	6	27
TOTAL	8	100

From Table 4.4.2.5 above shows that 25 % of the respondents said no while 75 % of the respondents said yes. It can be interpreted that acquisition is through tendering by the customers and single sourcing, hence promotional activities do not have the desired effect on business generation.

Table 4.4.2.6 Operation and technology strategy

	Frequency	Percentage
Manual	**1**	**12.5**
Semi Automated	**5**	**62.5**
Automated	**2**	**12.5**
Total	**8**	**100**

From Table 4.4.2.6 above shows that 12.5 % of the respondents said that their operations are manual, majority of the respondents 62.5 % said that their operations are semi -automated while 12.5 % said that there operations are fully automated. This explains why they have dedicated staff at custody services business unit to process to process the high transactions volumes.

Table 4.4.2.7 If manual or semi automated, whether considering computerization

	Frequency	Percentage
Yes	**8**	**100**
No	**0**	**0**
Total	**8**	**100**

From Table 4.4.2.7 above shows that 100 % of the respondents said they are considering fully automated their processes. It can be interpreted that due to the high volume nature of the custodian transactions, institutions desires to achieve straight through processing once the right information technology platform is available in the market.

Table 4.4.2.8 Is information technology a critical factor in the delivery of custody services

	Frequency	Percentage
Yes	6	75
No	2	25
Total	8	100

From Table 4.4.2.8 above shows that 75 % of the respondents said yes while 25 % of the respondents said no.

Table 4.4.2.9 Profitability of custody services industry in Kenya

	Frequency	Percentage
Attractive	6	75
Not Attractive	2	25
Total	8	100

From Table 4.4.2.9 above shows that majority of the respondents 75 % said yes while 25 % of the respondents said no.

Table 4.4.2.10 Assessment of business growth for custodian banking services in Kenya

	Very Low		Low		Moderate		High		Very High	
	Freq	**%**	**Freq**	**%**	**Freq**	**%**	**Freq**	**%**	**Freq**	**%**
No of customers for the last 5 years	1	12.5	1	12.5	1	12.5	1	12.5	4	50
Increase in profits	1	12.5	1	12.5	4	12.5	1	50	0	0
Increase in portfolio value	1	12.5	25	1	12.5	37.5	1	12.5	1	12.5

From Table 4.4.2.10 above shows that 50 % of the respondents said customer's growth is very high while 50 % of the respondents said profitability is high while 37.5 % of the respondents said portfolio growth is moderate. It can be interpreted therefore that custodian banking services is general profitable and has potential for further growth.

Table 4.4.2.11 Whether institutions have a compliance office

	Frequency	%
YES	**2**	**25**
NO	**6**	**75**
TOTAL	**8**	**100**

From Table 4.4.2.11 above shows that 75% of the respondents said no while 25% of the respondents said yes. It can be interpreted therefore that institutions have to ensure that they have a compliance office to monitor compliances.

Table 4.4.2.12 Whether regulations are a major catalyst for the development of the custody service industry

	Frequency	%
YES	**7**	**88**
NO	**1**	**12**
TOTAL	**8**	**100**

Table 4.4.2.12 above shows that majority of the respondents 88% said yes, while 12% of the respondents said no. It can be interpreted therefore that regulations is a major catalyst for the growth of custodian banking services .

CHAPTER FIVE: SUMMARY, DISCUSSIONS AND CONCLUSIONS

5.1 Introductions

This chapter discusses the findings of the research and draws conclusions from the major findings. The study was a census survey of custodian banks licenced by the Central Bank of Kenya, registered by the Retirement Benefits Authority and Capital Market Authority. The main objective of the research was to assess responses of custodian banks to environmental changes affecting the banking industry in Kenya. Primary data was collected using a questionnaire that was distributed using the "drop and pick later" method to the respective respondents.

5.2 Summary, Discussions and Conclusions

The first objective of this study was to analyze the changes in the banking environment that have affected custodian banking services and the challenges posed by these changes. The results found out that that there are three major macro-environmental changes that affected custodian banking services in Kenya. These are economic, legislative and regulatory and technological advancement changes.

The economic growth has resulted in more business opportunities for the custodian banking service providers. Organizations growth has been on the upward trend, this has created new job opportunities and increased pension contributions. Because the assets of pension are managed and invested by the custodian banks, the increase in assets means more business to the custodian banks. In addition the economic growth has led to new companies being set up and the organizations sponsors setting up new retirement benefits scheme or joining the existing independent retirement benefits schemes. The economic growth has resulted into the introduction of new investment vehicles such as the collective investment schemes known as unit trusts .The unit trusts are required by law to appoint a custodian to hold the assets of the scheme and also to appoint a Trustee, all this services are provided by the custodian banks. With the liberalization of the economy and the current business growth being experienced, foreigners and offshore customers have been streaming into the country setting up new investments or buying out existing business, the new entrants have created competition in the provision of services and raised the performance bar for the existing local institutions in the provision of custodian banking services as they have to comply with the industry and international best business practices. All this activities happening due to economic growth have created more opportunities for banks offering custodian banking services, competition to the service providers and high benchmarks for the services delivery.

The introduction of the new regulations and regulatory bodies to enforce compliances was the milestone in the provision of custodian banking services in Kenya. The introduction of the Retirement Benefits Act 1997 provided for the formation of a retirement benefits authority body with the principle objective of creating harmony in the retirement benefits sector through the creation of regulations to support sound management and transparency in the management of retirement benefits schemes in Kenya. The regulation provided for the appointment of fund manager with primary responsibility of offering investment advisory and a custodian who must be commercial banks to hold scheme assets .All the service providers to the retirement benefits schemes must be registered with the retirement benefits authority in order to be eligible to offer the services. With this development, banks responded by registering with the retirement benefits authority and setting up full fledged custody services business unit to cater for the provision of custodian banking services to retirements benefits schemes.

Within the capital markets the introduction of the collective investment scheme regulations 2001 provided the regulatory framework for the setting up of unit trusts, employee shares ownership among other capital markets products. The regulations required the promoters of these products to engage a fund manager, a custodian and a trustee as part of the compliance requirements. The services of a custodian and a Trustee are offered by commercial banks that have been registered as authorized depository with the capital markets authority. These regulations provided another avenue for the growth of custodian banking services. Further, with the introduction of the regulations to support the delivery of custodian banking services, foreign investors and other global custodians moved into to establish relationships with the Kenyan custodians banks in order to facilitate offshore investments.

On the other hand the introduction of regulations means more costs to the schemes and investment vehicles, as they will have to pay for the services. Secondly, the custodian has to comply with the Banking Act, Central Bank Act, Capital Market Act, Retirement Benefits Act and Kenya Revenue Authority among others. These are too many bodies causing confusion and duplication, making compliance a nightmare and expensive in terms of the fees paid to these regulatory bodies. The stringent regulatory requirements meant that many banks opted a wait and see attitude resulting in only 8 commercial banks offering custodian banking services from a total of 52 licenced commercial banks as at 30th June, 2007.

On the banking industry as whole there has been changes from manual processing of transactions to computerized processing, introduction of automated teller machines and one branch bank. Institutions have continued to upgrade their systems in order to keep pace with the changing customer's needs and the desire to become efficient. The goal is to have straight through processing of transactions. Due to the high volume nature of transactions involved in the provision of custodian banking services, information technology plays a very big role. Custodian banks process huge volume of transactions, on a daily basis they receive instructions from the customers or their appointed agents for processing. Custodian use two information technology platforms, a core banking software which is used to process the cash transactions and a custody reporting system which is used to give a detailed account of the transactions and a holding report of the assets. Custodian banks use their core banking systems for the cash reporting while for custody reporting use either an in house developed custody reporting system or an off the shelf acquired system. Due to the dynamic nature of the industry, custodian needs to keep abreast with the customer's timeliness for reporting, regulatory reporting and other industry requirements. Information Technology is very costly, with the hardware, software and people requirements it is quite a challenge to manage a robust system. Institution needs to continuously upgrade their system due to the dynamic nature of technology. These costs are passed on to the customers hence increasing the cost of service provision.

It was further found out that as result of the macro environmental changes challenges were encountered in the areas of service demand, customer expectations, increased competition, legislative compliances, income distribution and saving culture.

Service Demand, the major consumers of custodian banking services are the retirement benefits schemes and collective investment schemes. Since the introduction of the retirement benefits regulations and collective investment schemes regulations in 2001, most of the schemes have already now appointed their services providers. Demand from the existing market segment is getting saturated and what is left is for the service providers to poach from each other. To address this challenge custodian has turned to other market segments requiring their services, these are offshore customers and large institutional investors who have funds requiring to be professional managed.

Customer expectations, consumers of custodian banking services are very demanding both in services delivery and security of assets. They insist on getting value for their money and as such they always push custody fees downwards. The custodian has to contend with the high volume nature of transactions, complexity of the transactions, investment in information technology and people. The challenge for the custodian is on how to generate revenues, meet customer's expectation without compromising the quality of services. These challenges are being solved through education and training programs so that they understand the value created by the custodian banks while the costs are being justified through the provision of quality services to the customers

Increased competition, all banks offering custodian banking services offer the same services. Custodian banking services is standard across all the service providers competing in the area of service delivery and relationships. Because of this stiff competition custodian banks have been undercutting each other on pricing and in the process eroding further their revenue base. To solve this challenge custodian have been turning to international and cross-border customers and/or Fund Managers for business. They are also focusing more on service and support and are now offering value-added package, which includes compliance, information on new developments in legislation and in the industry in order to retain their customers.

Legislative compliances, To many regulatory bodies with different requirements, some of the functions of the bodies are overlapping, for example a custodian must obtain licence from the Retirement Benefits Authority and are also required to obtain authorized depository licence from the Capital Market Authority. The duplication of duties in regulations makes it difficult to interpret and comply. The costs paid by the services providers to more that one regulatory body make it expensive to the customers and service providers. To solve these challenges the industry stakeholders have taken up the issues with the government advocating for unitary regulatory body to regulate the financial sector. The has met stiff resistance from each regulatory body claiming each has a role to play and are complementary to the one another.

Income distribution and saving culture, most of the formal and informal employment is located within the urban. At the rural people only engage in small scale activities to just provide for their basic necessity food. With this scenario of evenly distributed income and poverty levels in the country, less or no funds are left for saving. This creates a challenge on the growth of retirement benefits schemes, as people do not have additional funds to save for investment or retirement.

Technology, the promise of a custodian is to provide their customers with information regarding their cash balances in their bank accounts and transaction history on the purchase and sale of their investments. Custody Services handles multiple transactions daily, and it is imperative they have an online real-time information technology system. It is a challenge to provide information on real time basis to the customers considering that the customer needs are very dynamic and so is technology. To solve this problem custodian banks have been upgrading their systems to keep abreast with the new development and constantly train people and customers for optimum results.

From the foregoing discussions the following conclusion may be drawn from the changes and challenges posed to the custodians banking services in Kenya. Macro economics changes in the banking industry in Kenya provided an opportunity for the commercial banks to diverse their product portfolio through the provision of custodian banking services; that the commercial banks which took advantage of these changes grew their business portfolio and revenue streams from reliance on interest income to non interest income. The banks offering custodian banking services embraced the challenges across board resulting in improved customer care, processes and transparency achieved through regulatory compliances.

The second objective of this study was to identify the strategic and operational responses being employed by the custodian banks in response to the environmental changes in the banking environment. The results showed that custodian banks responded to the changes and challenges in the banking industry through the various strategies namely corporate restructuring, business process re engineering, down sizing, outsourcing of non core services, diversification, pricing and embracing of information technology systems. The commercial banks that choose to offer custodian banking services restructured their organization and created fully fledged custody services business units. Senior managers were appointed to head this unit and most of the units were placed under corporate banking division signifying the importance given to the product. The custody unit had fully fledged dedicated staff .The objective of the restructuring was to align the business with the regulations and the customers .Through the restructuring other services considered non core were outsourced, some of these services are fun management and scheme administration which were by the bank. Excess staffs were redeployed and others had their services terminated. The new custody services business units created reviewed their processes in order to make them more efficient and respond to the business needs. To address the issue of low revenue ,custodian banks increased their product range and commenced offering Trustee and Central Depository Agency services. In their pricing of the custodian banking services, the banks reviewed the overall relationship the customers had with the bank before given them concession. New it systems were developed in housing and others were acquired off the shelf to facilitate provision of information. From the literature review there exists a mismatch between the internal characteristics of custodian banks and its external environment which was solved by creating a “fit” between the internal characteristics of the organizations and the external environment (Aosa, 1988).

Previous research findings reveal that the changes and challenges arising out of environmental changes can be identified and addressed through the process of strategic planning. My views are that the changes and challenges from both the internal and external environments can comprehensively be addressed once they are identified through the efficient process of strategic planning.

From the foregoing discussion the following conclusion may be made, that custodian banks have encountered changes and challenges which have provided them with an opportunity to diversify from reliance on interest income to reliance non-interest income and thereby increasing their product range.

5.2 Limitation of the study

The study focused on the major macroeconomics factors changes, strategic and operational responses. It is likely that other changes and strategies impacted on the custodian banking services may have some aspects that were not captured by the current study. Another limitation is the sample of the study because out of the fifty (52) commercial banks only eight (8) banks registered with the Retirement Benefits Authority and Capital Markets Authority were studied. The study could have given a better insight of the custody services business in Kenya if all the commercial banks were offering custodian banking services. Again time of the research was short limiting.

5.3 Opportunities for further research

The key reason for the responses to environmental changes is to ensure organization survival through mitigation of threat to take advantage of the opportunities by aligning the organization and the environment through a strategy; the study recommends further research could be conducted to determine the responses of the fund managers, stockbrokers and investment banks to the environmental changes affecting them, this is so because they operate in the same market and are also consumers of the custodian banking services . The study will bring insights in the area of the study and will be complimentary to all stakeholders in the development of the industry

5.4 Suggestions for policy and practices

Custodian banks plays a very important role in the Kenya's economy, as they are expected to provide custodian banking services to all the registered retirement benefits schemes and collective investment schemes which are approximately valued at Kshs 140 billion. This study has shown that most of the custodian banks embrace best business practices and professionalism in the safe keeping of their customer's assets. It would therefore be beneficial for the country if the Government of and the association of custodians in Kenya would put in place policies that make it mandatory for formal and informal organizations to set up retirements benefits schemes, National Social Security Fund is made to comply with the Retirement Benefits Act and public bodies who hold large pool of public cash balances are compelled o use the services of fund managers and custodians. This will ensure that the principal of separation of roles is observed and there is transparency in all transaction. Again the Government of Kenya should put in place a regulatory body that will enhance the monitoring of the activities and performance of the custodian banks to ensure that interest of other customers falling outside the Retirement Benefits Act and Capital Markets Act are sufficiently catered. The association of custodian on their part should develop a code of conduct for self regulations, share technological resources like common data bases to enable them to quickly respond to rapidly technological changes and develop price guidelines for their services like the colleagues in the legal fraternity.

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APPENDIX 1: INTRODUCTION LETTER TO THE RESPONDENTS

Introduction letter to the respondents

University of Nairobi

School of Business
P.O. Box 30197
Nairobi, Kenya

Telephone: +2542-318262
Telegrams: “Varsity”, Nairobi
Telex: 22095 Varsity

Dear Sir/Madam,

The bearer of this letter Mr. Ambrose Juma Lugho registration number D61/P/8405/2001 telephone 0725974022 is a Master of Business Administration (MBA) student at the University of Nairobi.

The student is required to submit, as part of the coursework assessment, a research project report on a given management problem. We would like the students to do their projects on real problems affecting firms in Kenya today. We would therefore appreciate if you assist the student collect data in your organization to this end. The results of the report will be used solely for purpose of the research and in no way will your organization be implicated in the research findings. A copy of the report can be availed to the respondent organization(s) on request.

Thank you,

THE COORDINATOR, MBA PROGRAM

APPENDIX 2: QUESTIONNAIRE

Part one: Bio Data

1. Name of respondent : ____
2. Respondent job title in the institution: ________________________________
3. Name of the institution: ____
4. Year when the institution was established _____________________________
5. Ownership of the institution (Please tick applicable box)
   (a) Foreign owned ( )
   (b) Locally owned ( )
   (c) Partly locally and Foreign owned ( )
   (d) Partly governments and locally owned ( )
   (e) Government owned ( )

6. Who are the principle shareholders (5)

	Name of shareholder (s)	Number of shares
1		
2		
3		
4		
5		

7. Year when the institution commenced offering custodian banking services__
8. Number of employees in the custody services business unit_____________

9. Describe the nature of your services:

____

____

____

____

____

Part two: Environmental Changes

1. Under each of the following, please describe the changes in the banking industry in the last 10 years, which positively or negatively affected custodian banking services in Kenya.

(a) Economic Changes____

(b) Political Changes____

(c) Legislative & Regulations Changes________________________________

(d) Social & Demographic changes___________________________________

(e) Information technology Changes__________________________________

(f) Other changes____

2. Indicate the extent to which each of the following challenges have been encountered as result of the changes in the banking industry for the last 10 years. Rate them on scale of 1 to 5, where 1= Not challenging and 5 = Very challenging.

	Not challenging				Very challenging
Economic challenges	1	2	3	4	5
(a) Service demand	( )	( )	( )	( )	( )
(b) Customer expectation	( )	( )	( )	( )	( )
(c) Inflation	( )	( )	( )	( )	( )
(d) Unemployment	( )	( )	( )	( )	( )
(e) Disposable income	( )	( )	( )	( )	( )
Political challenges					
(a) Instability	( )	( )	( )	( )	( )
(b) Taxation Policy	( )	( )	( )	( )	( )
(c) Pending bills in parliament	( )	( )	( )	( )	( )
(d) Political influence	( )	( )	( )	( )	( )
(e) Constitution	( )	( )	( )	( )	( )

Legislative & Regulations challenges

(a) Banking Act	( )	( )	( )	( )	( )
(b) RBA Act	( )	( )	( )	( )	( )
(c) Capital Markets Act	( )	( )	( )	( )	( )
(d) Finance Bill 2005/6	( )	( )	( )	( )	( )
(e) Labour laws	( )	( )	( )	( )	( )

Social & Demographic challenges

(a) Population growth rate	( )	( )	( )	( )	( )
(b) Income distribution	( )	( )	( )	( )	( )
(c) Saving Culture	( )	( )	( )	( )	( )
(d) Levels of education	( )	( )	( )	( )	( )
(e) Lifestyle changes	( )	( )	( )	( )	( )

Other challenges

(a) ………………………	( )	( )	( )	( )	( )
(b) …………………………	( )	( )	( )	( )	( )
(c) …………………………	( )	( )	( )	( )	( )
(d) …………………………	( )	( )	( )	( )	( )
(e) ………………………	( )	( )	( )	( )	( )

Part three: Responses

Strategic responses

1. Diversification

(i) Have there been any addition of a new business acquisition to the custody services business distinct from its established operation for the last 10 years?

Yes ( )   No ( )

(ii) If yes please describe the nature of new business acquisition______________

____

(iii) To what extent have the objectives of the acquisition been met?

Very Small Extent   Very Large Extent

1	2	3	4	5
( )	( )	( )	( )	( )

2. Restructuring

(i) Have there been any corporate restructuring of the business unit for the last 10 years

Yes ( )   No ( )

If yes please describe the nature of restructuring

____

____

(ii) What were the objectives of the restructuring____________________________

____

____

(iii) To what extent have the objectives of restructuring been met?

Very Small Extent   Very Large Extent

1	2	3	4	5
( )	( )	( )	( )	( )

3. Have you undertaken any of the following activities in the last 10 years

	Yes	No
Business Process Re engineering	( )	( )
Reduced Staff (Downsized)	( )	( )
Divested	( )	( )
Dropped products	( )	( )

If yes please describe the nature of activity____________________________

____

____

4. Have you undertaken any of the following collaborative strategies for the last 10 years

	Yes	No
Entered Strategic Alliance	( )	( )
Entered into a merger	( )	( )
Licencing and Franchising	( )	( )
Other	( )	( )

If yes please describe the nature of strategies__________________________

____

____

____

____

5. Have you outsourced any of the following

	Yes	No
Investment management	( )	( )
Scheme Administration	( )	( )
Others	( )	( )

If yes please explain the reason for outsourcing________________________

____

____

6. From the statements below tick one best strategy that best describes your institution
   (a) We strive to achieve overall on cost leadership ( )
   (b) We strive to achieve market uniqueness about products and services ( )
   (c) We focus on specific group of a specific market segment retirement benefits schemes and collective investment schemes ( )
   (d) We focus on both the retails and corporate segments ( )

Operational responses

1. New Products

   (a) Has your institution introduced new custody related products in the last 3 years

   Yes ( ) No ( )

   (b) If yes state what needs the new product is addressing

   ____

   ____

   ____

2. Price strategy

   (a) Which of the following describes the pricing scenario for custodian banking services

   Monopoly ( ) Oligopoly ( ) Perfect Competition ( )

   (b) Do you consider pricing a critical factor in the acquisition of new business

   Yes ( ) No ( )

3. Place strategy

	Yes	No
(a) Do you offer custodian banking outside Kenya	( )	( )

(b) If not do you have sub custodian arrangements

____

____

____

4. Promotion strategy

(a) Do you carry out promotional activities for your products

Yes ( ) No ( )

(b) If yes which strategies do you use

____

____

____

5. Operation and Technology strategy

(a) Are your processes manual or automated

Manual ( ) Automated ( ) Semi automated ( )

(b) If manual or semi-automated, are you considering computerizing your processes

Yes ( ) No ( )

(c) Do you consider IT critical factor in the delivery of custody services

Yes ( ) No ( )

6. Financial strategy

(a) Looking at the overall profitability of Custody Services business in Kenya is the industry attractive or unattractive to investors

Attractive ( ) Unattractive ( )

(a) Indicate the extent to which each of the following factors describe the growth of custodian banking services business in your institution for last 10 years. Rate them on scale of 1 to 5, where 1= Very low and 5 = Very high

Scale :	Very low	Low	Moderate	High	Very high
	1	2	3	4	5
No of customers for the last five years	( )	( )	( )	( )	( )
Increase in portfolio value	( )	( )	( )	( )	( )
Increase in profits	( )	( )	( )	( )	( )

7. Human resources strategy
   (a) No. of employees directly supporting Custody Services business unit :___
   (b) No. of employees in -directly supporting Custody Services business unit :___

Others

1.Compliance monitoring
   (a) Do you have a compliance office? Yes ( ) No ( )
   (b) Describe the nature of compliances undertaken by the office?

____
____
____

   (c) What regulatory obligation do you have on the following bodies: -

Retirements Benefits Authority

____
____
____

Capital Markets Authority

____
____
____

Central Bank of Kenya

____
____
____

Kenya Revenue Authority

____
____
____

(d) Do you agree that regulations is a major catalyst for the development of the custody service industry Yes ( ) No ( )

If not what are the other catalysts?

____

____

____

Do you think the current government regulations in place adequately cater for the growth of custodian banking services?

____

____

____

If not what specific incentives do you recommend

____

____

____

2. Please indicate, in order of priority, major problems faced by the custodian banking services business

____

____

____

3. Please propose solutions to the problems experienced in 2 above

____

____

____

4. Please provide any other information you consider useful concerning your business.

____

____

____

Thank you for taking time to fill the questionnaire and may the Lord bless you.

APPENDIX 3: LIST OF REGISTERED CUSTODIANS

Custodian banks registered by the Retirement Benefits Authority (The Retirement Benefits Act No. 3 1997), notice on registered custodian and fund managers 2007 and (Capital Market Authority Act), grant of licence, gazette notice no. 2616 as at 31 30th June, 2007.

	INSTITUTIONS
1	Barclays Bank of Kenya Limited
2	CFC Bank Limited
3	Co-operative Bank of Kenya
4	Investment & Mortgages Bank Limited
5	Kenya Commercial Bank Limited
6	National Bank of Kenya
7	NIC Bank Limited
8	Stanbic Bank Kenya Limited