

**ANALYSIS OF INTERNATIONALIZATION OF BANKING IN EMERGING  
MARKETS: A CASE OF KENYA**

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## DECLARATION

The research thesis is my original work and has not been presented to any university for award of any degree in any institution of learning and therefore any resemblance to it in part or whole, is purely coincidental.

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## APPROVAL

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

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Signature

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\_\_\_\_\_  
Date

## **DEDICATION**

Dedicated to Banks to all Kenyan Banks internationalized and those intending to join the path of Internationalization

## **ACKNOWLEDGEMENT**

I wish to thank the Almighty God, the creator of everything seen and unseen for his guidance my studies this far. I specially want to acknowledge my supervisor, Gerrishon Ikiara for guiding me through the study. His insights were vital in enriching the document and changing the initial orientation. I wish to thank the contributors, various banks, IMF and World Bank who through their reports this study has been strengthened. My gratitude goes to my lecturers in the Institute of International Studies and Diplomacy, University of Nairobi for their support. Lastly, to my family I owe this to you. They have been the pillar of my strength throughout.

## **ABSTRACT**

Paradigm shift in financial intermediation globally from inward looking operations to outward vibrancy in provision of services has been attributed to emergence of globalization. Globalization has made many countries to liberalize their financial markets. For nearly two decades, banking across the world has evolved from initial blue chip targeted clientele towards financial inclusivity for economic development and poverty eradication. The research problem of this study therefore is how internationalization of banking in Africa was approached, with special reference to Kenyan banks. In understanding this, the study provides an analysis on trends of internationalization, strategies employed and whether it has provided competitive edge for Kenyan indigenous banks expanding in East Africa. The international theories of a firm (The learning, the inter-governmental, the strategic competition and the institutional-economic perspectives) are main theoretical lenses guiding the study.

A deductive descriptive approach has been used to carry out the study. The study moves the internationalization process from a generalized point to a particular scenario in Kenya where three Kenyan, relatively large banks, the Kenya Commercial Bank, Equity Bank and Cooperative Bank of Kenya have been used as case studies and Eco-bank used to as an experiential benchmark for the study. The study has relied heavily on secondary data from the International Monetary Fund, World Bank Reports, and Central Bank Reports among others.

Findings show that African banking industry is rapidly growing, driven by market and increased investment in information technology which has strengthened innovation. Emergence of new segmented markets such religious banking, unsecured loans and mobile banking are the emerging frontiers for leveraging Pan-African banking. Across the continent, there are sovereign bonds being floated which provide good

tidings for inter-country banking expansion. East African region was found to be malleable with regulatory framework for cross border trade. The EAC is fast emerging as a powerful economic hub facilitated by cross-border banking. A lot of regional policy activities are going on aimed at harmonizing the banking supervisory, licensing and regulation to enable faster growth and move towards East African Monetary Union by 2024 and single currency use. The study found that the foreign banking ownership in Africa and even East Africa is gaining momentum with nearly half of total banking assets being foreign owned in respective countries.

In Kenya, the internationalization process is unique. Banks apply four distinctive models: Greenfield approach, the use of diaspora and agency banking, follow-the-customer and collaboration/cooperation models. The role of CBK was lauded for leading the pack towards East African integration by showcasing good monetary policy implementation, fostering the liquidity, solvency and proper functioning of cross-border financial system. Policy development in Kenya has propelled the expansion of Kenyan banks in the region. Among the operationalized legal and regulatory framework include Proceeds of Crime and Anti-Money Laundering Act (2009), issuance of guidelines on agency banking, and rolling out of the credit information sharing mechanisms.

The study concludes that the internationalization strategies common to Kenyan market include: subsidiary development, follow-the-customer model, the agency and internet banking, and diaspora banking models. The performance of the Kenyan banks in terms of assets, deposits, profitability and innovation has increased since they got involved in cross-border banking. The strategy of expanding the branch network, both within Kenya and in the greater East African region, automation of service needs and globalization challenges has enhanced the growth. One key recommendation is that

policies should be generated to cushion Kenyan banks from risks associated with destination country challenges like in the case of Burundi and South Sudan. The expansion of banking must be conducted in a manner that does not marginalize the banking sectors of neighbouring countries as this could provide a backlash. Lastly, diaspora banking must be well organized to reduce incidences of money laundering and terrorism financing.

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## **ABBREVIATIONS AND ACRONYMS**

AU	African Union
BOP	Balance of Payment
BEP	Break Even Point
CDF	Critical Decision Factors
COMESA	Common Markets of Eastern and Southern Africa
DTB	Diamond Trust Bank
DRC	Democratic Republic of Congo
EAC	East African Community
ECOWAS	Economic Community for West African States
EPC	Export Promotion Council
FDI	Foreign Direct Investment
GDP	Gross Domestic Product
KCB	Kenya Commercial Bank
MNEs	Multinational Enterprises
NIM	Net Interest Margins
Ph.D.	Doctor of Philosophy
PIBPM	Perceived International Business Performance Measure
ROE	Return on Equity
ROI	Return on Investment
SACCO	Savings and Credit Cooperative Societies
SADC	South African Development Corporation
SEM	Structural Equation Modeling
SPSS	Statistical Package for Social Scientists
TCA	Transaction Cost Analysis
UK	United Kingdom
WTO	World Trade Organization
Post-WWII	Post-World War II

## CHAPTER ONE

### INTRODUCTION

#### **1.1. Background to the Study**

*“Internationalization may be thought as, a process, an end result, and/or a way of thinking by which a firm becomes increasingly internationalized as it becomes more involved in and committed to serving markets outside its home country. This may be a planned and orderly process, or arise from perceived new opportunities or threats.”*

(Albaum, Strandkov, & Duerr, 2002, p. 4). Expansion of banking through cross-border trade globally is influenced by increased innovation of financial products, regulatory reforms in financial intermediation, liberalization of markets, globalization of business, role of e-commerce in business through improved business technology. Smith and Walter (1998) emphasized this factors through documenting globalization trends, performance of cross-border trade, estimation of volume of transactions of acquired financial institutions by banks in developed work either in partial stakes or fully in emerging markets particularly in the developing countries. The internationalization trends seem to be bottom-up as financial institutions in emerging markets now internationalize through cross-border expansion. This study is therefore motivated to study the internationalization process in the developing country and using Kenya as a case scenario.

In the contemporary sense, the concept “internationalization” is not new. It gained momentum during the post-great depression era where it was seen as a viable methodology to imperialism to facilitate cross-border trade between market economies (Welch & Luostarinen, 1988). Post-WWII era intensified focus on economic internationalization until 1970s, when the orientation changed as Cold War dedicated that influence had to go beyond economics. Elements of globalization that

go beyond economics were now more featured to enhance the internationalization discourse (Gjellerup, 2000). Gjellerup (2000) broadly classify the factors that directly influence globalization of financial intermediation as: enhanced technology which is not only cost effective but also acts as an agency to network people and places; liberalization in the markets manifested in banking as financial deregulation and the provisions of the Washington Consensus that instigated economic reforms affecting most emerging markets such as structural adjustment.

The relevance of internationalization of business has not been eroded with this new development hence the credibility of theories of internationalization remain steadfast (Baronchelli & Cassia, 2008). Operationally, the term “internationalization” has gained credence within financial markets as outward movement of international operations, whereas “globalization” emphatically is in reference to connectivity of markets and the interdependence within national economies that has an impactful result on operations of financial companies. Internationalization by implication is a changing state where a business entity’s growth sets a platform for internationalization, results in or causes internationalization and company growth to be intertwined or subsumed (Nieminen, 2011). Many studies have researched on early internationalizing enterprises but more prominent ones are Rialp et al. (2005) who gave influences to rise of early internationalization: new markets in a variety of sectors in the economy; technological advancement in business processes and transactions; increased focus on global network, alliances and trading blocs and enhanced capabilities of entrepreneurs and businesses entities that are keen on early internationalization (Rialp, Rialp, & Knight, 2005). Additionally, Baronchelli and Cassia (2008) propounded that early industrialization in businesses was highly attributed to: falling trade barriers, deregulation, privatization, and maturity in

domestic markets, high technology investments that cannot be sustained by domestic demand, shortening product lifecycles, globalization of competitors and industries, and the free movement of capital, goods, services and people (Baronchelli & Cassia, 2008).

This study is motivated by the increased international activities of Kenya banks particularly in the EAC region. The main question the study strives to answer is whether the internationalization of banking in Kenya is reactionary or proactive. Is it a default process driven by market forces or is it a designed process to conform to the global trade trends and innovation?

## **1.2. Statement of Research Problem**

International business literature and theories are littered with the perspectives of mature multinational corporations being internationalized whereas limited information exists on the businesses oriented particularly from developing world internationalizing. The evidence from several countries especially those that have experienced a balanced of payment deficits, have offered incentives to ensure that international business operations of the companies incorporate within their jurisdiction. The main intention of these internationalized activities is to expand the economic growth, cut unemployment and creation of potential mini-MNEs (Multinational Enterprises) for the future. The regulations from World Trade Organization do not permit for trade protectionism implying that the home bank companies are susceptible to competition from the foreign owned banks or franchises and issue of tax evasion are real in many instances. The broad contextualization of internationalization is the expansion in geography of economic operations and activities of businesses over a home country's border. Academic inquiry into business internationalization has mainly focused on an enterprise's international activities by



just doing analysis on product development, business operations or market trend analysis (for instance, Luostarinen, 1979) or also network analyses like in the case of Johanson and Mattson (1993).

Many researches in East Africa have focused on factors that influence entry point to the host countries. Even instances where the studies analyze the indigenous banks, the interest is on factors that hinder their quest for internationalization. No study has offered an academic explanation of the enhancers of internationalization and whether internationalization of banking makes economic sense. The question is indigenous banks are “going out” to improve the competitive advantage to other countries, why are foreign-based banks “coming in” to improve their competitive advantage as well. Are there opportunity mismatches or strategic support from policy stand point?

This study steps in to bridge this gap in research by conducting a comparative analysis of internationalization of banking in Kenya.

### **1.3. Research Objectives**

#### **1.3.1. General Objective**

The main objective of the study is to examine the internationalization of banking in emerging market with Kenyan banks as a case reference.

#### **1.3.2. Specific Objectives**

1. To find out the internationalization of banking process and trends in the African context;
2. To analyze the internationalization of banking in Kenya, strategies used and resultant outcome;
3. To examine the association between international operation of Kenyan banks and financial performance.

#### **1.4. Research Questions**

1. What are trends and influences for Internationalization and cross-border banking in Africa?
2. How is internationalization of banking approached and its resultant outcomes in Kenya?
3. Is there association between the international banking operations and financial performance of Kenyan banks?

#### **1.5. Justification for the Study**

##### **1.5.1. Advancing Regional Policy Discourse and Banking Regulatory Framework**

Given the size and strength of Kenyan economy and the ever increasing volume of trade of between her and other international trade partners in Europe and Americas and between her and African trading blocs like Common Markets of Eastern and Southern Africa (COMESA) and East African Community (EAC), it is justifiable to advance an argument that this research can potentially and concretely inform planning and as well offer insights to banking organizations wishing to expand into or from Kenya. This study offers empirical evidence on the internationalization of banking in Kenya and by extension the East African region. This could be used to inform regional policy discussions particularly within the EAC region and for improvement of regulatory and supervisory. This study meets the aspiration of the Post-2015 development agenda ongoing discussions that have placed a big price on use of data, research and evidenced information for policy practice and intervention.

##### **1.5.2. Relevance to Banking Industry and Cross Border Trade**

The study is important to the banking sector as it provides empirical evidence and information on internationalization of banking and more specifically cross border banking. The findings of this study clearly distinguish the design of expansion of financial intermediation in EAC which might have been covered before but in fragments as the institutional reporting like IMF and World Bank are keen on specific

attributes of internationalized banking. The study associates the increased performance of the selected banks to their cross-border activities. The study has attempted to isolate the contribution of “foreign” subsidiaries to the specific banks performance. The established association between banking sector performance and cross border activities serve to encourage for other Kenyan banks wishing to internationalize based on proven evidence.

### **1.5.3. Advancing Internationalization Research Discourse and Academia**

This study is an analysis of internationalization of banking in emerging markets. The studies on this subject are mainly in global policy reporting for International Monetary Fund, World Bank among others. Uniquely, this is a case study which many give an in-depth focus on a particular market and understanding its dynamics. Studies of this nature use surveys which are more generalized to give description of the phenomenon being studied. This study is therefore timely as information on cross-border banking for Kenyan banks is still scanty being a new business model, the uniqueness in the Kenyan and East African markets. The contextual approach taken comprehensively focuses the study and thus will greatly contribute to the literature that exists. The use of qualitative case study as a method allows a holistic approach to investigating the research problem as the questionnaires will be open ended thereby the responses will not be prompted there by objective.

### **1.6. Definition of Terms**

This study regularly uses several key terms that are specific to this analysis. These terms are identified and defined with further detail below:

1. **Internationalization:** Currently there is no universal definition, though Welch and Luostarinen (1988) define it as the process of increasing involvement in international

markets, whereas Reid (1983) defines it as a measure of the perceived difference between foreign markets and the home market space along economic, cultural, political, and market-strategic dimensions. The definition of Welch and Luostarinen (1988) and Reid (1983) are relevant and therefore will guide this study.

**2. International Entrepreneurship:** This study favors the definition by McDougall and Oviatt (2005) in that it is a “combination of innovative, proactive and risk-seeking behavior that crosses or is compared across national borders, and is intended to create value in business organizations.” This definition is widely accepted and used in the field of international entrepreneurship research (Oviatt & McDougall, 2005).

**3. Emerging Market Economy:-**Described as progressive economies through positive and rapid growth indicators and hastening industrialization. Their influence in the global economy and geo-political formations can be felt.

### **1.7. Literature Review on Internationalization Process**

A literature review can be regarded as an evaluative report of various related studies as literature (Boote & Beile, 2005). They further classify the functions of the review as describing, summarizing, evaluating and clarifying this literature. The review of literature also presents the theoretical lens of the study while assisting the determination of the how the study in question should be handled. This is usually done in a manner that information is centrally concentrated on the subject area rather than just collecting junk of any literature on the topic (Wentz, 2014)

#### **1.7.1.Review of Internationalization Theory**

The process of internationalization of business can be explained in different theoretical lens and perspectives. This sub-section discusses four different perspectives which will act as theoretical lens to provide different notions of internationalization process. The utility and usefulness of each perspective is reliant

on the context and specific situation. Because each banking institution have different strategies and reasons for internationalization, it is important to thoroughly interrogate the each of the 4 view point and in the end deduct with the banks have followed a systematic way in their programmes. In the following paragraphs, the four theoretical lenses have been described to offer an overview and analysis of internationalization.

### **1. The Learning Perspective-The Uppsala Model**

Early researches on internationalization to provide empirical evidence from practice were done in 1970's. One notable study is Johanson and Vahlne (1977) whose milestone work in understanding internationalization was devoted to Uppsala Model or the stage model. The model oriented in the stepwise approach taken by the companies towards full status of internationalization (Vahlne & Johanson, 1977). This steps exhibit an incremental, dynamic and gradual as the knowledge base increases. The four stages are distinct though in some cases they overlap starting with (1) a localized phase when the company is setting base in the home market (no export), to (2) spontaneity phase where the exports are sporadic via an agent. The business entity (3) later establishes a sales subsidiary before it eventually announces (4) its holistic presences by production and operations in foreign markets (Vahlne & Johansen, 2009). Each stage however must be facilitated with higher market commitment (Hollensen, 2011). The learning perspective lens advances the prediction of businesses entities to internationalize to be based on markets they easily understand and then enter distant markets later(Hollensen, 2008). This kind of choice is determined usually by the psychic distance from the home to host country. The interpretation is that markets that draw a semblance to the home market in regard to cultural values, education, industrial development partners and business practice

exhibit characteristic of low psychic distance and are selected usually as the first market destinations then gradually these business entities extend their international or export presence gradually to destination markets considered to be of higher psychic distance later (Vahlne & Johansen, 2009).

Vahlne and Johansen (1977) believed that the incremental nature of process of internationalizing business function is occasioned by lack of or difficulty of obtaining market intelligence and business information. This cannot allow a one off exercise therefore knowledge gaps are directly attributed to stepwise internationalization process (Johansen & Wiedersheim-Paul, 1975). This kind of uncertainty for further progress to high psychic distance countries can be bridged by improved market intelligence and information gathered. Distinctively, the Uppsala model offers the difference with regard to knowledge and experiential knowledge where the former is knowledge that can be taught and transferred to new markets, and experiential knowledge obtainable on account of personal experience and emphasizes on uniqueness of each targeted market (Rask & Strandskov, 2008). Experiential knowledge is pertinent as it evidential and learnt over a period of time in the foreign markets. Challenges attributed to lack of experiential knowledge are very high risks and uncertainty on costs and insecurity because most companies adopt the learning-by-doing expansion.

The initial model was done on only four Swedish companies that had internationalized and date back to end of 19<sup>th</sup> Century. Critiques to the learning perspective, as advanced in the Uppsala Model, is based on scope on empiricism and difficulty in generalization based on sampling sizes usually taken which makes the deductions questionable (Lakomaa, 2009). The critics further argue that most a times,

the issue of timing arises. When a particular study is conducted to examine the process might be too late to notice the stages and therefore it might not be factual to demarcate the stages. This might compromise the findings as the situations and business models might have changed in some instances. In practice, the processes of internationalizations are not marked in phases, they happen or overlap thereby not some steps may not be noticed. The emergence of technology in communication and transport has changed the globalization therefore internationalization might not per se be consistently stepwise or be hampered by high psychic distant information access. This was not captured in the original Uppsala Model from 1977.

An updated theory of internationalization done by Hedlund and Kverneland (1985) expanded the sample to 18 Swedish companies' involvement in Japan. The results presented an alternative to international process is different to that proposed by the Uppsala model. The findings showed that the establishment and growth strategies in foreign markets are fast shifting towards more direct and rapid entry as compared to the stepwise process as adduced by Uppsala model (Vahlne & Johansen, 2009). Some companies are actually starting directly from internationalizing skipping stages. According to Hollensen (2011) argument, many companies have leapfrogged the stages and cut the niche through direct entry and therefore, summarily the speed of with which internationalization is undertaken seems to have been accelerated. Evidence to point to increased globalised competition instigated by national companies that have taken the internationalization route earlier than anticipated. Perhaps this explains why Kenya incorporated banks have started to internationalize from the East African Community (EAC) spreading to the COMESA region. Some companies are already establishing Far East markets like Dubai and China.

## **2. The Inter-Organizational Perspective**

The unique element of inter-organization perspective is the network oriented thought process which regular market models lack as they are not interrelated to each other. The firms in this model are networked and dependent on each other thereby the coordination is within and through the network (Mattsson and Johanson, 1988 in (Petersen & Marquart, 2013)). Such coordination happens between the firms where a standardized price is just one of the component factors. The characteristics in a network include technical, legal and economic ties. Interpersonal relationships are a strong component in enhancing such business relationships. Most companies join these networks as a form of synergetic strategy to competitiveness and mitigate risks associated with individualized schemes. The unit of analysis, in this network perspective is the multiplicity of relationships drawn and how it works for the betterment of different groups of firms. Cautionary mechanism are placed through strategic possibilities and restrictions that service to curtail activities that might break down relationship within a network (Petersen & Marquart, 2013)

Although the initial internationalization step is usually as a result of domestically networking, the process outcome could end up in strengthening business action to go beyond local borders (Vahlne & Johansen, 2009). Peerage forms the foundation of the networks by one company following another in the foreign country or establishing links that foster interrelationship. Rapidity of internationalization through networks actually adds to the critique of the original Uppsala Model but the renewed model in 2009 captures network.

When entering a network, the internationalization process will often proceed more rapidly than described in the learning perspective. Johanson&Vahlne original Uppsala



model has especially been criticized for not being able to explain the fast advance in internationalization, and partly based on this background, the model was renewed in 2009 to focus on networks as the primary driver for internationalization. The utility of technology to facilitate operation has successfully been used by networks to advance their entrepreneurship internationally (Hollensen, 2008).

The conceptualized model for network theory has four steps that facilitate internationalization. Although the orientation is quite different from the learning perspective, the network model similarly has incremental steps leading to finalization of internationalization process (Vahlne & Johansen, 2009). The steps can be summarized as: (1) Knowledge opportunities-where needs capabilities, strategies, and networks that directly and indirectly related to the firms are recognized; (2) relationship commitment decision-a decision is taken by focal firms to increase or decrease commitment levels to one or several relationships in within its network. The changes effected would include changes in entry mode, size of investments, organizational changes, and level of dependence; (3) Learning, Creating, Trust-building-The speed, intensity and efficiency of learning, creating knowledge and building trust depend on the existing body of knowledge. Opportunities are created through assistive power within networks on the market information and business intelligence and (4) Network position-relationship is established with character of knowledgeability, trust and commitment which have different level of relationships within the network. Usually changes commitment could work either strengthen or weaken the links established. Decision made with networks is deepen relationships by establishing more or new channels of engagement through strategic partnerships or interdependency in other related networks (Vahlne & Johansen, 2009).

### **3. The Strategic Competition Perspective**

The strategic competition perspective draws its orientation from classical economic theory on competitiveness and industrial economics (Porter, 1985). Competitive view of internationalization has been advanced by theorists working to build on Porter's mechanisms. This theory suggests that internationalization is driven by both internal and external competitive factors in an enterprise (Porter, 1985; 1980). The factors could be focusing on local and global competition, entry barriers, competitors, the firm's strategic direction, administrative heritage (Ghoshal & Bartlett, 1990). The international process of banks is informed by interplay between internal and external drivers. The firms making a decision to internationalize their operations must be privy to the cost drivers, competitive drivers, government policy drivers and customer drivers. Necessity is the mother of invention; consumers globally have preferences towards standardized products as an outcome of the technological development and globalization (Levitt, 1983). The kind of appetite exhibited for certain products only found in other areas would propel the internationalization process. Internationalization is demand driven and therefore commensurately supply must be developed thus internationalization.

Through the process of cross-subsidization or portfolio-management, resources can be accumulated and developed with the intention of taking to another destination to compete. The international market in the sense of internationalization refers to one global market that local market players undergo competitive disadvantages and challenges for protecting the home market, the globalized vision is lacking. Controversially, Hamel and Prahalad (1985) are categorical that internationalization process is dictated by competitive gaps and competition. Yip (1989) viewpoint is that external drivers' role is basically setting a base for a firm being anchored on

internationalization process but internal capabilities and resources dictate the outcome of input from external drivers and from internationalized functions. Kogut and Zander (2003) illustrating the important role played by both internal and external factors, expressed that the interrelationship helps in creating synergy which offers the company a competitive edge. The two controversial thoughts advanced by both Douglas and Craig (1989) and Hamel and Prahalad (1985) converge at internal factors being a steady component because reaction to external factors of internationalization is do not exhibit same patterns for different companies.

Douglas and Craig (1989) complemented the school of thought that internationalization has phases with increased commitment but uniquely each phase is triggered by external and internal phases. The strategic competition framework for internationalization can be mapped on the thoughts of Perlmutter (1969) who theorized country orientation against a more world-orientation in business thinking (Perlmutter, 1969). The theory of the phases as propagated by Douglas and Craig (1989) has a convergence in the original Uppsala model as it advances the notion of phases that resembles steps and obtaining of more knowledge which is the fulcrum of learning perspective. Perlmutter (1969) perspective, describes the notion of phases from an abstract orientation as it entails transiting from an ethnocentric view towards a geocentric view based on increased market intelligence and business knowledge of targeted foreign markets.

The critique on strategic competition perspective is the threshold of empirical evidence where analysis requires colossal amount of data for corroborating information. Analysis of internal and more particular complex value chain activities and their relationship to external factors and drivers is necessary but quite number assumptions have to be made before the analyzed results are admitted (Persaud, 2005)

#### **4. The Institutional Economic Perspective**

The institutional economic perspective on internationalization (Hymer, 1976) has borrowed heavily on transaction-cost theory (Coase, 1937) which stated that the continual growth of a company reaches an optimum where internal transaction costs become equal to the cost of the same transaction on the market (Petersen & Marquart, 2013).

This school of thought serves to have transaction costs as being driving the decision taken regarding vertical integration (Petersen & Marquart, 2013). These transaction costs simply include the summation of ex-ante costs and ex-post costs. Characteristically, ex-ante costs entail search cost (for finding intermediary or trading partner on the market and additional costs like for gathering market intelligence) and contracting costs relating to contractual process facilitation. On the other hand, ex-post-costs incurred in setting up operations in foreign land after contracting and other costs related to monitoring and enforcement for those who are not fulfilling their obligation (Hollensen, 2011).

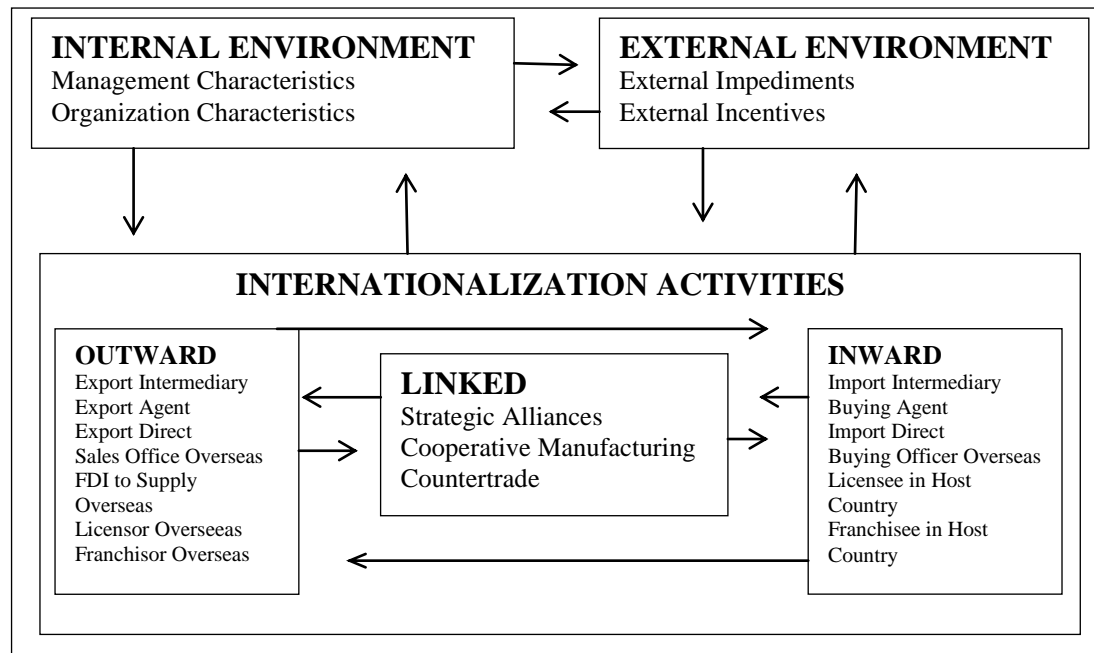
The basic thought here is why firms internalize internationally as opposed to delegating the tasks to the market. The institutional economic perspective therefore focuses on offering insights to decisions made to internationalize, externalize and entry modes of business entities relying on transaction costs. The transaction costs dictate the direction taken by business internationalization initiative and entry mode on foreign markets (Hollensen, 2011). This of course is subjected to market imperfections and therefore externalized activities are done in free market economies where perfect competition exists. The human element resulting from friction between

buyer and seller and bounded rationality accompanied by opportunistic behaviours directly has an effect on transaction costs (Williamson, 1981).

Anderson and Gatignon (1986) introduced model relating transaction cost and internationalization. They established an optimal entry mode based on transactional cost based pulled different transaction cost propositions. The framework has contributed greatly to understanding factors influencing internationalization processes. The framework is however limited in the sense of resources as different companies have different levels of investments and therefore establishment of the best entry point might be a mirage or not universally applicable (Brouthers&Nakos, 2004). The internalization and transaction cost are dynamic and therefore the theory can be described as evolutionary. The use of electronic communication has revolutionized how business is done and the increased influence of external intermediaries (Andersen, 2005). This is has however, minimized transaction costs and opportunistic behaviour even though human behaviour is inherent therefore personal trust-building is not substitutable (Andersen, 2005).

One of the weaknesses of for this institutional-economic perspective is that it ignores internal transaction-costs. The challenges with institutional power-struggles within the subsidiaries or conflict of interest have not been factored (Strandskov, 1995).Ghoshal and Moran (1996) offered an advice against relying on the framework exclusively as the threat of opportunism which is not quantifiable most times bloats the transition costs. The work of Shelanski and Klein (1995) emphasized that predictions of transaction costs have empirical evidence and therefore institutional-economic perspective can be admitted for explanation of internationalization process of any business entity (Shelanski & Klein, 1995).

The figure below presents a conceptualized Model for Internationalization Theories



**Figure 1.1: Conceptualized Model Linking Internationalization Theories**

Source: (Petersen & Marquart, 2013)

### 1.7.2. Internationalization Process

The internationalization can be viewed from different angles: as an entrepreneurship process; as an expansion and growth process; as a systemic change process and as an institutional process. Akokangas (1998) argued that the internationalization models are either oriented in market, firm or entrepreneurship perspective. The market perspective of internationalization is rooted in diversification strategies for large firms and has the stages model of internationalization. Current literature on internationalization has distinguished the focus on large and small businesses. At global level, the studies have focused on strategic international alliances and problems of diversification and control. Reid (1983) in Forsgren and Hogstrom (2004) defined internationalization as a measure of the perceived difference between foreign and home market space based on economic, cultural, political and market-strategic dimensions (Forsgren & Hogstrom, 2004).

Commitment to international business is directly associated with the requirements of the operation modes chosen and the size of business assignment. The later expresses the position of businesses between the extreme of no involvement (a domestic business entity) and full commitment (a business entity with a realized foreign direct investment). Study of internationalization has shifted focus from mere definition to and analyses of international activities to a more resource based model. The definition from resource based entails having an internationalizing business that strives to mobilize unique and interdependent resource stocks that operationalize a firm's international activities within its natural context. In a nutshell, the internationalization is simply the "*process of mobilizing, accumulating and developing resource stocks for international activities*", contentment with actual involvement of the businesses internationally notwithstanding.

The entrepreneurial stage mode of business internationalization show that targeting foreign markets entails having the opportunities, skills, networks and strategic choices of the entrepreneurs wishing to be involved. The entrepreneurs systematically seize opportunities which might appear unexpectedly (Sorensen, 1997). The ability to signal these opportunities is fundamental part of entrepreneurship, and this accelerates the internationalization process.

The first stage of the model is pre-internationalization stage that the entrepreneur makes a decision whether or not to internationalize based on opportunities that have identified. It is more of a planning and preparation process where intelligence is gathered on markets, legal issues and potential partners and potential customers. This planning is aimed at allowing for activation of networks and planning for the management processes of the internationalization(Lakomaa, 2009).

The second stage involves Early Internationalization, the process of internationalization process has been initiated and incept even though more learning is taking place in unfamiliar territory. The capture of market is can be described as trial and error learning method at this stage. The company is working with local partners as agents to gather more knowledge and mitigate the risks. This phase still has the element of decision making of whether to commit to the identified target market(Lakomaa, 2009).

Stage of Evolving Market Commitment is the third stage and the entrepreneur feels more ready and comfortable to remain in the target market and facilitate the operations to take opportunities on the potential. The businesses take more risks to commit to the new targeted foreign markets and organize business ways through deepened partnerships(Lakomaa, 2009).

The final stage is referred to as High Market Commitment. The entrepreneur has much experiences of the target market and is willing to more risks to through increased investment. The networking at this level is hi-tech as people with vast experience and advanced skills are targeted for further development. The table below presents the summary of entrepreneurial stages of internationalization(Lakomaa, 2009).

**Table 1.1: Entrepreneurial Steps of Internationalization**

Stage 1 People and Organizations	Stage 2 Local Business Knowledge	Stage 3 Financing	Stage 4 Distribution & Logistics	Stage 5 Business Operations
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Source: (Lakomaa, 2009)

Frank Bradley (1995) suggested that the main models of internationalization are: the life cycle of the product, the foreign direct investment andthe transaction costs



(Bradley, 1995). Sorensen (1997) proposed a more comprehensive classification for internationalization in four groups: internationalization modes (progressive models), contingency models, businessnetwork (interactive models) and social construction. In improving to the earlier models, SvendHollensen (2004, 2008) had the following recommendations for the model:the product life cycle, the Uppsala model, the transaction cost, theinternational business network and the globalization as models for internationalization. In recent years, the models have improved with Rubaeva(2010) dealing with Uppsala Model, International network, REM and eclectic models (Rubaeva, 2010; Buckley & Hashai, 2009).

**Table 1.2: The Main Characteristics of the Internationalization Models**

<b>Groups of models/ Scientific dimensions</b>	<b>Progressive models</b>	<b>Contingency models</b>	<b>Interactive models</b>
Objective vision vs.subjective vision	Objective	Objective	Subjective
Static perspective vs. dynamic Perspective	Comparative Static	Static	Dynamic
Planned orientation vs.Action	Planned	Planned	Interactive

**Source:** Sorensen, 1997, pp. 4-5.

### **1.7.3. Factors influencing Internationalization of Banking**

Factors affecting internationalization are manifested several ways including regulatory risks and costs, the policies of regional trade bloc (EAC); liberalization, taxation regime, and diplomatic support.

The market risks are common to not only banking sector but also to other companies or agencies venturing in exports business (Danciu, 2012). The market risks manifest themselves in different ways like economic, political or operational risks. Situations in the target market that trigger instability in economics or political increase market risks and decrease attractiveness for potential investors (Buch, Koetter, & Koch, 2010). Evaluations of economic risks is done by assessment of economic situation influenced by international trends as well as unemployment, gross domestic product

(GDP) and other economic indicators like fiscal policies. Political challenges that contribute to market risks are attributed to social unrests, frequency of changes in regime or lack of, or the level of religious intolerance, ethnic tensions and harmonious co-existence between different groups in a country like middle class and the poor (Petersen & Marquart, 2013). Gathering of evidence in the targeted countries to assess the level of risks on political and socio-cultural situations is a requisite to financial companies wishing to internationalize (De Burca, Fletcher, & Brown, 2004)

Many enterprises in the emerging markets face challenges with planning and decision making. This is a critical area in the whole process of internationalization and one which determines whether a business would stick in the destination country or retreat. Jori (2008) noted that planning and decision making concerns internationalization and is influenced by the resources and capacity of the banking institutions to support operations through human resources and financial resources. In many other instances, adequacy of resources does not guarantee success in international business operations because planning and entry strategy difficulties. Internal analysis of the business by re-evaluating current situation of company and the destination market is critical for planning for a successful strategy for internationalization (Jori, 2008)

The inadequacy of company resources can be great nightmare to companies wishing to internationalize. Malkamaki (2007) observed that there was a big difference in the experiences of large multinational banks and the Small and Medium banks joining internationalization businesses. For small and medium banks, the negotiations for exports and support may be quite demanding as in terms of work involved and even psychological status to brave the murky waters of internationalization (Malkamaki, 2007).

The shift in business operations can be a big problem as it adjusts the company structure and coordination. For the small and medium banks such changes can be very enormous as new levels or organization hierarchies are introduced to handle the international business cooperation and prospects. Jori (2008) expressed that such reorganization could be done by reframing the organization though recommend an overhaul to ensure smooth transition. It must be noted that internationalization process in both two cases as change in its own self is a great challenge (Jori, 2008)

Cultural shift in terms of adapting to new market preferences, destination market laws and regulations and adjustment of company to comply with the demands of the market(Jori, 2008). Cultural management is a major challenge of the internationalization process. Sensitivity to cultural backgrounds is necessary for anticipated organization outcomes like increased markets and profitability. The market itself has expectations on business operations which sometime might not be signalized or planned by the banks that internationalize (Jori, 2008).

An internationalization study of Kenya Commercial Bank (KCB) limited had the following findings on the challenges: market risk as a results of stiff competition, poor information communication technology, poor infrastructure, international fraud, legal challenges, liability to foreignness, transparency and corruption, state of local economy, stability of currency, financial resources, inflation level, taxation level, entry mode, timing of entry, language, religious belief, organizational changes, availability of skilled labor, involvement of labor unions, employment regulations and nature of legal system and laws (Asira, 2013). Broadly, Asira (2013) concludes by classifying challenges of internationalization process of KCB as market challenges, political challenges, legal challenges, and economic challenges, geographical

challenges internal challenges and cultural challenges. The case study recommends that commercial banks wishing to internationalize must be in full compliance to host market destination requirements and harmonious engage with the regulators and other public bodies regularly to fully entrench into the foreign markets (Asira, 2013)<sup>1</sup>.

#### **1.7.4. Relating Internationalization of Banking and Financial Performance**

New business paradigm has placed internationalization to be key to achievement of growth and superior performance. Increasingly academic inquiry has been dominated with relating business outcomes to internationalizations strategy, there is however scanty empirical evidence to substantiate the association between rapid, accelerated internationalization or enhanced export intensity and profitability. In a study of 783 Finnish exporting firms, Kuivalainen and Sundavist (2007) used a structural equation modeling (SEM) analysis on explaining the export intensity and business performance. The findings showed failed to draw a relationship between two constructs on generalized model. The segregated study of small and large firms in seclusion painted a different picture on the results. For small firms higher internationalization intensity translates to better sales, profits performance and is indirectly attributed to organization performance efficiency while for large firms higher internationalization intensity is reflected usually in terms of better profitability (Kuivalainen & Sundavist, 2008).

Martin-Martin and Papadopoulos (2008) model presented the stages of the internationalization process, and its potential to influence business performance. In a cluster analysis of 200 interviewed Spanish firms, corroborated findings of an earlier works on internationalization that had four phases but added a new stage at end of the

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<sup>1</sup>Asira, working for Standard Chartered bank commissioned a study that selected KCB and NIC bank to study internationalization of indigenous Kenyan Banks.

process, “globalization” that was not existent in earlier model (Martin-Martin & Papadoulos, 2008). The analyzed relationship between stages of internationalization and firm performance presented mixed results from the different indicators used. The graph drawn presented non-monotonic “valleys and peaks” adulations across the relationship of performance across five stages which directly imply critical challenges at strategic points during expansion to foreign markets. The overall implication is that clear public policy guidance on internationalizing business is necessary (Martin-Martin & Papadoulos, 2008).

In a research of 108 Tunisian service firms, the role of internationalization in amplification of innovation profitability has been emphasized. The study did analyze the direct effect of internationalization process on the firms’ innovative returns (Sdiri & Ayadi, 2014). Using the instrumental variable procedure, findings expressed a direct attribution of the innovation profitability to the internationalization process (Sdiri & Ayadi, 2014). The implication is the access to external market intelligence justifies the increase in the returns on innovation for the firms participating. Sdiri and Ayadi (2014) presented econometric results indicating the most predominant mode of internationalization was through export which enhanced the Tunisian service firms’ capability to innovate. The results of the survey had policy implications in that internationalization was offered a clear space for exchanging prospective opportunities running between countries. The support of Research and Development state owned department that capacity builds the capability to learn from innovation know-how has been highlighted. These benchmarks with the Learning-by-Exporting theory that stipulated that firms that integrates foreign markets into their operations have an enhanced level of knowledge and experience that improves their innovation effectiveness (De Loecker, 2007)

Mulder, Arjen and Slager (2008) investigated the impact of internationalization on banking performance. Using a novel data set that incorporated world's 46 largest banks in the period spanning 1980-2004, the findings showed that internationalization decreases performance measures especially on return-on-assets or return-on-sales. The negative effect is superimposed when controlling for risks or for response to time lags(Mulder, Arjen, & Slager, 2008). Mulder et al (2008) deduced that the very best, the effect of internationalization can weakly be described as positive on a forward-looking performance measure as Tobin's Q. Using non-parametric test, the discrepancy in performance is explained and the result is weak evidence for a non-linear pattern. The conclusion is internationalization cannot deliver meaningful value beyond be a threshold level of 50 percent of internationalization for banking institutions (Mulder et.al, 2008).

Slager (2006) investigated the relationship between the internationalization of banks, profitability and shareholder value. The study hypothesized that general internationalization did not have a positive contribution to profitability and the shareholder value has not increased from bank involvement in international activities(Slager, 2006). A database with internationalization measures had targeted 3 to 5 large banks in 8 countries and was constructed to monitor the performance between 1980 and 2003 which in total had 44 banks. The methodology involved the trans-nationality index was calculated for each targeted bank and combined foreign assets, foreign income and foreign staff into one index. The examination of the relationship between internationalization and performance, the study compiled information on the difference between foreign and domestic profitability and delved into investigating if more internationalization meant more profitability.Slager (2006) reported findings of foreign profitability being less than domestic and established a

negative relationship between total profitability and internationalization. The graphed data presented a “J-Curve” shape which suggested that to some given degree of internationalization (about 40 percent of foreign staff, income and assets) costs exceed the benefits. This kind of pattern was replicated for the shareholder returns where the banks that have increased their internationalization engagement had posted lowest shareholder return as a group, while banks that retreated had higher level of shareholder(Slager, 2006).

In recent times questions have been raised on the benefits accrued from the international engagement of financial markets. According to Buch, Koetter and Koch, 2010, large and internationally active banking companies have acquired considerable market power, and international activities have not alleviated their susceptibility to risks. There is however limited linkages on studies of bank internationalization, bank risk and market power. Buch *et al.* (2010) jointly estimated the determinants of risks and market power of banks and analyzed the effects of such changes with regard to number of foreign countries (the extensive margin) and the volumes of foreign assets (the intensive margin). The findings of the study were summarized into four: firstly, there is a strong negative association between risk and market power; secondly, banks with higher shares of foreign assets, in particular those held through foreign branches, have higher market power at home; thirdly, holding assets in a large number of foreign countries tends to increase bank risk and lastly, the impact of internationalization differs across banks from different banking groups and of different size (Buch, Koetter, & Koch, 2010).

**Table 1.3: Reviewed Research Areas in Internationalization of Businesses and Banks**

References	Study Areas	Variables	Theoretical Lens	Methods Used	Findings
Bell, Crick and Young (2004)	Small Firm Internationalization & Business Strategy <i>An Exploratory Study of 'Knowledge-intensive' and 'Traditional' Manufacturing Firms in the UK</i>	Business Strategy & Internationalization Interrelationships		A qualitative approach 30 indepth interviews with key decision makers of internationalizing small firms based in 3 UK regions (15 'knowledge-intensive' and 15 'traditional' firms)	Business policies (linked to ownership and/or management changes, influenced the international orientation of many firms. Close relationships between product policies & market focus, with product or process innovation instrumental international expansion.
Awolusi (2013)	Factors influencing the internationalization of Nigerian Manufacturing firms: an empirical analysis Awolusi, Olawumi Dele (Ph.D.)	<i>Critical Decision Factors (CDF) of internationalization by Nigerian manufacturing firms, as well as, examines specific relationships between these CDF and Perceived International Business Performance Measure (PIBPM).</i>	<i>An institution-based view of international entry decision, in combination with transaction cost- and resource-based views,</i>	<i>Using the integrated conceptual framework of international business strategy Multiple Regression Analysis</i>	A single multiple regression model of the identified factors
Schoenmake & van Laecke (2007)	Determinants of International Banking: Evidence from the World's Largest Banks	New approach, measure the level of internationalization of the world's largest commercial banks. -home-country factors explain the level of internationalization.			-The size of the country and the concentration of the banking system appear to be significant variables. -In addition, trade or economic integration is an important driver of internationalization (for the EU, but not for NAFTA). Interestingly, economic integration does not only stimulate cross-border banking within the region, but also global banking beyond the region. -degree of internationalization is found to be uneven across the



					three main continents.
Boojihawon&Acho Ionu (2013)	Internationalization process of African banks: an exploratory study	Work on internationalization theory to propose an integrative framework that investigates the internationalization process of African banks.		Using a qualitative, case-based approach, the study explores the distinct cases of four banks (three in Nigeria and one in Kenya/Mauritius) and explores their internationalization behavior and pathways to understand how they have leveraged their ability to internationalize their businesses	The internationalization pathways of African banks are shaped by a balancing act of leveraging accumulated global and regional strengths to achieve international growth and expansion.
Asira (2013)	Internationalization of Indigenous Kenya Commercial Banks within Eastern Africa: A survey of Selected Commercial Banks	Motives/determinants of internationalization of indigenous commercial banks.	The Uppsala Model The Eclectic Paradigm and Transaction Cost Analysis (TCA) Theory Industrial Network Approach A Business Strategy Approach Innovation -Related Internationalization Model	-Descriptive Study (Qualitative Analysis)- Content Analysis  -Sampled 3 local banks with operations; 7 senior managers were interviewed from 2 targeted commercial banks. -Self Administered	<b>Motives</b> - business growth strategy and the need to enjoy economies of scale and scope - to diversify financial and political risks; <b>Benefits</b> -growth in profitability, growth in share prices, growth in asset and capital base and creation of opportunities for career growth across the various geographies they operate in <b>Challenges</b> Regulatory framework Legal hurdles Language barriers Competition for manpower/resources

Chebii (2015) (Current Study)	Comparative Analysis of Internationalization of Banking In Emerging Markets: A case of Kenya	Internationalization of banking in Africa and specifically narrowing on Kenya case	Uppsala Model; Inter- organizational, Strategic Competition; Institutional Economic Perspectives	Deductive Approach Descriptive study & Qualitative & Quantitative 3 Local & Foreign based	Factual analysis of cross-border banking and internationalization in Kenya and EAC
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## **1.8. Research Methodology**

This section presents the research design, population and sampling, data collection and information gathering, secondary data analysis, scope, limitation and delimitation and ethical consideration.

### **1.8.1. Research Design**

The empirical study has been designed following the deductive approach. This is a positivism approach. The rationale for the choice is the internationalization is evolutionary as banking sector itself and therefore generalization of conclusions do not hold for a very long time. The other reason is that the study intends to integrate the use of qualitative and quantitative data so that the weaknesses related to subjectivity of qualitative analysis are partially cured. This justifies why inductive approach has not been considered in the study.

The study utilizes both qualitative information and quantitative data. Internationalization of banking especially for emerging economies therefore requires description of findings with the aim of theorizing the facts. Being a case study, a critical review of the Kenyan context on cross-border banking is used to help generalize for Sub-Saharan Africa (SSA).

### **1.8.2. Population and Sampling**

The targeted banks are Kenyan banks with better geographical reach in the region and extensive subsidiary network within the EAC and beyond. The study has purposively selected three Kenyan banks: Equity, Kenya Commercial Bank and Cooperative and Eco-bank as a foreign bank representative for benchmarking. The choice of foreign based bank has been informed by number of years. The rapid internationalization of indigenous banks started not more than 10 years ago, it was therefore important to compare with banks that have also not been in Kenya for more than 10 years

**Table 1.4: Targeted Population in Banks**

<b>Banks</b>	<b>Status</b>	<b>Areas of Internationalization</b>	<b>Sample</b>
KCB	Local/Kenyan	Uganda,Tanzania,Rwanda, S.Sudan, Sudan&Agencies Overseas	1
Equity	Local /Kenyan	Uganda, Rwanda, DRC, Southern Sudan, & Agencies Overseas	1
Coop Bank	Local/Kenyan	S.Sudan& Agencies Overseas	1
Eco-Bank	Foreign	West Africa, East and Central Africa and Overseas	1
<b>Total</b>			<b>4</b>

Source: Central Bank of Kenya, December 2014

Barclays bank of Kenya has been focused on a section of the study but that is for quality purposes it was not the target of the study as its experience and years of operation would distort the findings of the newly internationalized banks.

### **1.8.3. Data Collection**

Secondary data was primarily used to guide the study. The study reviewed various in-country reports, Central Bank Governor's speeches, Central Bank Reports, Kenya Banking Sector Outlook Reports, individual annual financial reports, International Monetary Fund (IMF) and World Bank studies on Africa, East Africa and Kenya specific. All the data used in the study was obtained from reports that were published or written between 2009 and 2015.

### **1.8.4. Secondary Data Analysis and Presentation**

The study focuses on comparative analysis of banks. The guiding idea of the qualitative analysis was to examine the meaningful and symbolic content of qualitative data gathered. In analyzing the interview, the study has explored how the internationalization process is undertaken, conditionality, challenges and risks in internationalization process and comparative analysis of local and foreign banks. The secondary data identified and clustered into themes through content, trend and pattern

analysis. MS Excel has been used to draw the diagrams and figures and compute statistics.

The following variables have been explored for objective 1: Bank penetration rates across regions expressed as %, global financial characteristics (depth, access, efficiency, and stability) expressed as % for both banking institutions and markets; number of branches and subsidiaries (expressed in number column graphs); regulatory framework changes were measured by the proportion of tightened and loosened expressed as % for any regulation, presence, activity, supervisory discretion, information, depositor insurance, resolutions and other; share of foreign banks was expressed as %. In partially achieving objective 3, the following parameters were used to measure African cross-border performance: growth in performance, average lending and deposits expressed as %, while comparative performance for foreign and domestic (local) banks was expressed in Lerner index expressed in percentage.

Objective two had the following parameters: Trends in GDP growth in Kenya, number of subsidiaries for Kenyan banks, Liquid liabilities in Kenya expressed as percentage of GDP; Comparative analysis of Kenya banks assets and loans expressed as % YoY, comparative for Kenya against other peer countries for total banking assets as a % of GDP. Regulations have been analyzed through content analysis of various CBK reports and measured qualitatively.

On objective 3, the financial performance has been measured in terms of ROA and ROE, both expressed as percentage, dividend yield (%), efficiency ratio. To associate performance of banks with international operations, the contribution of each bank's subsidiaries have been expressed as percentage of total bank earnings; and the performance of the banks has been expressed in Ksh. Billions presented in a column

graph to show distinctive comparisons. This study does not use a cause-effect relationship for international operations and financial performance but instead deductively attributes the expressed parameters to imply strong association.

#### **1.8.5. Hypothesis Formulation**

The study is guided by two hypotheses:

- 1). Internationalization of banking follows the theories of theories of internationalization.**
- 2). Internationalization of banking is associated to financial performance of banks.**

#### **1.8.6.Scope, Delimitation and Limitation**

This study is focused on the internationalized banks within Kenya. The study focused on the internationalization trends, strategies and resultant outcomes for the Kenyan selected banks and did not go into the transactions costs or costs of establishment.

The study is not without its limitations. Firstly, the voice of the customer and other stakeholders is lacking in the study. The study has taken four banking institutions that have internationalized and has not taken the perspectives of non-internationalized banks (control) to understand their hurdles or intention.

#### **1.8.6.Ethical Considerations for Research**

The research appreciates that the design of a study must be formulated by a well-defined research question, developing hypotheses and choosing an appropriate study design. The study has strived to discuss these issues in depth in the first part of the review series. Where people have been quoted, their identity has been concealed and instead their working positions to indicate that their views are based on respective banks thoughts and do not introduce bias of personal opinions. All the materials directly quoted have been referenced and where adjustment has made partially or completely has been explained.

## **1.9. Chapters Outline**

### **Chapter 2: Global and African perspective on the international banks.**

An exposition into the international banking and influence factors is presented. Global trends on financial target markets, number of branches and subsidiaries are examined. The chapter further delves into the drivers of change in international banks and regulations for supervision and monitoring of internationalization activities. Risks and benefits of internationalization for developing countries are also explored. The chapter is summed up by discussing the cross-border banking models in Sub-Saharan Africa.

### **Chapter 3: Internationalization Of Banking In Kenya: Strategies, Context And Impact**

It discusses internationalization process, strategies and resultant outcomes three Kenyan banks of Kenya Commercial Bank, Equity bank and Cooperative Bank of Kenya. The chapter makes a comparison of Kenya banking sector and the regional banking. The expansion of Kenyan cross-border banking and regulations and supervisions is explored. The chapter is concluded by a comparison of 3 Kenyan bank cases for internationalization.

### **Chapter 4: Summary of Findings, Conclusion and Recommendations**

It provides conclusions on the internationalization of banking based on findings and gives recommendations. The association between the study findings and internationalization theories has been explained in the chapter.

## **CHAPTER TWO**

### **GLOBAL AND AFRICAN PERSPECTIVE ON INTERNATIONALIZATION OF BANKS**

#### **2.1. Introduction**

This chapter focuses on the overall review of internationalization of banking and the factors influencing and inhibiting cross border banking operations, globally, continentally (within Africa), regionally within East Africa. Additionally, discussions are presented on policy environment for cross-border banking operations within Africa and East Africa and the opportunities therein.

#### **2.2. Review of Internationalization of Banking**

##### **2.2.1. Global Overview of Internationalization of Banking and Influence Factors**

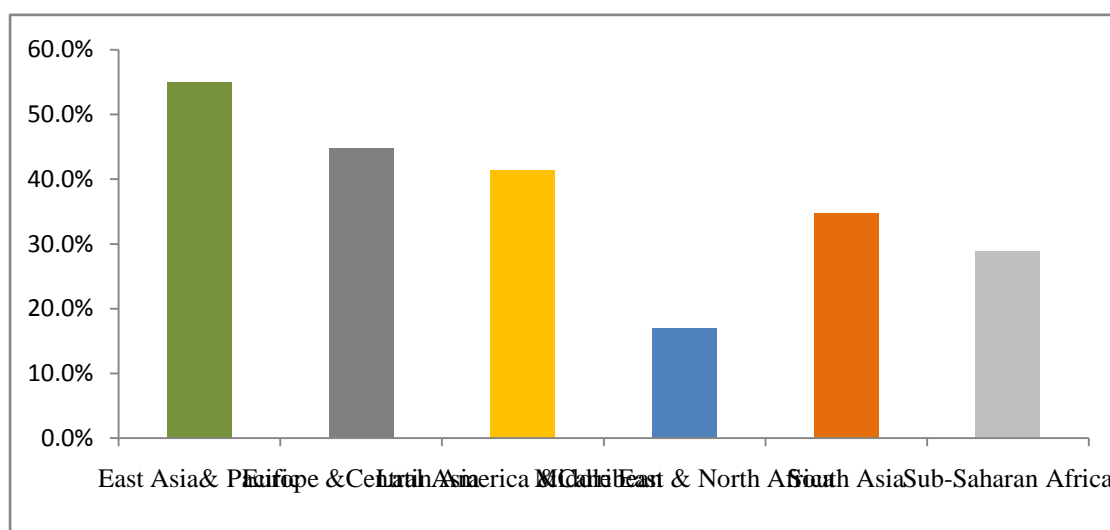
Technology advancement, deregulation and liberalization of financial services have been attributed to the rapid expansion of banking services globally. International Monetary Fund (IMF) and World Bank Reports have found harmony in their studies of the extent of internationalization of banking across-and intra-continent. Understanding of internationalization activities of banks is therefore best approached from focusing host country or bank-specific factors and intrinsic parent country influences. The focus of this study has been to investigate the home-country (Kenya) factors explaining the level of internationalization. The study first presents a general overview of global experiences before contextualizing to Kenyan case experience.

##### **2.2.1.1. Global Trends on Financial Targeted Markets**

Internationalization of banking is influenced by market forces globally as the banks strive to move where they have comparative advantage and competitive edge. This section assesses how the financial services have been deepened globally through analyzing the account penetration for adult population, financial institutional characteristics, and financial market characteristics.



The figure below presents the account penetration of adult population globally.



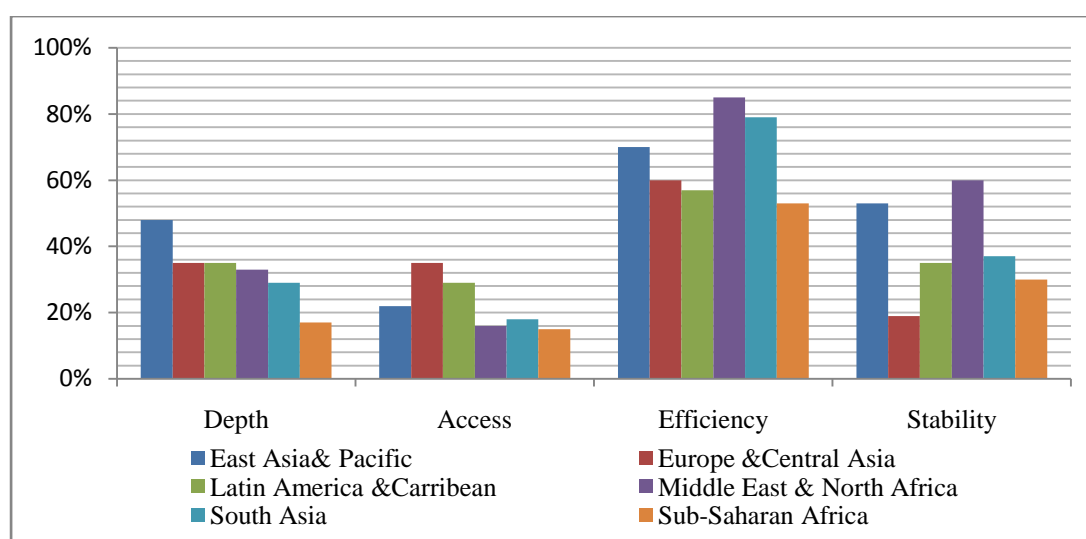
**Figure 2.2: Global Account Penetration of Adult Population (%)**  
**Source: Compiled from Demirgüç-Kunt and Klapper (2012)**

Based on the Demirgüç-Kunt and Klapper (2012) IMF study (Figure 2.2), all the regions have less than 50 percent of penetration of the banking services. Middle East and North Africa region is the least banked with less than 30 percent while East Asia and Pacific Region has deepened the financial services with approximately 55 percent of the adult population owning accounts. Europe and Central Asia and Latin America and Caribbean have less than half of their population owning accounts. In these regions at least 4 in every 10 persons have bank accounts. South Asia has about 35 percent of their adult population operating bank accounts. The Sub-Saharan Africa has less than a quarter of its adult population owning bank accounts. In economic theory, businesses move or tap into markets where they can receive maximum returns. Most of the banks in developed world deal with saturated markets and thus expansion of banking to international status relies on market intelligence in terms of value that can be added to the market, weaknesses existing for the services providers and generally innovation to introduce new processes and technology where it is lacking or obsolete.

With only 1 in every 4 persons in Africa owning a bank account, the continent has greater room to deepen its banking. Perhaps this should explain why Pan-African banks are the fastest growing comparatively to other regions<sup>2</sup>. This explains why internationalization of banking is fast spreading into other continents and regions such as SSA.

Beyond the accounts penetration rates it is necessary to examine the differences in financial institutions and market characteristics.

The figure 2.3 shown presents the characteristics of global financial institutions.



**Figure 2.3: Global Financial Institution Characteristics**

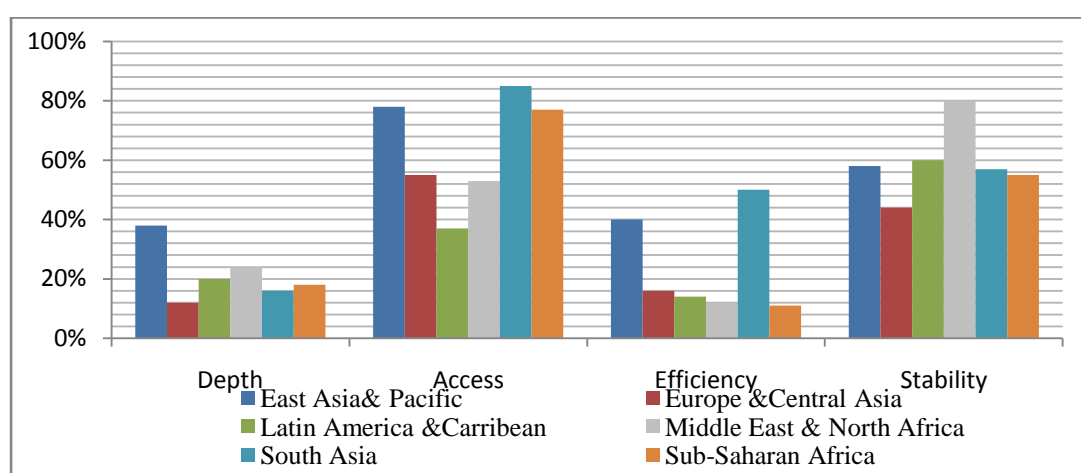
**Source: Redrawn from Cihak et al (2012)**

As presented in figure 2.3, the results show that in terms of depth, East Asia and Pacific heads all the sub-regions and Sub-Saharan Africa (SSA) is the least penetrated (Figure 2.3). In terms of access to banking institutions, Europe has better access than all the regions while Africa has less than 15 percent ratings. Results on banking efficiency indicate that all the regions are quite low with an averaged value of 50 percent. Middle East and North Africa was the least efficient while SSA was the most efficient in banking. SSA banking institutions have higher efficiency comparatively.

<sup>2</sup>CSAE Working Paper WPS/2013 Banking in Africa By Thorsten Beck and Robert Cull\* First Draft: August 2013

On stability of banking institutions, the East Asia and Pacific region though just about 50 percent rating and the Middle East (60 percent) were highly rated. Africa’s rating on stability of banking institutions was estimated at 30 percent. Should this be the reason for increased internationalization of banking in Africa especially from other regions? The stability of Middle East and North Africa banks could further reinforce the internationalization of Islamic banking to Non-Muslim nations in Africa.

Figure 2.4 presents the marketing characteristics of financial services globally.



**Figure 2.4: Global Financial Market Characteristics**  
**Source: Redrawn from Cihalket.al, (2012)**

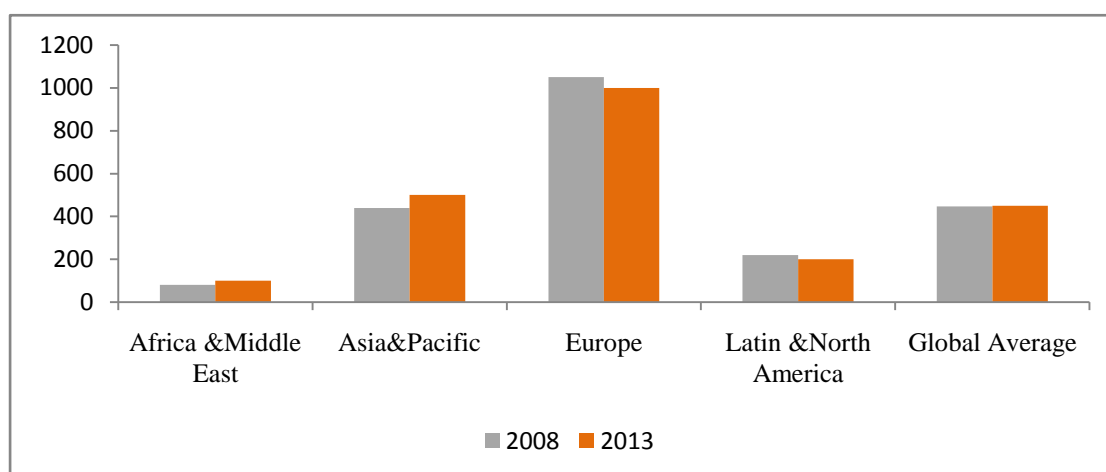
As shown in figure 2.4, internationalization of financial services is dependent on market characteristics. The size of the population of a country and the concentration of the banking system is significant in analysis of access of financial services across the globe. The influence of trade or economic integration on internationalization of banking cannot be ignored as it does not only stimulate cross border trading but is vital in globalization of banking services beyond a particular region. Comparing Sub-Saharan Africa (SSA) to other sub-regions the penetration to the market is still less than 20 percent, access to market is rated at over 75 percent. Efficiency in targeting the market in SSA is negligible whereas market is higher than Europe and Central

Asia. Sub-Saharan African is provided within an opportunity to deepen trade and access to banking services.

### 2.2.1.2. Global Bank Branches and Subsidiaries (2008-2013)

Greenfield is a strategy that banks globally use internationalize their services. Most banks get into different countries through establishing their branches in their destination countries while some develop subsidiaries in their host countries.

The figure below presents the number of branches of foreign banks (2008<sup>3</sup>-2013) disaggregated by region.



**Figure 2.5: Number of Branches of Foreign Banks (2008-2013)**

Source: Redrawn from IMF staff estimates<sup>4</sup>

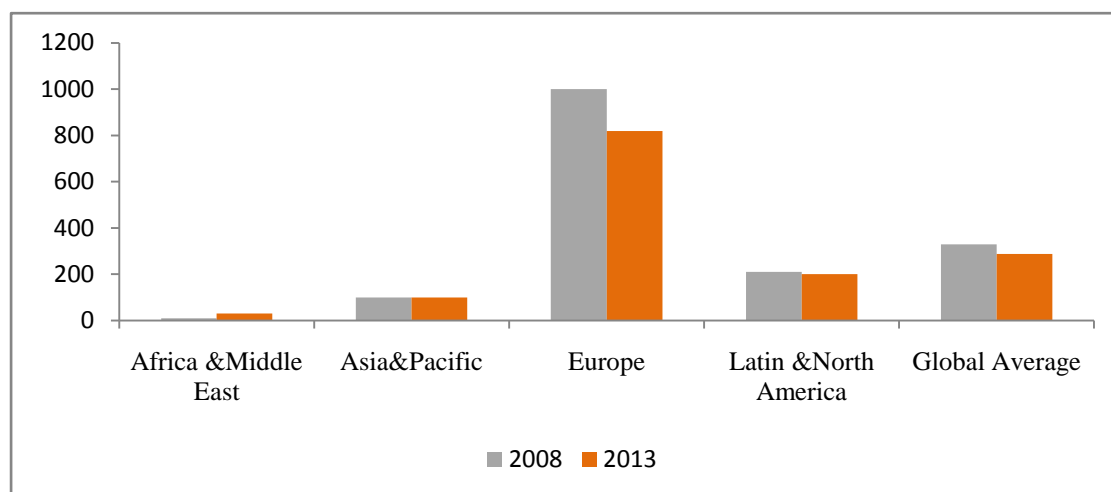
In all the regions as shown in figure 2.5, the number branches of foreign banks in Africa and Middle East, and Asia and Pacific regions have marginally increased between pre-crisis and post-crisis. The global average is higher that it was in the post-crisis compared to pre-crisis. This should explain expansion of banking as a strategy to diversify risks away from the home markets. Europe was hard hit by the financial

<sup>3</sup> Before financial crises while 2013 is after the financial crisis

<sup>4</sup> Africa and Middle East = Bahrain, Botswana, Israel, Jordan, Kuwait, Nigeria, Oman, Qatar, Saudi Arabia, South Africa, United Arab Emirates; Asia and Pacific =Australia, China, Hong Kong SAR, India, Indonesia, Japan, Republic of Korea, Malaysia, New Zealand, Philippines, Singapore, Thailand; Europe = Austria, Belgium, Bulgaria, Cyprus, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, the Netherlands, Poland, Portugal, Romania, Russia, Slovak Republic, Slovenia, Spain, Sweden, Switzerland, Turkey, Ukraine, the United Kingdom; Latin and North America = Argentina, Brazil, Canada, Chile, Colombia, Costa Rica, Mexico, Paraguay, Peru, and the United States. See Fiechter and others 2011.

crisis as the number of branches were marginal reduced after the crisis. SSA has less number of foreign branches further indicating the immense opportunity that existing to deepen banking.

The figure 2.6 presents the number of Subsidiaries of Foreign Banks, 2008-2013, by region.



**Figure 2.6: Number of Subsidiary of Foreign Banks (2008-2013)**

Source: Redrawn from IMF staff estimates

As shown in the figure 2.6, Europe has the highest number of subsidiaries comparatively. Africa and Middle East has least of number of subsidiaries. Save for Africa and Middle East regions, all the other regions had the number of subsidiaries reduced. This should explain where internationalization of banks in Africa is increasing. The global average of number of subsidiaries had reduced since the pre-crisis period.

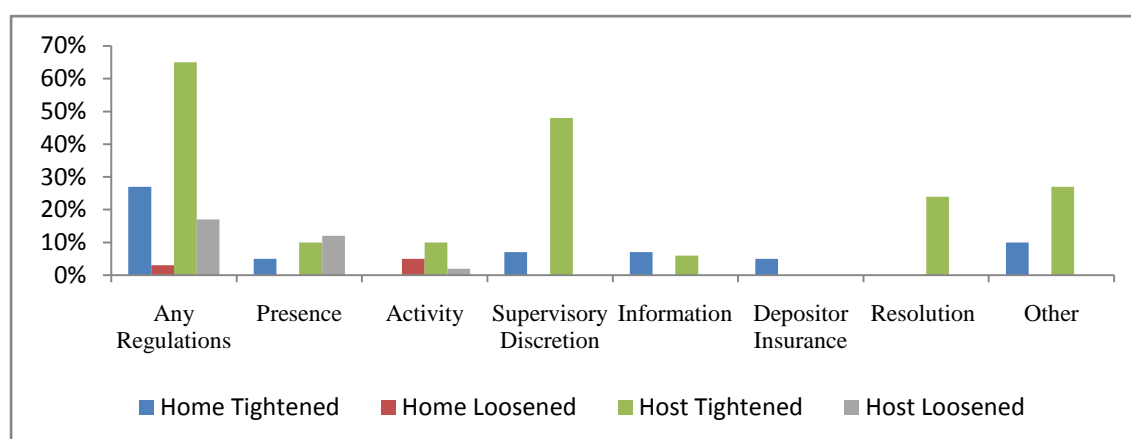
### 2.2.2. The Drivers of the Changes in Internationalization of Banking

As presented in figure 2.7, the proportions of home and host countries with regulations tightened for any regulation<sup>5</sup> categories were approximately 25 percent and 65 percent respectively. Similarly, the proportions of home and host countries

<sup>5</sup>Shares were calculated from survey results on banking regulations for international operations. The columns of “any regulation” will represent the share of countries that changed their any regulations related to banks international operations spanning 2006-2014. The “other” column corresponds to the shares of countries that have changed ant corresponding type of regulation.

with regulations loosened in all categories were approximated at 3 percent and 7 percent respectively. The implication is that most destination or host countries have their laws or regulatory policies tightened in line with the protecting either their infant banking institutions or avoid foreign control of their financial markets. At home, there was no interference with presence regulations thought approximately 5 percent of the companies had their home regulation tightened for presence. In the host countries, the proportion of countries with loosened presence for host countries were more indicating that the host countries could admit foreign banks without a presence or with just agencies or subsidiaries.

Figure 2.7 presents the share of countries that have changed their regulations on international banking operations between 2006 and 2014.



**Figure 2.7: Global Changes in Regulations of International Banking (2006-2014)**  
Source: Redrawn from IMF Staff Calculations

Further, figure 2.7 has shown that information sharing was tightened by 7 percent of home countries and 6 percent for host countries. Home countries had about 5 percent by proportion of banks being asked to join depositor insurance. Resolution regulatory changes were effected in about 25 percent of the all the host countries for foreign banks. The other tightened regulations were 10 percent and 27 percent respectively.

### **2.2.2.1. Description of Changes in International Banking Operation Regulations**

This subsection examines the drivers of changes in international banking operations. This analysis augments the findings of a confidential survey for banks on their operations at home and in destination (host) countries<sup>6</sup>. As shown in figure 2.7, the many countries have tightened their regulations of the international operations or have strengthened their supervisory roles for a period spanning 2006 to 2014 while just a small proportion have loosened. The supervisory authorities within the countries present a high certainty to impose stringent measures in operations compared by for example, having the discretion to impose ring-fencing measures to protect infant banks. The resolution authorities have been granted more powers to regulate foreign bank branches in their territories.

The implication is that the regulatory changes affect targeted banks international operations and bank capital requirements in three distinctive ways. First, tighter regulations have a tendency to reduce foreign bank lending and consequently this could stall the operations. Secondly, incongruence in the regulatory policies has the potential of inducing countervailing effect as the countries with tightened regulations may increase their claims in countries with loosened regulation. This corroborates the findings of Houston, Lin, and Ma (2012), Ongena, Popov, and Udell (2013), Bremus and Fratzscher (2014)<sup>7</sup>. Thirdly, the regulatory changes may trigger substitution effect as there are disparities in lending rates across different countries.

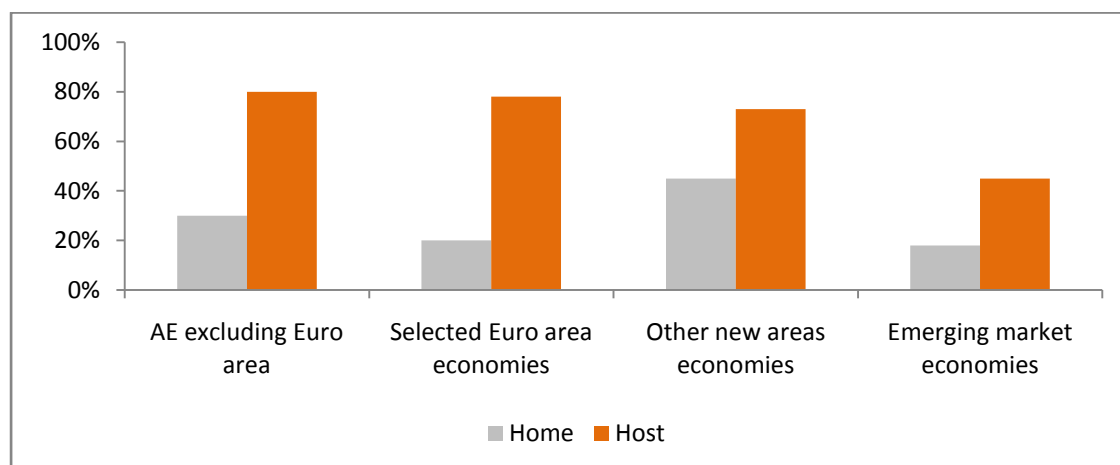
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<sup>6</sup> *The responses were gotten from 40 countries that top recipients of international banking claims. Survey respondents were Argentina, Australia, Austria, Belgium, Brazil, Canada, Chile, China, Croatia, Denmark, Finland, France, Germany, Greece, Hong Kong SAR, Hungary, Indonesia, Ireland, Italy, Japan, Luxembourg, Malaysia, Mexico, the Netherlands, Norway, the Philippines, Portugal, Romania, Russia, Saudi Arabia, Singapore, the Slovak Republic, South Africa, Spain, Sweden, Switzerland, Thailand, Turkey, the United Kingdom, and the United States.*

<sup>7</sup> *Different literatures have corroborative evidence on the regulatory arbitrage across countries, and Chapter 2 of the October 2014 Global Financial Stability Report presents the existence of regulatory arbitrage between banks and the non-bank financial sector.*

Figure 2.8 examines the sensitivity of international banking claims unique to each explanatory variables and their attributed contribution to GDP. It was found that tighter bank regulations either in operations or capital regulations for home countries is attributed to reduction the lending from the countries (Figure 2.8). The resultant effect is obvious as the banks find themselves with limited options which imply indirect restrictions to foreign asset ownership<sup>8</sup>. Countries that are organized well with strengthened supervisory institutional capacity rip more from foreign claims, probably as a result of regulatory arbitrage. There was no statistically significance on the effect of regulatory changes on local claims. The countries that have tightened their regulations show positive indices in their changes in banking international activities.

The figure below presents the data on the share of countries that have tightened their regulations<sup>9</sup> on international banking operations for the period between 2006 and 2014.



**Figure 2.8: Share of Countries with Tightened Regulations on International Banking**

Source: Redrawn from IMF staff calculations

<sup>8</sup>Figuet, Humblot, and Lahet (2015) estimate that the Basel III regulatory reforms could lead to a drop of 20 percent in cross-border claim inflows to emerging markets.

<sup>9</sup>NB: AE = advanced economies. Selected euro area economies are those with high borrowing spreads during the 2010–11 sovereign debt crises and comprise Greece, Ireland, Italy, Portugal, and Spain. Other euro area economies comprise Austria, Belgium, Finland, France, Germany, Luxembourg, and the Netherlands.



#### **2.2.2.2. Risk and Benefits of Internationalization of Financial Services for Developing Countries: Perspective of World Trade Organization and World Bank**

Based on the wide-ranging cross-country analysis and some detailed case studies have studied effects on banking stability and efficiency, the established the relationship between capital account liberalization and internalization of financial services and regulatory requirements on costs and gains of opening up.

To strengthen and liberalize financial systems in developing countries, internationalization of financial services must be given due consideration. This could be done through eliminating discriminatory treatment between foreign and domestic financial services, enacting a quasi-open door policy to facilitate cross-border barriers and for new entrants. WTO and World Bank (2014) suggested that financial systems would be more stable and efficient when international standards and practices are introduced. Absence of adequate regulatory framework and institutions creates high risks and susceptibility for internationalization of banks.

The following are issues and benefits of internationalized banks. First, the role of international financial services is strengthened financial systems for robustness and efficiency through introduced international practices and standards; enhancing of the quality, efficiency, and breadth of financial services; and by promoting stability of sources of funds. These benefits are fundamental for institutional development of developing countries' financial systems<sup>10</sup>. Secondly, economic growth is facilitated by increased banking competitiveness. Empirically, it has been found that the number of foreign entrants in the market and not their market share that dictates their positive contribution of national banking markets. Intensive competition however shrinks the domestic bank profits though banking customers gain through decreased net interest

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<sup>10</sup>BIS Papers No 76

margins, lower cost of fee-based services, and the diversified services. Thirdly, the differences in foreign and domestic financial institutions are manifested in performance, interest, and operational focus. There is locational disparity between developed and developing countries for foreign entry and this are attributed to competitive and regulatory conditions. Fourthly, the extent of internationalization benefits is influenced by domestic financial deregulation and capital account liberalization. The evidence from European Union established a mutual relationship between the status of internationalization and domestic deregulation. Fourthly, the extent to which capital account is liberalized influences the gains and accrued benefits of internationalization. It is not a strict requirement to fully operate a capital account to internationalize. Internationalization therefore reduces the level of distortion and volatility in capital flow while ensuring financial sector stability<sup>11</sup>. Fifthly, it is of necessity to harmonize and be compliant to the regulatory framework based on the international approved regulatory and supervisory functions stipulated in Basel II. This Basel II regulates stipulates how the non-performing loans are dealt with. Lastly, reforms are sequenced based on multilateral agreements like GATS and credibility is added to their plans for financial system liberalization<sup>12</sup>.

## **2.3. African Overview of Internationalization of Banking and Influence Factors**

### **2.3.1. African Context of Banking**

African continent still has a largely underdeveloped financial services sector though banking is one of the chief contributors to economic growth in terms of total assets and support services<sup>13</sup>. There is however policy discourse on the development of the financial sector with many policy reforms to being acted by various trade blocs to

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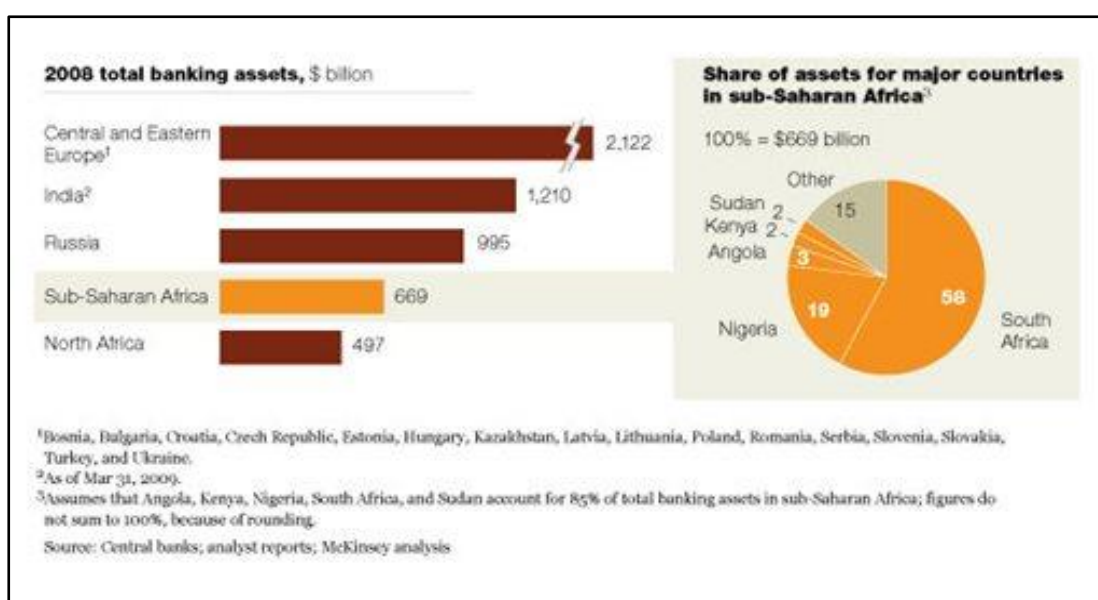
<sup>11</sup>IMF *Regional Economic Outlook*, April 2012.

<sup>12</sup>Oxford Policy management. 2013. "Cross border banking supervision in SADC region"

<sup>13</sup>Levine, R (1996): "Foreign banks, financial development and economic growth", in C Barfield (ed), *International financial Markets: harmonization versus competition*, Washington DC, AEI Press

improve business environment. Individual governments are moved first to improve their legal regulatory framework, information technology infrastructure and regulatory institutions<sup>14</sup>The last two decades can be christened African decades of banking as the depth and coverage of financial systems have blossomed in terms of measures of ratios of broad money volumes of bank deposits and private sector credit relative to respective GDPs<sup>15</sup>. Comparing the African banking experience in comparison with other emerging markets there is a big disparity (Figure 2.9).

The figure below presents share of SSA banking assets.



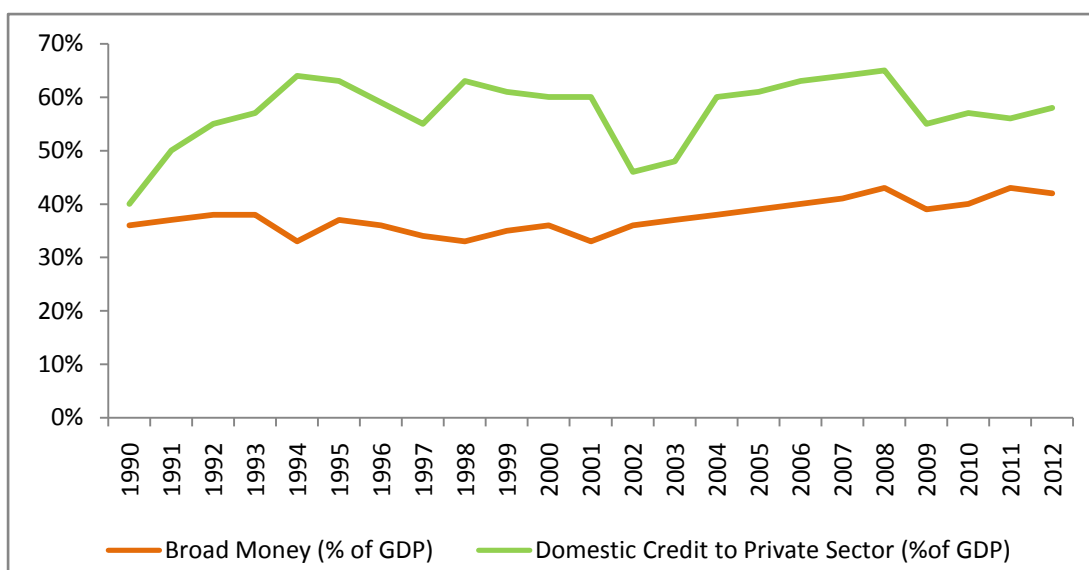
**Figure 2.9: Share of Assets for Major Countries in SSA**

Source: Central Banks and Mckinsey Analysis 2008

A corroborative benchmarking study commissioned by the World Bank in 2012 further emphasizes the opportunities for banking based on the indicators of financial system access, depth, efficiency and stability. The findings indicate that Sub-Saharan results were weakest comparatively based on average (Figure 2.10).

<sup>14</sup>Association of African Central Banks. 2012. Roundtable on Regional Banks in Africa: "Safeguarding and Leveraging a New Force for Financial Sector Development in Africa"

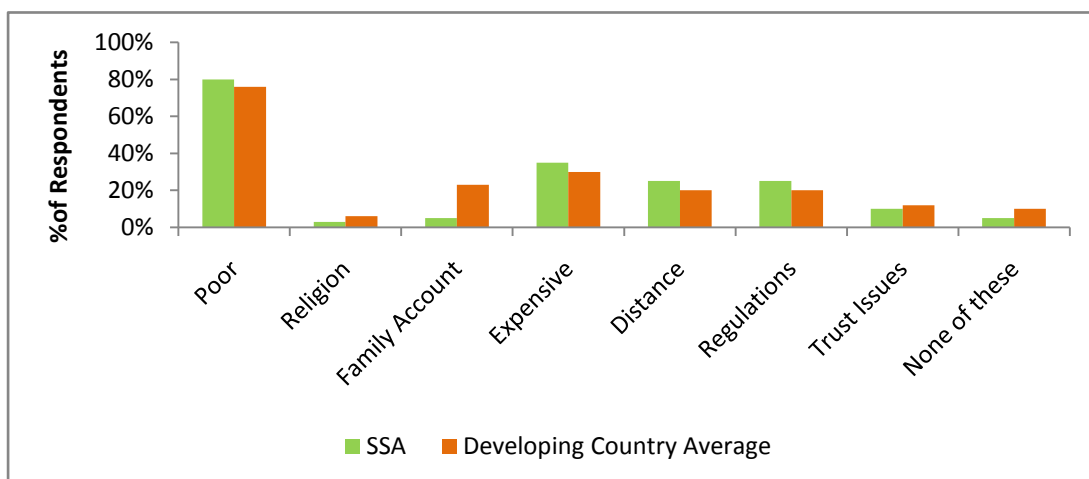
<sup>15</sup>Mckinsey Analysis 2008



**Figure 2.10: Sub-Saharan African Financial Depth and Coverage**

Source: World Bank (2013)

Internationalization of banking relies on the population characteristics and marketing dynamics. Figure 2.10 presents the barriers to formal account use in SSA compared with other developing countries.



**Figure 2.11: Comparative Analysis of Barriers to Formal Account Use**

Source: Redrawn from Demirguc-Kunt and Klapper (2012)

A large proportion of African population is still unbanked. The Global Findex Database (2012) found the total SSA adult banking population to be 24%. This represents about half of the banking adult global population. Numerically, 115 million of 482 total estimate of adult SSA population operate accounts in formal financial

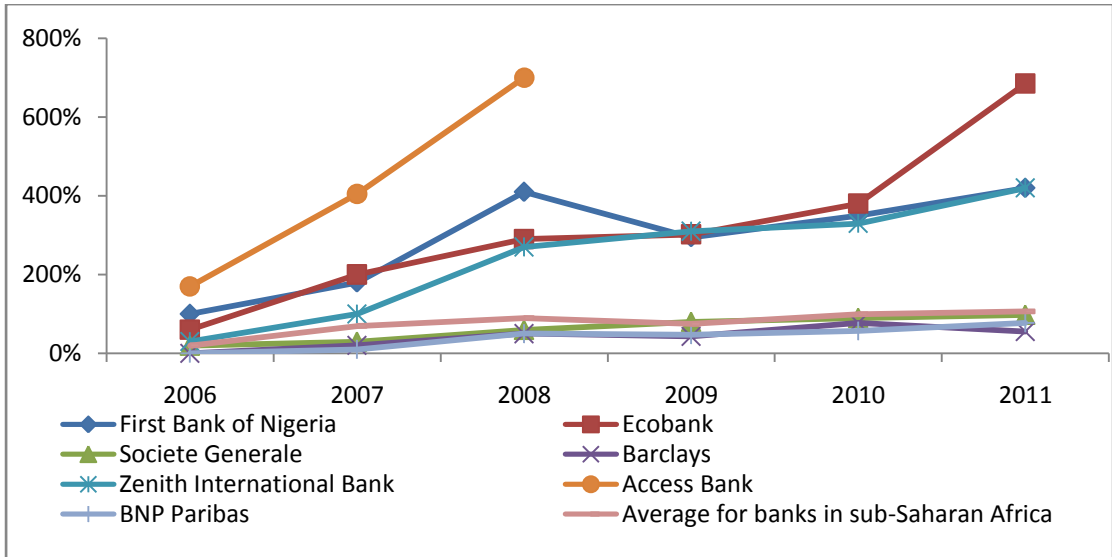
institutions. There are countries that have less than 10% of the adult population having formal bank accounts: Sudan, Senegal, Democratic Republic of Congo, Central African Republic, Chad, Niger, Madagascar and Mali.

The attribution of low financial inclusion in SSA based on survey responses rated poverty and low income levels high. Approximately, 95% of the adult population earns less than US\$.10 per day have no access to banking accounts. Other notable barriers are the expensiveness of the account maintenance, proximity to the banking services and onerous regulatory requirements. Engaging the unbanked population into formalized banking sector could significantly improve the deposits and provide positive externalities such as leveraged economies of scale. These anticipated returns could be a greater motivation for the internationalization of banking.

### **2.3.2. Growth and Trends of Banking in Sub-Saharan Africa**

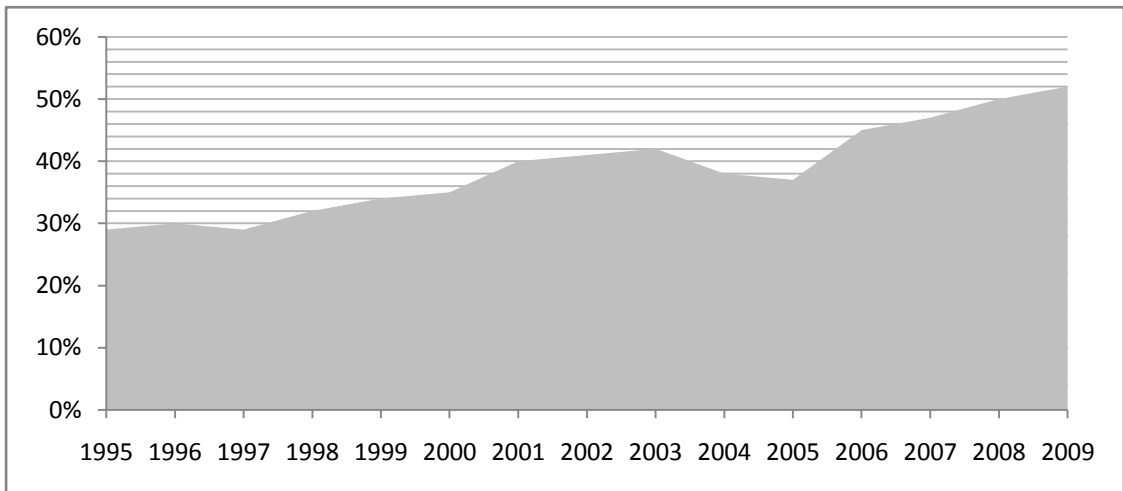
The study examines the growth and trends SSA (excluding South Africa) and comparing local and foreign banks. Findings show that indigenous African banks are growing at a faster than the foreign non-African banks. The expansion of Ecobank and the two Nigerian banks of First Bank of Nigeria and Access Banks are more than 7 and 5 times respectively. Figures 2.12 and 2.13 further emphasize the expansion of cross-border banking in Africa. In the last two decades, African cross-border bank branches or subsidiaries has almost doubled from 120 to 227 (figure 2.12). Proportionally, the number of banks has marginally remained the same increasing the share of foreign banks from 29% to 51%.

Figure 2.12 presents the growth of the Main Banks in SSA comparing the local banks against the foreign banks.



**Figure 2.12: Growth of the Main Banks SSA: Local Banks vs Foreign Banks**  
 Source: Adapted from Computed figures in Bankscope Database and Banks' Annual Reports.

Figure 2.13 shows how foreign shareholding has appreciated in period 1995-2009.

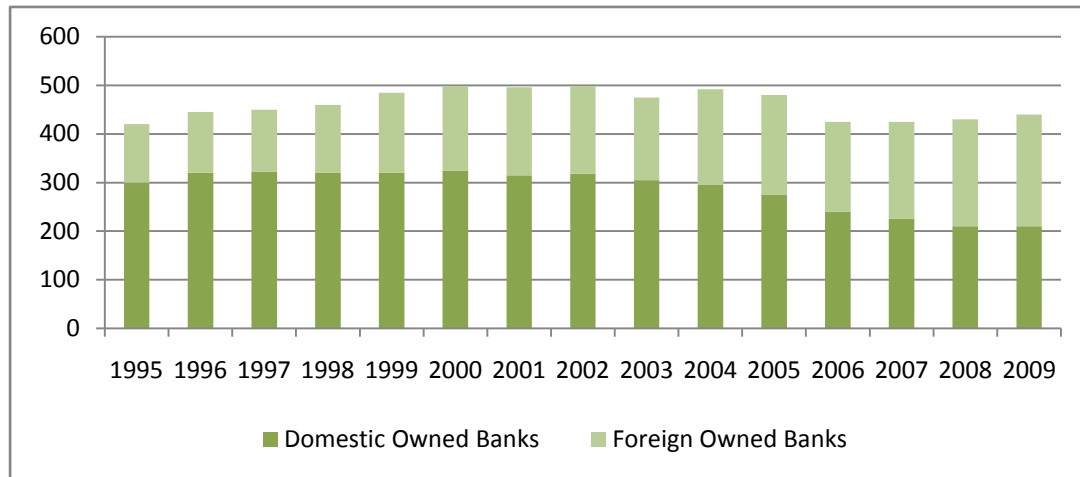


**Figure 2.13: Share of Foreign Banks in Africa, 1995-2009**  
 Source: Claessens and van Horen (2014) Bank Ownership Database

As presented in figure 2.13, the foreign shareholding for banks among African nations has improved from just 29 percent to 55 percent reported by Claessens and van Horen (2014). The proportion of foreign ownership in African banking stands at nearly 50 percent as the domestic shareholding.

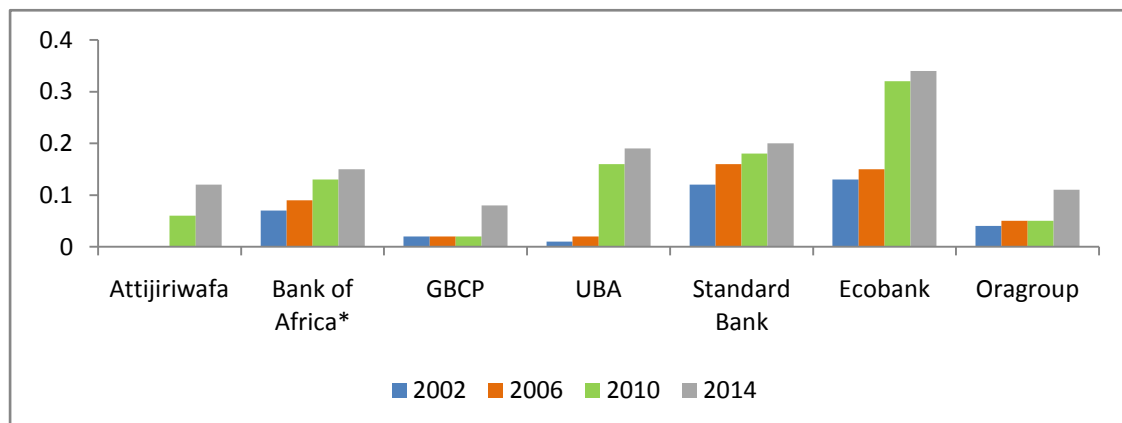
Figure 2.14 presents the total number of foreign and domestic banks proportional to total banks every year. In this regard cross-border bank is considered a domestic bank

in its country but a foreign bank in each country where it operates a subsidiary or a branch. The credit crunch of 2008/09 diminished the aggregate shares though the foreign shareholding was increased by proportion of domestic shareholding.



**Figure 2.14: Comparison of Domestic and Foreign Bank Shareholding in Africa**  
Source: Claessens and van Horen (2014) Bank Ownership Database.

Figure 2.15 presents the comparison of cross-border banks expansion by the number of subsidiaries in Sub-Saharan Africa. The analysis focuses on the Attijariwafa, Bank of Africa, GBCP, United Bank of Africa (UBA), Standard Bank, Ecobank Transnational and Oragroup.



**Figure 2.15: Major Pan-African Banks Cross Border Expansion 2002-14**  
Source: Compiled from Bank websites by World Bank (2014)

\*BMCE is a majority owner of Bank of Africa Group since 2010<sup>16</sup>

<sup>16</sup>BMCE = Banque Marocaine du Commerce Extérieur); GBCP-Groupe Banque Centrale Populaire

All the banks exhibited an upward trend in expansion across Africa since 2002. The Ecobank has the most expanded bank followed by UBA and South African headquartered Standard bank. African market presents opportunity for international banks to take greater interest, the Pan-African banks seems to be championing the intra-African trade and the African regional integration.

### 2.3.3. Cross-Border Banking Models in Africa

Cross-border banking models in Africa are exhibited differently in their quest to expand across Africa. New entrants into African markets have to make a decision on: (a) whether they establish a branch or subsidiary; (b) integrating their affiliates' operations with the parent (home country banks); (c) through merging or acquisition or Greenfield investment; and (d) market segmentation or product differentiations.<sup>17</sup>

World Bank Banking Regulation and Supervision Database (2012) indicated that predominantly, the Pan African Banks form branches or subsidiaries. Branching is the most preferred by method of foreign entry for African banks. There are 21 out of 48 (see table 2.5) African Countries found to have made their banking entry in their host countries through established branches representing 44 percent by proportion (AfDB, 2010)<sup>18</sup>.

**Table 2.5: Number of Countries with their Banks Branched**

	Sample	Aggregate	Proportion
Countries with Branches	21	48	43.75%
Defacto Branches	10	48	20.83%

Source: Compiled from data of AfDB 2010

<sup>17</sup>The information is based on a *study* conducted by IMF staff led by Charles Enoch et al. (2015) on *Pan Africa Banks, Opportunities, and Challenges for Cross Border Oversight*. Published by IMF in Washington, and approved by African Department and Monetary and Capital Market Departments.

<sup>18</sup>World Bank Banking Regulation and Supervision Database (2012) and the Regulatory Framework Database (AfDB, 2010).



The defacto entry branch was verified for 10 countries. Branching as an entry strategy was found to be a characteristic of financial sectors such as South Africa and other off-shore financial centres such as the Mauritius and the Seychelles. This study explains that the decision taken by many banks to either internationalize through branching or established subsidiaries is closely influenced by regulatory requirements though the factor of taxation cannot be wished away in some cases. Taxation is however very secondary. Kenya, for instance has an established capital requirement that applies to both subsidiaries and branches. The choice for either branching or establishing a subsidiary is decided on costs as the regulations increase the cost of compliance for a subsidiary. Each cross-border bank has their business model guiding their decision to internationalize through entry as a branch or subsidiary. Cross-border banks keen on segmenting their clientele like corporates or with modest capital and still uncertain on the risk levels find branching model more pliable<sup>19</sup>. Contrastingly, the cross-border banks intending to establish broad-based retail operations have adopted a subsidiary model that offers the autonomy in the host country operations with separate liquidity and capital buffers and with their own management boards and committees.

The extent of intra-group integration is a great influence on the decision made to enter a foreign market. For banking groups, consolidation, integration and conglomeration of cross-border banking services is common place<sup>20</sup>. African countries do less of intra-group integration as the regulations do not permit. “Indigenization” policies stipulate that as regulation requirement, banks need to develop self-standing subsidiaries that have established local information technology (IT) functions,

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<sup>19</sup>Claessens, S and J Lee (2002): “Foreign banks in low-income countries: recent developments and impacts”, mimeo, World Bank.

<sup>20</sup>Claessens, S, A Demirgüç-Kunt and H Huizinga (2001): “How does foreign bank entry affect domestic banking markets?”, *Journal of Banking and Finance*, vol 25, pp 891–911.

extensive employment of local labour, and establishment of independent, local management functions such as boards and risk-management capacity<sup>21</sup>. This study has established that level of integration is varied by banks. Some banks have large capacity thus have centralized their functions such as information technology, risk management, customers, or treasury operation but their subsidiaries heavily rely on parent bank in the home country for technical backstopping. Some cross-border banks exhibit behavioural financial linkage or dependency traits where their subsidiaries place their deposits with their parent banks or have intra-group swap transactions, joint guarantees, and syndicated lending operations that involve parent and foreign subsidiaries. Lastly, there is a category of subsidiaries of cross-border banks that function as independent entities with their own established systems and conduct intra-group financial transactions at arm's length. Generally, foreign banks from outside of Africa have low integrations level, while African-based cross-border banking is closely integrated comparatively. West African banks such as Bank of Africa (BOA) and United Bank of Africa (UBA) have strong intra-group financial support<sup>22</sup>.

Most banks have a tough decision to make between merger and acquisition and Greenfield investments<sup>23</sup>. Acquiring the operations of an existing financial institution can often give relatively quick and easy access to extensive operations; however, it is not without challenges, such as combining different corporate cultures. On the other hand, banks have also reported significant start-up costs and long break-even periods from entering a host country in the form of Greenfield investment. In Kenya, Ecobank acquired the former East African Building Society (EABS). The Barclays bank had its

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<sup>21</sup>Claessens, S, A Demirgüç-Kunt and H Huizinga (2000): "The role of foreign banks in domestic banking systems", in S Claessens and M Jansen (eds), *The internationalization of financial services: issues and lessons for developing countries*, Boston, MA, Kluwer Academic Press.

<sup>22</sup>KPMG Africa Limited (2015), Sector Report Banking in Sub-Saharan Africa.

<sup>23</sup>Giannetti, M and S Ongena (2005): "Financial integration and entrepreneurial activity: evidence from foreign bank entry in emerging markets", *CEPR DiscussionPapers*, no 5151.

subsidiary in South Africa fully acquired and now operates under the Barclays Africa Group in many countries. The Standard bank merged with CFC bank to form CFC-Stanbic bank in Kenya. The United Bank of Africa (UBA) had a tough decision to make between acquiring Equity Kenya and starting Greenfield<sup>24</sup>. UBA got into Kenya as Greenfield, and has struggled in its financial performance posting losses. The Equity group is currently among the best performers with subsidiaries and branches in East and Central Africa.

The last strategy common to most Pan-African Banks is market segmentation and strategy. “Follow the client” strategy has been embraced by most of the banks. Citizens of home country for the banks are targeted where they work professionally or corporates and organizations with interests in target countries. West African banks such as the UBA and the Eco-bank Transnational have subsidiaries outside the African continent. UBA has a pronounced presence in United States, United Kingdom and France, which Ecobank has extended its network to Dubai probably targeting the Nigerian and other African clients that have business interest in Asia. Dubai acts as a transit point. Some African banks are innovative and have differentiated their products. The three Kenyan banks under study have agency model where they work agents in target countries. KCB has an agency and an affiliated Savings and Cooperative Society (SACCO) that serves people in America and Europe. Equity bank who pioneered for agency banking has extending this beyond just banking and are now exporting their insurance functions. Cooperative bank has agencies that are affiliated to the diaspora banking division.

The other important factors that influence African cross border banking and they comprise. There banks that are on growth geographical expansion strategy. The pan-

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<sup>24</sup> Respective banks website. The interpretation is based on the information provided in this banks websites and annual reports.

African Ecobank Transnational has employed more than 11,000 personnel in more than 750 branches in at least 30 African Countries. The success is attributed proper inter-connection and networking between their autonomous subsidiaries which are responsive to market needs of the locals and still relevantly connect regionally through shared financial and human resources. Some banks with superior technology and sustainable growth choose to enter new market segments. Kenya banks which adopted internet banking like NIC bank, Diamond Trust Bank, and the big three have leveraged on mobile and internet banking. South Africa's Capitec Bank has a strong technological orientation and therefore implements its low-cost banking model to attract unbanked population through the pillars of affordability, accessibility, simplicity, and individualized customer service. Channel innovation is an opportunity being explored by many banks. The utilization of only electronic channels has increased internationalization of banking as one does not need to establish branch network. Kenya's M-Pesa has helped those who are unbanked to deepen the financial services even to those in the remote parts and beyond the conventional banking hours<sup>25</sup>. Lastly, some banks have adopted the expansion along the value chain. West African banks especially Nigerian are steadily expanding while building in-house capabilities in areas that were a preserve of foreign banks such as corporate and investment banking<sup>26</sup>. Guaranty Trust Bank (GTBank) is leading in this as it adds synergy for all its business units<sup>27</sup>.

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<sup>25</sup>Central Bank Kenya Governor's speech on mobile banking at a Mombasa seminar organized by Kenya banking association in 2013.

<sup>26</sup>Bank for International Settlements (2011): *Central bank governance and financial stability*, a report from a Study Group of the Central Bank Governance Group.

<sup>27</sup>*Hilary De Grandis and Gary Pinshaw (2010), Banking: Building Africa's growth sector by sector. Africa's growth goes beyond extractive industries (De Grandis is a consultant in McKinsey's Johannesburg office, where Pinshaw is a principal consultant)*

## **2.4. Internationalization of Banking in East Africa Overview**

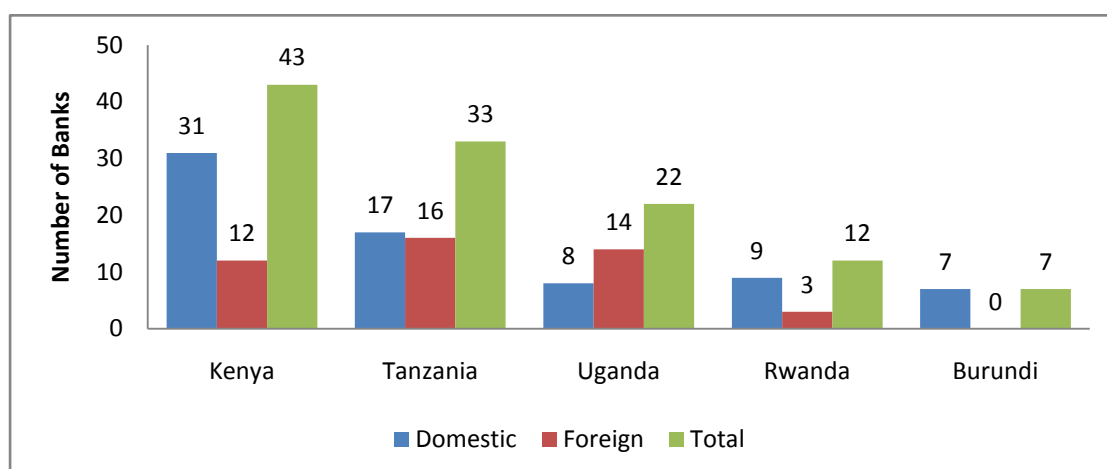
### **2.4.1. East African Banking Perspective**

How is the banking system in East Africa structured? For the purpose of this study, East African countries targeted are Tanzania, Uganda, Kenya, Rwanda and Burundi. South Sudan though a late entrant was deliberately excluded for lack of factual data to admit into the study. All the countries mentioned belong to the East African Community headquartered in Arusha, Tanzania. The banking spread is as follows: Kenya has 43 commercial banks (12 are foreign banks) and has established 14 subsidiaries across EAC. The reforms in banking system in Tanzania have enhanced growth of banks though it has comparatively fewer banks which are mostly dominated by top tier of large domestic banks and foreign banks. The regulated banks in Tanzania are 33 with 16 of them being foreign. Regarding ownership structure, the Government of Tanzania has 4 small fully-owned banks and minority stakes in three largest domestic banks. The top tier banks serve the small group of large corporate who form the bulk of loan book portfolio at 70 percent. The Uganda scenario is unique as the lifting of memorandum on licensing new banks in 2005 breathed a new lease of life into the banking sector by the licensing of 8 new banks<sup>28</sup>. This means Uganda has pushed their total banking to 22 commercial banks which include 14 foreign owned. Like explained earlier, foreign ownership in Uganda is considered 100 percent for majority shareholding as otherwise all bank might be considered foreign. Rwanda has 12 commercial banks out of which 3 are foreign owned and lastly, Burundi has 7 banks and two are considered financial establishment whose cumulate asset base is 54 percent of her GDP. The privately owned banks account for 73 % of total banking assets and 80 percent deposits, though the government is a major

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<sup>28</sup>Erst and Young (2014) “*Eastern Africa Banking Sector.Strong economies stimulate asset growth,but lower interest rates squeeze profits: A review of the 2013 calendar year.*”

shareholder in 2 financial establishments that are specialized in housing and development (Figure 2.16).



**Figure 2.16: Spread of Banks across East Africa as at December 2014**

Source: Compiled from EY (2015) East Africa banking sector report

This study used Uganda scenario a case for East African banking. The table below presents the decomposition of interest rates as at 2008 for Uganda.

**Table 2.1: Decomposition of Interest Rate Spreads in Uganda in 2008**

Parameters	All Banks	Domestic	Foreign
Average Lending Rate	16.72	18.44	15.24
Average Deposit Rate	1.97	2.31	1.90
Spread	14.75	16.13	13.34
Overhead Costs	4.66	2.74	6.22
Loan-Loss Provisions	0.72	0.38	1.01
Reserve Requirements	0.22	0.26	0.21
Taxes	2.51	3.34	1.64
Profit Margin	6.65	9.42	4.26

Source: Adopted from Cull and Trandafir (2010)<sup>29</sup>.

The results presented in the table 2.1 show that high operating costs is a factor that should influence entry into Uganda financial markets. Foreign banks incur high operation costs compared to local banks thus while making a decision to enter Uganda market, transaction cost should be a determining factor. Even though negligible contributors provisions of loan loss and reserve requirement contribute marginally to

<sup>29</sup> IMF (International Monetary Fund). 2012. *Global Financial Stability Report: The Quest for Lasting Stability*. Washington, DC.

the interest rate spread. Lack of effective competition has increased the profit margin which stretches the interest rate spread and also providing a buffer against risks. Comparatively, domestic banks show much higher spreads compared to their foreign-owned banks counterparts which is explained by higher lending rates due to risk averseness. The domestic banks reflect higher spread in profit margins compared to foreign banks as they charge higher rate repayments to clients. The foreign banks on the other hand have relatively high overhead costs and low profit margins as they usually target the high end market segment that have projects that are capital intensive to evaluate and maintain. Set up charges or cost like staff inventory, IT investments and product differentiation could still be reason for diminished returns for foreign banks as such capital outlay usually impact in the long run. The foreign banks profitability is half of the indigenous banks despite them incurring more on overhead costs and having low interest rates for deposit and loans.

Regarding the indicators of market contestability, the presence of foreign banks in a country within EAC is not associated with greater competition for individual countries best indigenous banks. Foreign-owned banks have a prominence in EAC as they account for above half of the total assets of the banking sectors in Uganda, Rwanda, and Tanzania (79 percent, 54 percent, and 51 percent respectively) whereas Kenya is 45 percent and Burundi is 41 percent. This has a direct effect on segmentation of the market. This poses a challenge for local banks to compete with foreign as the constraints in terms of technology uptake that is enjoyed by foreign subsidiaries from their parent-home country banks and raising capital.

Table 2.2 presents data that indicates that foreign-owned banks in the EAC are less competitive, particularly in Kenya and Uganda, foreign shareholding in banks or foreign ownership is dominant. Foreign banks in the EAC were found to be having

higher liquidity ratio (and accordingly, lower shares of loans) in their portfolios than indigenous (local) banks.

**Table 2.2: Comparing the Lerner Index in Foreign vs. Other Banks**

	<b>Bank</b>	<b>Ratio of Loan to Total Asset</b>	<b>Ratio to Legend of Total Asset</b>	<b>Performance (Risk Adjusted (ROA))</b>	<b>Lerner Index<sup>30</sup></b>
Kenya	Foreign	0.54	0.34	4.20	0.32
	Other	0.57	0.33	1.75	0.28
Rwanda	Foreign	0.50	0.39	0.28	0.28
	Other Banks	0.51	0.32	4.62	0.40
Tanzania	Foreign	0.40	0.50	3.63	0.32
	Other Banks	0.51	0.33	1.47	0.40
Uganda	Foreign	0.45	0.40	4.64	0.38
	Other Banks	0.41	0.41	4.30	0.35

Sources: Bankscope; and Compilations of Researcher, 2013

Bankscope research defined a foreign bank as a financial service provider that at least 51 percent owned by a foreign entity. If this definition holds with exemption then all Ugandan banks targeted by study sample be foreign owned. For the case of Uganda therefore, the threshold is waived and foreign bank is considered one that has 100 % foreign holding of shares.

It is therefore deducible that foreign banks contribute significantly in increasing cross border flows and risk diversification, their contribution to improving access to financial services is low in East African region(table 2.2). Foreign banks have a greater market power marginally compare to other banks in Kenya and Uganda as shown by the Lerner Index. Local banks in Rwanda and Tanzania have higher market power probably associated high government controls.The Rwanda banking regulations are highly protectionist compared to the Kenyan regime thereby explaining the difference (table 2.3).

<sup>30</sup>Formalized by Abba Lerner (1934), the Lerner index is used to describe a firm's market power. It is usually defined by market price set by the firm (denoted by  $P$ ) and a firm's marginal costs denoted by  $MC$ . The Lerner index has values between highest being 1 and lowest being 0, and is interpreted as the higher value implying greater market power.

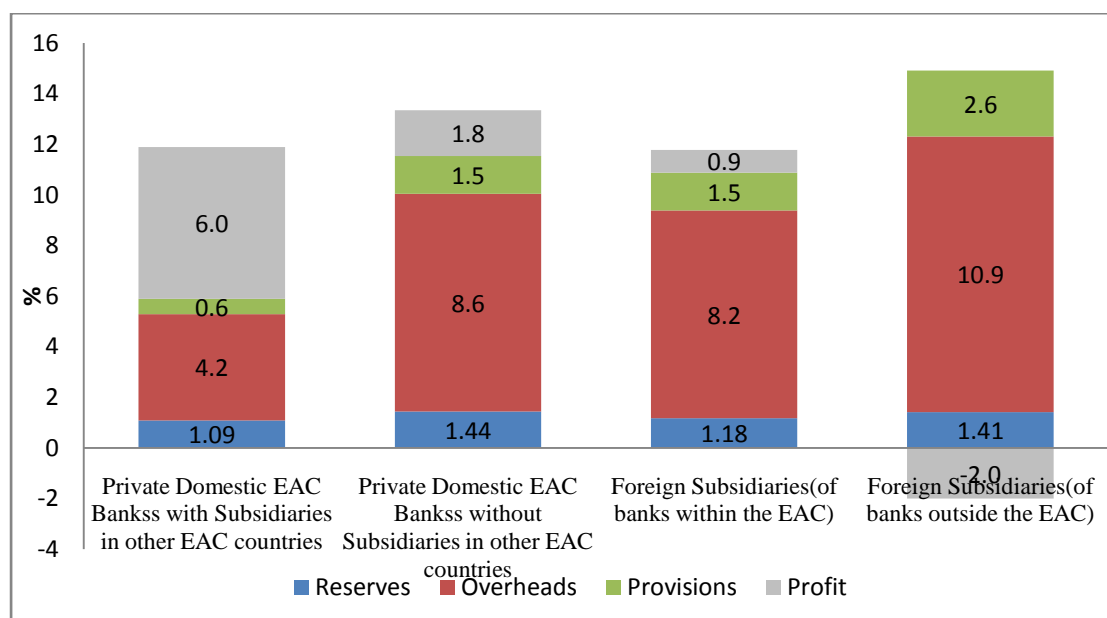


These findings corroborate the World Bank (2007) on analysis of foreign banks contribution on financial services deepening in Sub-Saharan Africa. Poghosyan (2010) further supported the findings by asserting that foreign banks do not improve competition in emerging economies. Though, Jeon et.al.,(2011) provided contrasting evidence of positive influence of foreign banks competition where the financial systems are less concentrated.

The government interference in a banking system is highly associated to low level of competitiveness. This presents a greater opportunity to enhance deregulation and liberalize the banking systems to reduce the monopolistic tendencies of state-owned banks in the EAC countries. In Kenya, Rwanda and Burundi the government has the highest shareholding in the largest banks though Uganda and Tanzania bank cases are highly privatized.

There is limited evidence that associates the effects of cross-border banking and financial service efficiency and competition in Africa. In East Africa, evidence show that cross-border banking has different resultant effects across countries and across time. Cihak and Podpiera (2005) found that in early years of 2000s, foreign banks in Tanzania and Uganda provided more lending and charged less than domestic or indigenous banks, while foreign banks in Kenya provided less lending comparative to their Kenyan indigenous counterparts. This could have triggered by desire to attract local consumers and remain competitive in markets that are considered volatile. In 2013, World Bank facilitated a Financial Sector Assessment Programme on the EAC that covered Burundi, Kenya, Tanzania, and Uganda which insightfully described the differences between foreign banks from different destination. The study found that EAC-headquartered with subsidiaries with EAC have lower spread and have higher efficiency rating compared to other private domestic banks (Figure 2.17). The parent

banks are simultaneously profitable in their home markets, and therefore act as buffers for the subsidiaries in the initial years of operations. Comparison of subsidiaries in EAC bloc and subsidiaries of foreign banks outside the regions exemplify the business model differences as the former have a lower spread and lower overheads than the latter. It must however be noted that at times the higher cost of non-EAC foreign could be attributable to high staff costs and/or higher compliances which further reinforces the conservative approach employed by EAC market as a protectionist measure. EAC banks that have expanded within the region have introduced innovative business models like agency banking into their destination markets which hastens the rate or timing to break even compared to other foreign competitors. Figure 2.19 presents the interest rate spread by cross-border banks though it might not directly reflect in gains to clients and use of those gains to improve their financial performance.



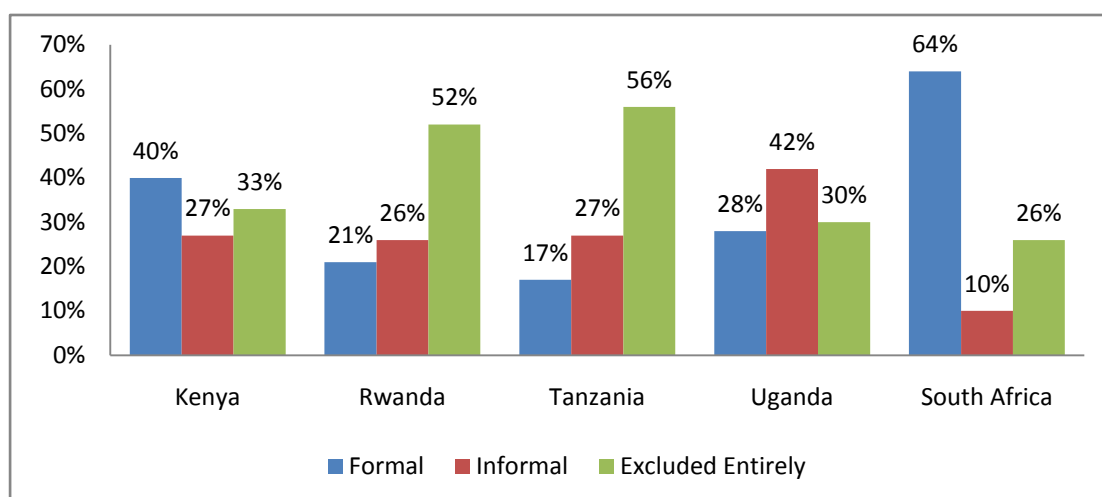
**Figure 2.17: Interest Rate Spreads EAC by Foreign and Domestic Bank Type in EAC**

Source: World Bank (2013).

The data presented in figure 2.18, further illustrates that internationalization of banking improves performance of banks. The profits of private domestic EAC banks

with subsidiaries in other EAC countries was estimated at 6 percent compared to private domestic EAC Banks without Subsidiaries in other EAC countries. EAC market was found to be a better destination for banking business further corroborating the findings on African market potential. Foreign subsidiaries of banks within the EAC were found to be more profitable than foreign subsidiaries outside EAC.

In summary the access to financial services is presented in below.



**Figure 2.18: Access to Financial Services in EAC**

Source: Compiled from FINSCOPE (2010)

Figure 2.18 shows the level of access to access to financial services in the East African Community trade bloc. Formal banking was found to account for less than a third by proportion of populations in Rwanda, Tanzania and Uganda. Kenya has about 2 in every 5 persons accessing financial which still less than an estimated 3 persons in every 5 for South Africa. This study deduces that Kenya banks should be lured by the gap in the EAC and therefore are establishing subsidiaries and branches to leverage. Internationalization is driven by market forces and behaviour of the market influences entry. Interesting, Kenya’s market is not spared the competition as banks from South Africa and West Africa are trooping in to cash in on the “unseen” areas which battle being taken to further segment the banked 40 percent and reach out to 33

percent unbanked or formal bankers. Bank of Africa product of Chamas<sup>31</sup> has revolutionized banking in Kenya with major banks adopting the group model too to reduce the requirement of collateral for unsecured loans. Ecobank has been targeting corporates with their products. The emergency of investment finance and other areas of Shariah compliant banking are frontiers for intense competition.

### 2.3.4. Banking Regulation of EAC Countries

The summary of regulation for entry in the East African Community is not harmonized. The most protected market markets are Burundi and Rwanda as the capital requirement to start a bank is very high nearly half of what is required in Tanzania and nearly 7 times what is requested by Uganda. Even Kenya lags behind the two small states in capital requirements. Rwanda is the easiest country to do business as she provided flexibility in nearly all conditions attached to banking except the capital caveat. Entry into different markets attracts different regulations. Kenya, Rwanda and Burundi have uniform regulations on entry in any form. Tanzania and Uganda do not permit branches.

**Table 2.3: Comparative Analysis of Banking Regulations in EA**

	Burundi	Kenya	Rwanda	Tanzania	Uganda
Supervisor	Bank of the Republic of Burundi	Central Bank Of Kenya	National Bank of Rwanda	Bank of Tanzania	Bank of Uganda
Requirement to operate a bank	License	License	License	License	License
Entry of foreign banks	Permitted	Permitted	Permitted	Permitted except for through branches	Permitted except for through branches
Minimum Capital	FBu 10 bil. (US\$ 8.1 mil)	KShs 0.5 bil. (US\$ 6.2 mil.)	Rwf 5 bil. (US\$ 8.4 mi.)	TShs 6 bil. (US\$ 4.0 mil)	Ushs 4 bil. (US\$ 1.7 mil.)
For a subsidiary of a foreign bank	same as above	Same as above	same as above	same as above	same as above
For a branch of a foreign bank	same as above	same as above	same as above	Not allowed	Not allowed

<sup>31</sup> Women savings and lending groups- though more investment clubs among working class are adopting the model.

Required Capital Adequacy Ratio	Solvency Ratio: 8%	Total: 12% Core: 8%	Total: 15% Core: 10%	Total: 12% Core: 10%	Total 12% Core: 8%
Required Liquidity Asset	100% of liabilities with a maturity of over one month	20% of all deposit liabilities, matured, & short-term liabilities	20% of all deposit Liabilities	20 percent of demand Liabilities	20% of deposit Liabilities
Maximum percentage of capital that can be owned by a single owner	20% (can be exceeded subject to an authorization)	25%	No ceiling (subject to permission)	29%	49%
Limit in lending to single of related borrowers	20% of equity	25% of core capital	25% of net worth	25% of core capital	25% of total capital
Securities Activities	Unrestricted	Restricted	Unrestricted	Unrestricted	Restricted
Insurance Activities	Prohibited	Prohibited	Unrestricted	Permitted	Prohibited
Real Estate Activities	Prohibited	Prohibited	Prohibited	Prohibited	Permitted
Shareholdings of nonfinancial firms	Restricted	Permitted	Permitted	Permitted	Permitted
Obligatory external audit by qualified auditors	Yes	Yes	Yes	Yes	Yes
Supervisory power to declare insolvency of a bank	No	Yes	Yes	Yes	Yes
Explicit Deposit Guarantee	No	Yes	No	Yes	Yes

Source: Central Bank of Kenya, (2013)

## 2.5. Challenges that Constrain Growth of African Banking

The performance of African banking in last two decades still bottlenecks that have served to deter progress and growth in the medium term<sup>32</sup>. Firstly, infrastructural challenges are still glaring. The cost of providing the necessary infrastructure has direct impact on cost doing business in Africa. In many parts of Africa, payment systems are incongruent with others thus adding to inefficiency in transactions. Reduction in cash handling is still a reserve of very few countries in Africa. Secondly, weaknesses in regulatory framework still permeate many African nations. After the global financial crisis of 2008/9, Basel guidelines were ratified to as international

<sup>32</sup>Based on Address by Mr Daniel Mminele, Deputy Governor of the South African Reserve Bank, at the Association for African Central Bankers (AACB) Roundtable on "Cross-Border Banking In Africa—A Force for the Good" Washington DC, 11 April 2014.

regulatory framework and with African continent, not many countries have complied. Though, progress in this regard is variegated depending on the countries and the regional blocs. African countries should strengthen their oversight and enforcement. Thirdly, and more fundamental is that accessibility to banking services is still hampered by unaffordability. Most African population is still relatively poor and are looked out of banking services on cost related reasons. The market segmentation of most bank mainly target people with high end income distribution or corporate clients as the other people working in informal sector are considered “risky”. Competition for high end market just improves the cost effectiveness for higher income households thereby creating a waged gap and classes with population. There is however beamed optimism as African middle class is rising and could benefit from innovative new African banking solutions. Fourthly, the liquidity ratio in Africa is obscene. Excess liquidity among African banks makes them unattractive for foreign investments. There is over reliance on generating revenue through government bonds and securities instead of growing loan books. For incidences where the banks advance more loans, the rate of interest rates spread between loans and deposits is very large. The development of identification and credit bureaus which are alternative enablers to growing retail credit portfolios is either absent or still at nascent phase in most African countries. Last but not least, the challenges associated with technology backlogs. In 2013, Industrial Development Corporation (IDC) published a white paper that projected information technology adoption and use as main setback towards operation of business especially financial services across Africa. Issues on data integrity, coordination of inter-banking transactions and clarity in architecture

abstraction governing interoperability is great hindrance to cross-border banks especially where investments in efficient IT platforms are low<sup>33</sup>.

## **2.6. Chapter Summary**

Africa and more precisely SSA still present a greater opportunity for deepening of banking. Account penetration staggers at less than third population of adults (Figure 2.2). Characteristics of banking institutions in SSA comparative are still low. Access and depth of financial services were less than 20 percent proportionally (Figure 2.3 and 2.4). Efficiency for financial institution was the highest in Africa comparatively (Figure 2.3). Market access for SSA was better than Latin America and Caribbean. The market stability was averaged at 50 percent though comparatively lower to other regions. Number of bank branches has increased in Africa and marginally increased for global average. Europe how however slumped due to the financial crisis of 2008-09. The number of subsidiaries reduced globally between pre-crisis and post-crisis. Africa however had increased its subsidiaries marginally in the same period (Figure 2.5 and 2.6). Regulations on foreign or internationalization banking activities have been tightened globally by host countries as well as home countries, though home countries have loosened regulation on international activities by less than 10 percent (figure 2.7). The emerging economies have enacted more flexible regulations comparatively (figure 2.8). Relating financial performance to international banking activities, banking assets share for SSA were less than India and Russia, and less than a third of Europe (Figure 2.9). The amount domestic credit advanced to private section has undulating been increasing over last decade (figure 2.10). Banking access was found to be hampered by poverty, cost, proximity issues and inhibitive

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<sup>33</sup> Based on Address by Mr [Daniel Mminele](#), Deputy Governor of the South African Reserve Bank, at the Association for African Central Bankers (AACB) Roundtable on "Cross-Border Banking In Africa– A Force for the Good" Washington DC, 11 April 2014.

regulations. Foreign shareholding of African banks has been increasing from an estimated 30 percent in 1995 to nearly 50 percent by 2009 (figure 2.13). In East Africa, Uganda was a case for comparing foreign and local banks performance. Foreign banks subsidiaries were profitable though their profit was about half of what the locals made. The overhead cost incurred by foreign banks is thrice what local banks reported on average thus it could be argued that foreign subsidiaries are likely to be equally or more profitable than locals (Table 2.2). The lending and deposit rates for foreign Uganda banks were comparatively lower. In the East African Region, the foreign banks have greater market power in Kenya and Uganda, while locals in Rwanda and Tanzania (Table 2.2). Private domestic EAC banks with subsidiaries on the EAC countries make more profit at 6 percent with less over heads compared to private domestic EAC banks without subsidiaries in EAC with a profit of 1.8 percent and overheads 8.6. The implication is here is there is a strong correlation between cross-border banking activities in the EAC as banks Foreign subsidiaries with banks in EAC posted a profit of 0.9 percent though with a higher overhead. The foreign subsidiaries with banks out of EAC recorded loss of 2 percent and high overhead of 10.9 percent (Figure 2.17). Lastly, the regulations for foreign bank entry are unharmonized and could be inhibitive for some countries such as Rwanda, Burundi and Tanzania (Table 2.3).



## **CHAPTER THREE**

### **INTERNATIONALIZATION OF BANKING IN KENYA: STRATEGIES, CONTEXT AND IMPACT**

#### **3.1. Introduction**

The section presents the contextualized case of Internationalization of Banking in Kenya focusing on three major banks Kenya Commercial Banks, Equity Bank and Cooperative Bank that have internationalized in the region. The study has also benchmark with the performance of West African subsidiaries in Kenya and East Africa at large.

#### **3.2. Kenya Financial Sector Overview and Profile**

Kenyan economic growth marked its peaked growth in the period spanning 2004 and 2007 where nearly every year the real GDP growth was estimated at an average of 6 percent annually. However, this systematic growth slumped to 1.6 percent in 2008 attributed to Kenya's Post-Election Violence (PEV) in the same year (Figure 3.1). The global credit crunch followed by inflation in food and fuel prices, prolonged drought, decline in tourism receipts, remittance and foreign direct investments and private flow reduction led to hyperinflation from 4.3 percent in 2007 to 16.2 percent in 2008 and later culminating at 31.5 percent at the beginning of 2009.

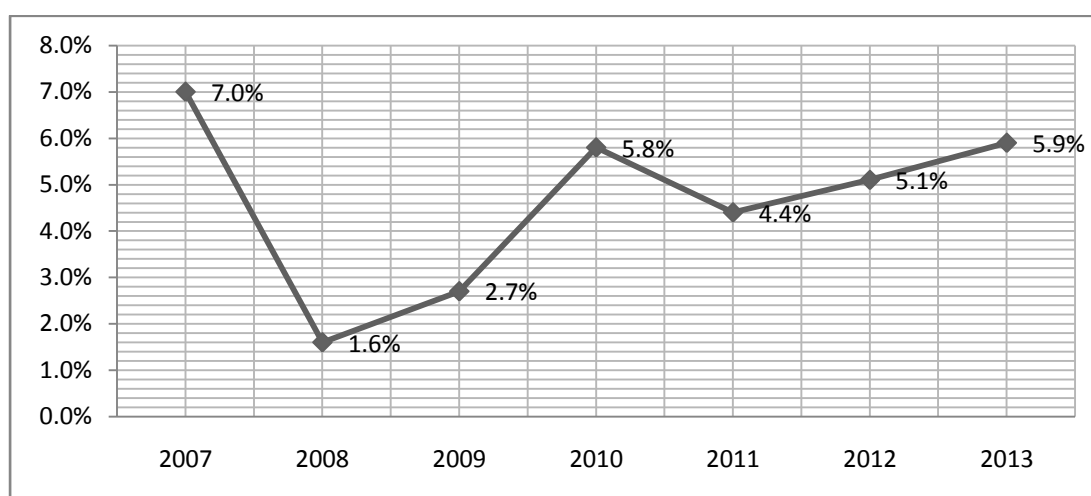
Through a series of economic and policy interventions, Kenya was able to reduce public debt and adopt malleable fiscal policies that enabled the domestic demand to be sustained even though the economic growth was slow. Banking supervision was strengthened and this ensured that banks were adequately capitalized and non-performing provisions buffered. In 2009, Kenyan economy reported growth from 1.6 percent to 2.7 percent and the inflation contained at 9.3 percent (Figure 3.1). This was majorly aided by falling import prices, rising domestic consumption and a normalization of food supply and transport and communication sectors<sup>34</sup>. In 2010,

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<sup>34</sup> Kenya Economic Survey report 2011

Kenya's GDP reported an increase of 5.8 percent. In 2011, however there was a slight slump and economic growth was estimated at 4.4 percent which supportive sectors being financial services and intermediation, tourism, construction and agriculture. In the years 2012 and 2013, economic growths registered were 5.1 percent and 5.9 percent respectively.<sup>35</sup>

Figure 3.1 presents the trend of Kenya GDP growth since 2007.



**Figure 3.19: Trend on Kenya's GDP growth 2007-2015**

Source: Computed from Central Bank of Kenya Statistics; Kenya Economic Reports 2012, 2013, 2014

Kenya's financial system is well supervised and regulated<sup>36</sup>. Her banking regulatory framework got a boost by the creation of the first credit-reference bureau in 2010 which has seen the uptake of credit blossom though it is still far from reaching its potential in supporting the allocation of economic resources and championing equality across the country. The banking figures as at December 2011, there were 43 banks with over 1,100 branches and 2,200 automated teller machines operated across the country<sup>37</sup>. The better performance of Kenyan banks was maintained by the proactive supervision by the Central Bank of Kenya which is sensitive to any shock waves.

<sup>35</sup> Extracted from the Economic Reports 2013-14 popular version

<sup>36</sup> CBK NjugunaNdungu's speech in Arusha on the EAMU conference (2014)

<sup>37</sup> Banking in Kenya (October, 2012): Introduction to Banking Industry in Kenya; available on <http://bankinRinkenya.com/banking-ke.nva> (accessed on September 05, 2015).

Internal banking policies have been tightened especially for appraising credit facilities and stricter monitoring of credit portfolio. Some banks have been keen on use of foreign banks and reviewed their relationships with foreign banks to reduce economic vulnerability occasioned by foreign exchange rate shocks. The banking sector in Kenya improved its non-performing loans indices by decreasing staggering 10.9 percent in 2007 to 5.4 percent in 2011.

Kenyan financial sector seem to be emerging with non-formal banking institutions such as Savings and Cooperative Societies (SACCOs), microfinance institutions (MFIs) and Kenya Post Office Savings Banking offering deposit and lending services particularly targeting unreached or neglected segments of the society<sup>38</sup>. This has deepened financial services to the rural and even informal settlements that were previously ignored by the conventional banks because of risks involved. This necessitated the enactment of the Microfinance Act of 2008 to improve regulation, supervision and licensing of the MFIs. Many banks have innovatively adopted the agency banking model which has reduced the cost of set up new branching and extended banking operations beyond conventional hours.

Kenya is recognized as a trailblazer in mobile banking. The remarkable M-Pesa platform and now Airtel Money and Equitel, the banking fortunes have been changes as there inter-linkage between the mobile platforms allows of money transfer, cash-flow management among other banking options<sup>39</sup>. Internet banking is part of

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<sup>38</sup>Ecobank research on the status and Kenyan banks financial performance in EAC region

<sup>39</sup>EAC (2014) report on Financial sector development and regionalization project (FSDRP) 1 Mobile and agency banking in the EAC countries: a diagnostic analysis

innovative trends that Kenya, it ensures improved access to banking services. Currently, more than 80 percent adult mobile phone subscribers use mobile money platform for banking, accessing loans and even paying bills.

Finally, the money market in Kenya is very kinetic as exhibited with nearly 44 banks participating in interbank money market, and is characterized by 30 unit trusts operated by the commercial banks and now Kenya Shilling Money Market Funds offered by various insurances companies and assurance agencies, investment banks and fund managers. The overnight market further intensifies the interbank activity as the 91-day Treasury bill remains predominantly used in benchmarking. With regard to fixed income market, Kenya's performance is sterling with 70 percent dedicated for Treasury bonds and bills and remainder 30 percent for domestic debt financing. Remarkable, Kenya sovereign ratings stood at B+ as of March 2013(Fitch and Standard and Poor's)<sup>40</sup>.

### **3.3. Comparing Kenya and Regional Banking Forecast**

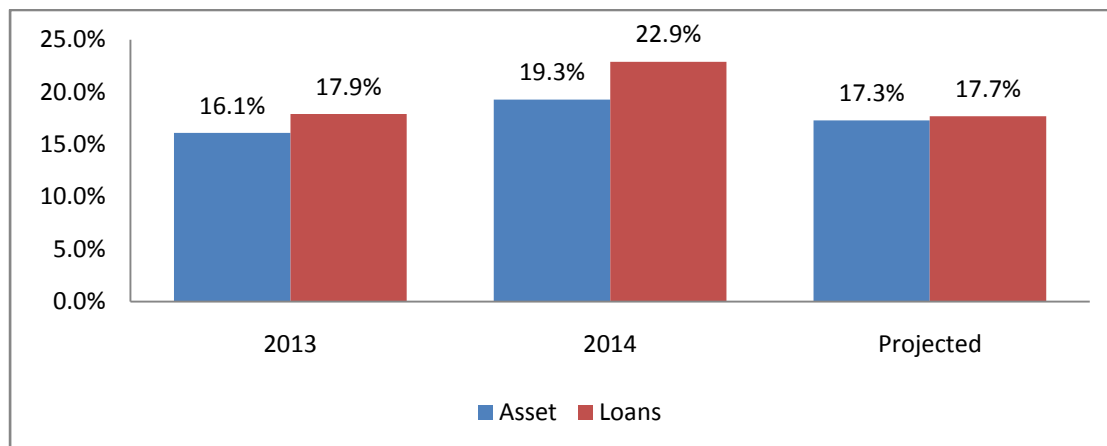
Kenya's banking asset and loan growth is projected to increase for a number years coming. Comparatively, only South Africa, Namibia, Mozambique and Mauritius (an offshore banking hub) banks have more shares. In 2015, the projected banking assets in Kenya will be about 70% from current 62 percent recorded in 2014. The demand for financial services has led to growth of 19.3% on asset in 2014 up from 16.1% in 2013 while client loans increased by 22.9% in 2014 up from 17.9%(figure 3.2). An annual increment of 6.3 percent of banking performance is predicted for 2015-17. On aggregate, aggregate it is expected that asset growth will be estimated at 17.3 percent and growing client loans is estimated at annual average of 17.7 %of GDP than Kenya,

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<sup>40</sup> Governor of CBK speech on the launch of Kenya Bank Reference Rate (KBRR) in 2014

there is greater room for improvement through deepened mobile financial services and potential regional expansions opportunities<sup>41</sup>.

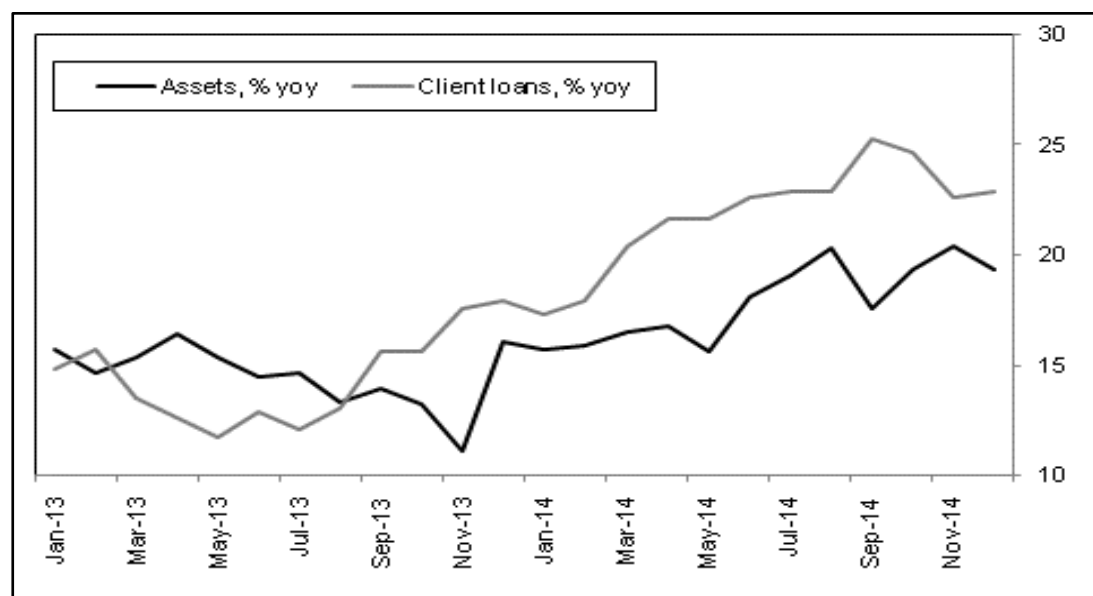
Figure 3.2 presents the projections of Kenyan banks assets and Loans growth.



**Figure 3.20: Projection of Kenyan Banks Assets and Loan Portfolio**

Source: Kenya Banking Sector Report, 2015.

Figure 3.2b presents the trend for Kenya asset and loans growth between 2013 and 2014. The period spanning 2013-2014, there has been steady increase in the loan book portfolio representing good tidings for the banking sector.



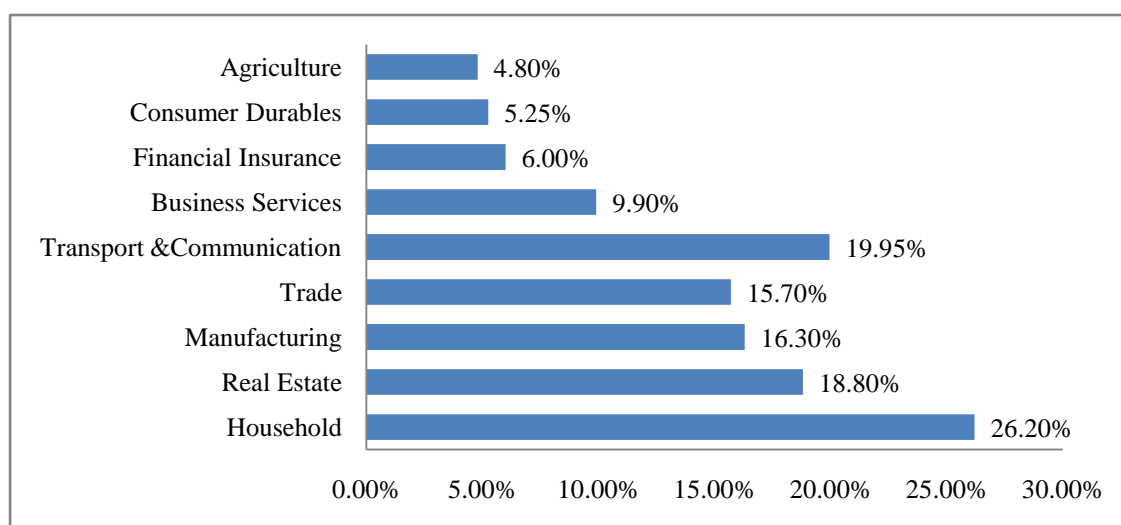
**Figure 3.21b: Kenya-Assets and Loans, % YoY**

Source: Kenya Banking Sector Report, 2015

<sup>41</sup>EAC (2014) report on Financial sector development and regionalization project (FSDRP) 1 Mobile and agency banking in the EAC countries: a diagnostic analysis

Kenya Banking Sector Report (2014) indicated that the loan growth was propelled by the expanded demand in various economic sectors. The distributed credit in 2014 was distributed as households (26.2%), real estate (18.8%), manufacturing (16.3%), trade (15.7%), transport and communication (11.95%), business services (9.9%), finance and insurance (6.0%), consumer durables (5.25%) and finally agriculture at 4.8% (figure 3.3).

Figure 3.3 presents economic sectors contribution to banking growth.

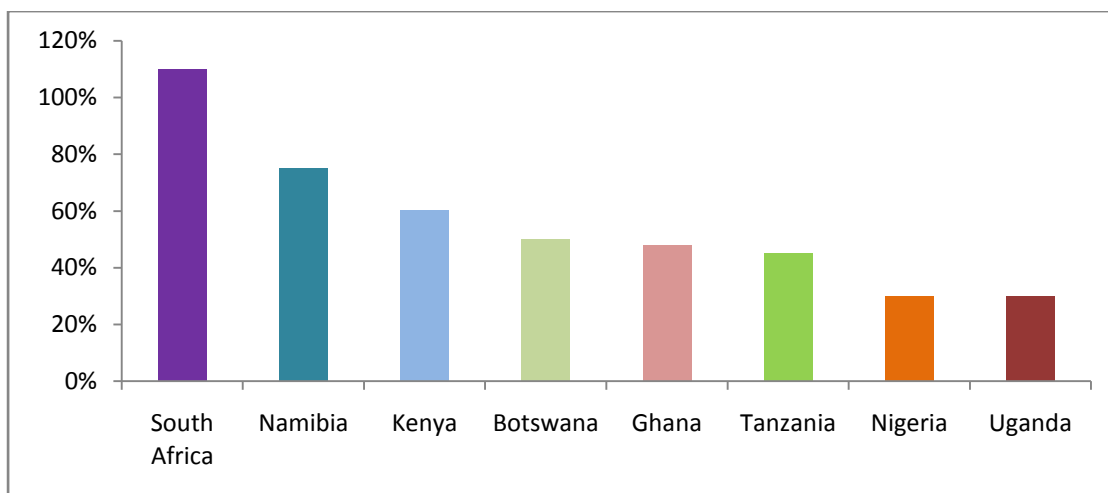


**Figure 3.22: Economic Sectors Contribution to Loan Growth in Banks**

Source: Kenya Banking Sector Report, 2015

Figure 3.3 compares commercial banking assets to Sub-Saharan African banks as percent of GDP, Kenya ranks third after South Africa and Namibia in the sampled selection. The other East African countries lag behind perhaps explaining why Kenyan banks are setting about subsidiaries in EAC. The West African counterparts are not favourably competing with Kenya and this could explain the interest of their banks in Kenyan and EAC market (Figure 3.4).

The figure below presents the total assets per country selected as a percentage of their Gross Domestic Product (GDP) at March 2015.



**Figure 3.23: SSA-Commercial Banking Assets, % of GDP**

Source: Kenya Banking Sector Report, 2015

Two critical factors explain the growth in asset base and profitability of Kenyan financial system. The emergence of Mobile phone technology, the Safaricom M-Pesa, has led money flowing estimated at 40 percent of the Country's GDP. Communication technology investment in Kenya far outstrips the aggregate regional totals. Mobile money services is threatens to outstrip the banking sector of the low income Kenyan's gradually thereby creating competition which has spark innovation among banks. The involvement of Kenya banks in cross-border is another factor that has improved the banking sector. There are 5 big Kenyan with subsidiaries and branches across EAC states and now South Sudan with Kenya Commercial Bank leading the park.

Table 3.1 presents the banking stocks through peer comparison of banks.

**Table 3.1: Banking Stocks-Peer comparison**

	<b>P/E (x)</b>	<b>P/B (x)</b>	<b>Dvd Yield (%)</b>	<b>ROA %</b>	<b>ROE%</b>	<b>FY 13 Efficiency Ratio</b>
KCB	8.57	2.22	4.23	3.78	24.38	45.79
Coop Bank	7.75	2.05	2.82	4.27	28.21	63.40
Equity Bank	8.43	2.95	3.98	3.89	24.61	52.99
Barclays Bank	10.42	2.2	4.88	5.09	28.11	56.08
StanChart	10.79	1.17	1.92	7.87	17.53	51.90
NBK	11.16	1	1.15	1.39	9.96	72.57
NIC	7.48	1.89	1.25	2.89	20.57	40.47
DTB	8.68	2.01	1.09	3.15	25.39	42.52
Average	9.173	1.9363	2.665	4.041	22.358	53.215

Source: Kenya Sector Outlook 2015

Results on table 3.1 show that the dividend yields for the three case banks of KCB, Coop bank, and Equity bank are higher than the other banks except Barclays bank. The return on assets (ROA) for the three banks is higher than all the indigenous banks except for non-African foreign subsidiaries. Rating of KCB, Coop Bank and Equity bank for return on equity is high and comparable to non-African Subsidiaries. NIC bank and Diamond Trust Bank (DTB) are the most efficient banks. Of the case study banks, KCB is the most efficient, followed by Equity and Coop bank at a distant. Of the three, it is only Coop bank that has an efficiency rating less than the average. It should therefore be concluded that banks with strong presence regionally in terms of the subsidiaries are more likely to be efficient compared to the others. The efficiency of NIC bank and DTB further corroborated this evidence.

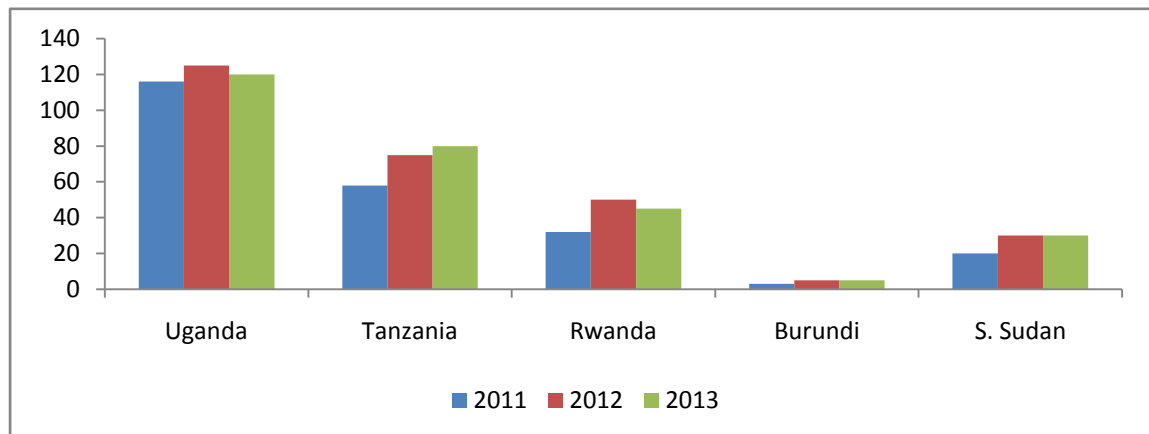
#### **3.4. Cross-Border Expansion of Kenyan Banks into EAC Trade Bloc**

Kenya continues to dominate the EAC market with its indigenous banks being investing more in other countries compared to their EAC counterparts. KCB, one of the leading financial institutions in Kenya, was the first EAC indigenous bank to enter the Tanzanian market in 1997. Today the bank boasts of over 288 branches in the EAC and now extended up to South Sudan. The common strategic methodology used



by even the other 2 Kenyan banks (Equity and Cooperative banks) under study was expansion through subsidiaries. The expansion has been extended to Common Market for East and Southern Africa (COMESA) trading bloc which includes DR Congo, Ethiopia, Malawi, Zambia, and with a planned extension to Somalia and its semi-autonomous region of Somaliland.

Figure 3.5 presents the distribution of Kenya’s branching network.



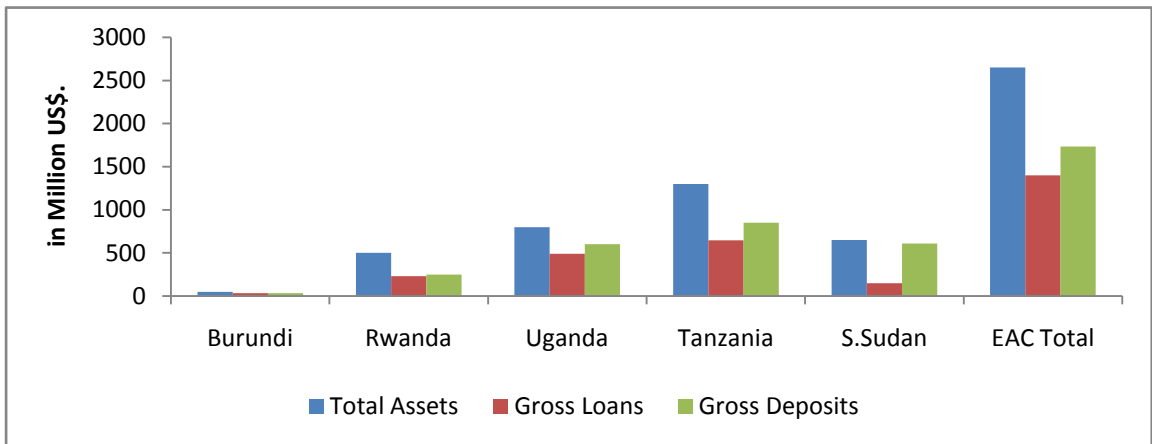
**Figure 3.24: Kenyan Subsidiaries Branch Network in EAC**

Source: Compiled from Central Bank of Kenya Statistics

Cross-border expansion of Kenyan banks into EAC and beyond has been market driven. The follow-the-customer approach is common with 3 case Kenyan banks to strategically to tap into agricultural commodities, manufactured products, retail trade and now labour force markets across the region. Diversification risks and capitalizing on opportunities for maximization of profits in unexplored, unreached and potentially emerging markets such as South Sudan is a potential fodder for increasing banking services. The performance of Kenya’s transnational bank assets is said to have appreciated by more than 35 percent each year on average since 2011. Cross-border banking activities for Kenyan banks account for nearly 10-12 percent of the total banking operations in terms of assets, loans, and deposits (Figure 3.7). It must however be noted that the move was not as rosy as eight subsidiaries in four countries

registered losses in the first years of expanded operations in markets showing intermediate penetration such as Uganda and initial capital outlay used.

Figure 3.6 presents the proportion of Kenya’s bank Subsidiaries activities across EAC in million US\$.as at 2012.

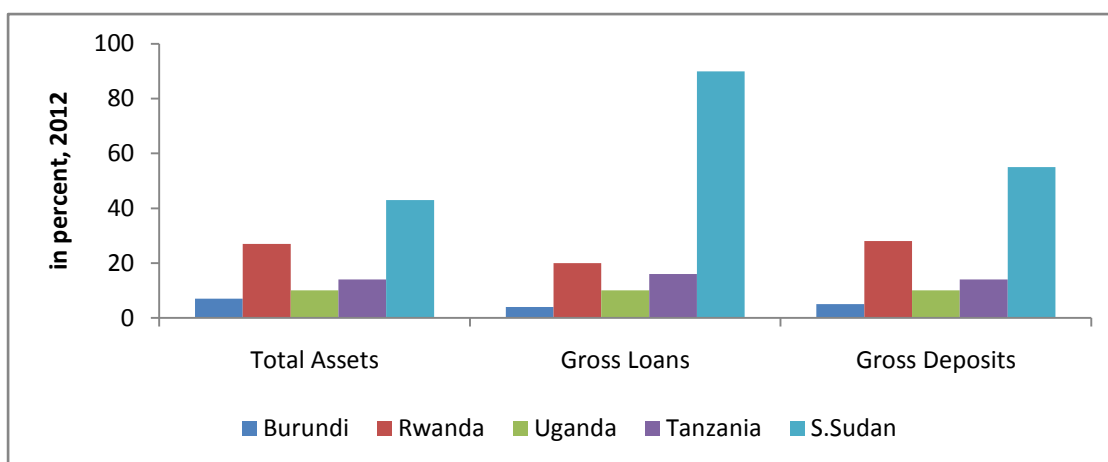


**Figure 3.25: Kenya Banks Activities in EAC and S.Sudan in 2012**

Source: Compiled from Central Bank of Kenya Statistics

The competition in the EAC market for banking services favours Kenyan banks as the other countries have less developed and capitalized banking system. Kenyan banks control 45 percent stake on aggregate of South Sudan banking assets while in Rwanda they control nearly 30 percent which is higher than the Nigerian and South African banks that operate in 9 and 25 countries respectively with an averaged share of 10 percent in banking assets in each of the market destinations.

Figure 3.7 presents the proportion of shares in host economies’ financial system.



**Figure 3.26: Kenyan Banks' Shares in Host Economies Financial System in 2012**  
Source: Adopted from EAC authorities and IMF staff reports (2015)

### 3.5. Kenyan Cross-Border Regulation and Supervision

The role of Central Bank of Kenya (CBK) cannot in fostering strong monitoring and regulatory framework cannot be ignored. CBK works with other regional regulators to improve surveillance of Kenya's transnational banks. To strengthen its institutional role, CBK has established supervisory colleges for KCB, Equity Bank, and Diamond Trust Bank to conduct joint supervisions. The CBK planned to establish some 2 more supervisory colleges in 2014. A number of Memoranda of Understanding have been set to with regulatory authorities in EAC countries, South Africa, Nigeria, and Mauritius to promote supervisory cooperation.

The CBK is leading the path in development of regulatory and supervisory policies for countries in EAC for instance the ratification of the East African Monetary Union (EAMU) Protocol set a clear stage for championing policy, legal and institutional framework single currency area to facilitate trade. The proposed institutions are creation of East African Monetary Institute to undertake preparatory work for the EAMU; the East African Surveillance, Compliance and Enforcement Commission; the East African Statistics Bureau and the East African Financial Services Commission. All this 4 fundamental institutions are supposed to be established

between 2015 and 2018. The milestones towards EAC economic integration were marked as attaining of Macro-Economic Convergence (by 2021), harmonization of Monetary and Exchange (by 2022) and Introduction of the Single Currency (by 2024). This milestone will improve cross-border trade and particularly banking as the losses associated with currency conversions will be reduced significantly.

To achieve the desired harmonization and improving the supervisory and regulatory framework, the EAC Central banks unanimously endorsed to be guided by international standard setting bodies such as the Basel Committee on Banking Supervision (BCBS), Financial Stability Board (FSB) and Financial Action Task Force (FATF) pronouncements to benchmark and guide the exercise. Areas of harmonization for the supervisory and regulatory rules proposed include: the legal status of licensed entities, licensing requirements, licence validity, prudential requirements on capital and liquidity, corporate governance requirements, permissible activities, prudential returns and public disclosures. The benefits attached this development is that product diversification, market size and strengthening of Kenyan banks will be guaranteed once the stipulated developments are explored. EAC central banks have introduced the East African Payment System (EAPS) meant to reduce the cost of doing business. These initiatives to integrate the EAC region are facilitative of cross-border banking<sup>42</sup>.

Another milestone in supervisory function of banking activity is the work done with the Kenya Bankers association to improve the transparency of pricing of banking services. Kenya has developed a reference interest rate called KBRR (Kenya Banks Reference Rate) that averages the CBR and the 91-Treasury bill which is considered a risk free return on asset indicator which is meant to boost investor confidence. It is

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<sup>42</sup>Pan-African Banks : Opportunities and challenges for cross-border oversight / prepared by a staff team led by Charles Enoch ... [et al.]. – Washington, D.C. : International Monetary Fund, 2015.

important to note that on 23<sup>rd</sup> June, 2014 Kenya was upgraded by the global standard setting body, the FATF (Financial Action Task Force) from 'Dark Grey List' to 'Grey List' on its Anti-Money Laundering/Combating the Financing of Terrorism (AML/CFT) Regime. Kenya's AML/CFT law was found wanting in 2011 and has since been amended which created Terrorist Financing Law and the established the Financial Reporting Centre. This milestone was meant to improve the correspondence banking facilities coordination, enhanced negotiation tool for competitive rates for international credit line and more fundamentally, is the positively enhanced credit and risk ratings for the country.

Regulating Kenyan banks in other countries has had a fair share of challenges. With Kenyan banks having about 282 branches in the region, this has a direct impact and accompanying regulatory and supervisory challenges. When financial markets are integrated then negative externalities of any bank failure is directly transmitted to subsidiaries beyond borders which are usually ignored by central banks and national supervisors. In some case close cooperation has worked to internalize the cross-border externalities though precautionary measures should be taken so that the aim is to strengthening response to such externalities but as remain sensitive to the heterogeneity of countries' legal and regulatory framework. The interventions taken by Kenyan authorities include the introduction of Country and Transfer Risk, Risk-based Supervision and Consolidated Supervision guidelines that are not only timely but also instrumental in mitigating cross-border Kenyan banks risks. Continentally, African bankers have established a Committee of African Bank Supervisors as a component in the African Association of Central Banks which is meant to further deepen African cooperation through shared informal exchange information and experiences and networking avenues.

Two major challenges are envisioned in increasing regulatory cooperation. Firstly, benchmarking with Eurozone experience without focus on proper resolution mechanism planning then the MOUs will remain non-binding and the College Supervisors will be relegated to a networking club that cannot resolve issues in brink of bank failure. Secondly, strategic focus should be on the development benefits accrued from foreign banks with considering to be a source of banking sector vulnerability. Positive mentality of success must be inculcated to rededicate for on economic development and sustainability of livelihoods for the populace.

### **3.6. Kenya's Case Study Banks and Internationalization of Banking**

#### **3.6.1. Kenya Commercial Bank**

Kenya Commercial Bank (KCB) is a bank incorporated in Kenya that the government has substantial amount of shares. Previously the bank was wholly owned by the government. The bank has 2 models of internationalization of banking applied simultaneously. The bank practices diaspora banking that attracts Kenya professionals who work abroad but with interests at home. The other model is having semi-autonomously operated banks in Rwanda, Tanzania and Uganda (EAC bloc) and now. It was the first Kenyan indigenous bank to go international in 1997. The aim for internationalization was to expand capital base and target new markets. KCB is among Kenya's oldest bank nearly half a century but just strengthen its internationalization activities 7 years ago.

The results of KCB for the year 2012 were expressed during the period of anticipated political contest in Kenya and the economic recession that had been compounded globally for the banking industry. The KCB group posted an increased profit of 14 percent in profits standing at Ksh.17.2 billion in 2012 compared to Ksh.15.1 billion in 2013.

The perception of the KCB is that the expansion to the East African is timely as the markets have remained vibrant despite the credit crunch that has been experienced in other African regions. For instance, in 2012 Kenya's GDP growth was diminished to 3.5 percent lower than 4.4 percent experienced in the previous year 2011. This was not any different from Uganda that reported 3.4 percent economic growth in the same period against 5 percent they had in 2011. The whole drop was blamed on inflationary pressures associated with foreign exchange market and poor climatic conditions hampering production, raised power generation costs, and consequently raised manufacturing of goods. Rwanda's economic growth was equally not spared with a slight decline of 0.9 percent between 2011 (8.6 percent) and 2012 (7.7 percent). In the Rwandese case the problem was diminished foreign direct investment (FDI), cuts on foreign aid from principal donors and the brunt of poor climatic conditions. The region however had countries such as Southern Sudan, Burundi and Tanzania with exemplary performance in 2012. The GDP performance were Tanzania 6.9 percent compared to 6.3 percent in 2011 while Burundi has GDP rise 4.8 percent compared 3.9 percent in 2011. In this case the improved growth in agriculture, transport and communication sector reinforced Tanzania performance while the growth in Burundi was attributed to improvements in agriculture earnings and increased construction endeavours.

**Table 3.2: KCB Subsidiaries Contribution to Pre-tax Profit**

YEARS	GROUP Ksh (Bn)	KENYA Ksh (Bn)	SUBSIDIARIES Ksh (Bn)	SUBSIDIARIES CONTRIBUTION %
2008	6.0	5.4	0.6	10%
2009	6.4	6.4	-0.1	-16%
2010	11.5	11.5	-1.8	-15.7%
2011	15.1	14.1	1.0	6.6%
2012	17.2	15.8	1.4	8.1%
2013	20.1	17.7	2.4	11.9%
2014	23.8	22.4	1.4	5.9%

Source: Compiled from Various annual reports of KCB

The contribution of subsidiary to KCB group performance has been laudable and except for losses made 2009 and 2010 which should be attributed to global financial crisis. Each year since 2011, the subsidiaries have been contributing at least 6 percent of the total banking performance (table 3.2).

### **3.6.2. Equity Bank Kenya**

The Equity bank is a champion of micro-financial model of banking. Targets lower segment of customers and businesses for financial inclusion and the motivation for internationalization was regional diversification and replication of micro-finance and financial inclusion for communities. Equity Bank has internationalised in Democratic Republic of Congo, Ethiopia, Rwanda, Tanzania and Uganda. In the case of Uganda and DRC, the strategy was acquisitions of local banks which operate as subsidiaries but are controlled from Kenya. Some of the challenging factors are political interference and stringent regulatory guidelines. The bank has a dedicated department for diaspora banking targeting Kenya professionals in other countries with interest in the country or who want remit or do savings. The bank has diaspora agents in several countries: USA (13), Canada (2), United Kingdom (2), South Africa (2), Australia (1), United Arab Emirates (2), and Germany (1).

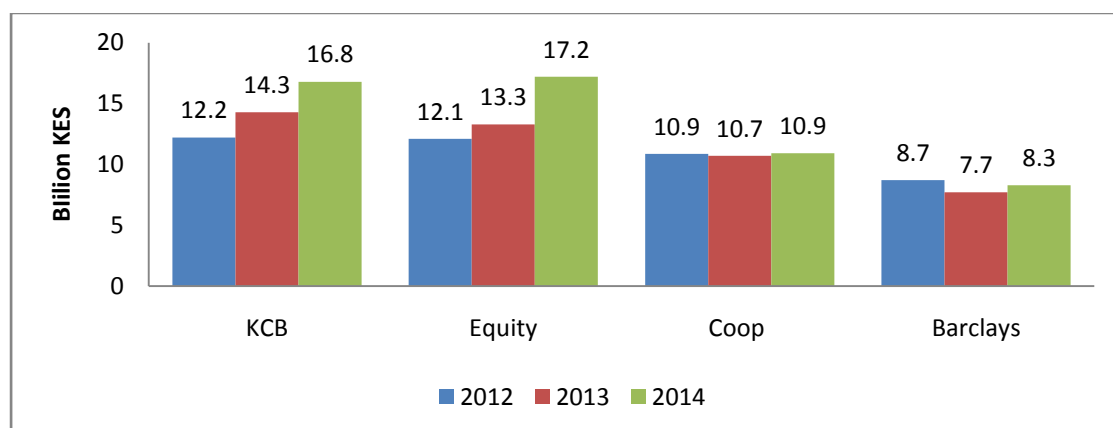
The performance for Equity Bank was impacting as it enabled them to truce Equity for the first times from the position of most profitable bank. In 2014, Equity Bank



posted a Ksh.17.15 billion profit which was 27.8 percent improvement of the results of 2013 at Ksh.13.42 billion. Comparatively, KCB had posted Ksh.16.8 billion net profits after tax in the same period representing an increase of 17.4 percent compared to Ksh.14.3 billion reported in 2013. The leap of Equity Bank was attributed to offloading their share stake (24.7 percent) in other mortgage lender company amounting to Ksh.2.8 billion and gained Ksh.1 billion in overall profit. KCB had however remained a top lender replacing Barclays bank as the most successful bank since 2011 with a net profit of Ksh.10.9 billion. The findings further show that the Equity Bank interest income had appreciated by 10.9 percent to 35.3 billion indicative of an estimated loan book of about Ksh. 214 billion.

The Equity Group CEO lauded the contribution of Equity’s subsidiary in Uganda and Tanzania for their impacting contribution to the bank’s performance and expressed the banks wish to reinforce their regional expansion through subsidiaries in the respective targeted markets. Findings show that this shift in profitability ranking has tilted the balance sheets in the last 10 years and this has enable KCB and Equity Bank to internationalize or expand regionally KCB and Equity Bank are distinctively the fastest growing banks and are trailblazers in regional expansion, with the aim of reducing over reliance on the Kenyan market.

The sample of Kenyan banks competition in the last 5 years.



### **Figure 3.27: Comparative Performance of Kenya**

Source: Business Daily (2015)

Barclays Bank Kenya has been introduced as a foreign subsidiary that has compares well with Kenyan banks in terms of capital base. Barclays Bank Kenya is however constrained as it cannot to move to the neighbouring countries to compete with the indigenous Kenyan banks as there are already other counterpart subsidiaries within the Barclays Africa Group. This challenge is real for English based foreign banks like Standard Bank as well which cannot go regional as their London-based parents already had established subsidiaries in the target East African markets. This further exemplifies how the role of cross-border banking on profitability of banks.

#### **3.6.3. Cooperative Bank of Kenya (Coop Bank)**

Kenyan based bank that is oriented on group or cooperative saving model. The bank is among the oldest having been incorporated in 1967. Has large corporate client base from mainly SACCOs and producer cooperative societies. The bank has a dual approach to internationalised banking. The bank has a subsidiary in South Sudan, was incorporated as an independent bank for reconstruction of newly independent nation, help in creating of cooperatives and revamp agricultural and productive sectors. The Coop bank has a variety of products targeting Kenyans in diaspora. The bank a dedicated department on diaspora banking for Kenya professionals leaving in diaspora with interest in the country which relies on technology and wire transfers.

Findings show that Coop bank has strategically positioned itself to harness the beaming potential of 67 percent Kenyans with formal access to financially services and deepen their reach in Southern Sudan. The Southern Sudan subsidiary is expected to tap the niche agribusiness market FOREX business and the benefits of SMEs funds. The performance of Cooperative Bank of Kenya was laudable with pre-

tax profit of 10.87 for the group in 2013 up from 9.98 in 2012 representing 9 percent increase. Findings show that the customer deposits appreciated by 11 percent moving from Ksh.162.3 billion for 2012 to Ksh.180.9 billion in 2013. Coop bank growth was attributed to increased client base of over 4.1 million new accounts including the Southern Sudan subsidiaries.

**Table 3.3: Co-operative Bank Subsidiary Contribution**

YEARS	GROUP	KENYA Ksh (Bn)	SUBSIDIARIES Ksh (Bn)	SUBSIDIARIES CONTRIBUTION %
2012	10.87	9.57	1.3	11.96%
2013	10.71	9.98	0.73	6.82%
2014	10.92	11.17	-0.25	-2.29%
2015*	8.69	8.40	0.49	5.64%

Source: Compiled from Cooperative financial reports

### **3.6.4. Eco-Bank Group Performance as a Benchmark**

Ecobank is a Togolese oriented bank with a branch network spanning West Africa, Central Africa and now East Africa. The bank acquired a building society in 2009 but has struggled to anchor itself well and be profitable as in other countries. It is the classical example of Pan-African bank as the network could just be considered 3 or 2 to Egyptian and South African incorporated banks. The Ecobank bank has clustered its operations into 7 geographical regions: six within Africa and a network of other 4 international offices (Paris, London, Dubai, and Beijing). The group has majority equity interests with its subsidiaries and provides them with management, operational, technical, and training, business development and advisory services.

The Ecobank bank posted different results for the parent company and the subsidiary. The Ecobank Transnational group CEO in his acknowledgement of the performance in 2013 for the bank and its subsidiaries was elated with the revenues of the bank having surpassed US\$.2 billion which accounted for 16 percent growth. In his comments, he was very enthusiastic of the growth displayed by their diversification

strategy as the cost-to-income ratio was reported improved in the 6 geographical regions they operate. Ecobank’s balance sheet showed strong growth with customer deposits having appreciated by double digits and net customer loans was reported increased by 20 percent. The group CEO attributed their sterling group performance in 2013 to increased impairment provisions where the results are announced after payment of taxes to reflect true position.

In the subsequent year 2014, the Ecobank bank group CEO commented while releasing of 2014 results. He sustained his belief in Ecobank’s diversified business model and lauded the contribution of customers in the Middle Africa. The loan book grew by US\$.890 million representing 8 percent while the deposits grew \$947 million representing 6 percent despite a strong dollar against many functional currencies. The revenue growth was 14 percent up from what was reported in 2013. Other improvement areas for Ecobank that directly affect efficiency were operating expenses that increased by 6 percent, cost-income ratio (CIR) improved to 65.4 percent compared to 70.1 percent reported in 2013. Even though the East Africa market has managed to reduce the operating loss marginally in 2013, the strategic challenges persist. The Ecobank has been strengthened by have direct investment of US\$.25 million of additional capital into Kenyan subsidiary.

**Table 3.5: Eco-Bank Group Financial Performance for 2013& 2014**

2013	2014
-Revenues up 16% to \$2.0 Billion	-Revenues up 14% to \$2.3 Billion
-Profit before tax down 34% to \$221.8M	-Profit before tax up 134% to \$519.5M
-Profit after tax down 48% to \$147.8M	-Profit after tax down 167% to \$394.8M
-Total assets up 13% to \$22.5Billion	-Total assets up 8% to \$24.2Billion
-Total Equity Down 2% to \$2.1Billion	-Total Equity Down 24% to \$2.7Billion

Source: Eco-Bank Group East Africa Financial Statement 2013 and 2014

### 3.7. Comparing the Three Case Banks Strategies for Internationalization

The following shows the different approaches taken by three case banks. Based on the comparison, the Kenya case study banks enter foreign markets in different ways. Each bank has strived to uniquely position itself to either improve its efficiency or reduce of the costs. KCB has developed subsidiaries where it struggles to promote indigenization of the banking platform through creation of semi-autonomy for its subsidiaries. Coop Bank approach is heavy reliance on technology to tap into diaspora remittances and the Kenyan clients in overseas countries. The entry of Cooperative bank in South Sudan was revolutionary as it strived to trigger investment and as well broker “peace” that will assist the war torn country to develop cooperatives and work on sustainable livelihood.

The table 3.6 compares the strategies used by Kenyan Banks for internationalizations.

**Table 3.6: Comparative Analysis of Internationalization Strategies of Kenya Banks**

<b>KCB</b>	<b>Equity Bank</b>	<b>Cooperative Bank</b>
<ul style="list-style-type: none"> <li>-Initially started branching in Tanzania.</li> <li>-Adopted subsidiary model for EAC countries and S.Sudan.</li> <li>-Acquisition in where the bank failed to break-even like in the Ugandan scenario.</li> <li>-Follow the customer model as is exhibited the range of products they provide.</li> <li>-Indigenization approach like in the case KCB Rwanda which exclusively semi-autonomous. This has been facilitated by public-private partnerships.</li> <li>-Diaspora banking model is with KCB with Kenya Bank SACCO developed in UK to facilitate joint investments.</li> </ul>	<ul style="list-style-type: none"> <li>-Started with subsidiaries;</li> <li>-Has adopted acquisition for the case of DRC;</li> <li>-Effective in Diaspora Agency banking model;</li> <li>-Diaspora customers highly segmented into their needs like education, investment, mortgages, remittance, and current accounts for business transactions.</li> <li>-Sensitive to Foreign currency models and has allowed EAC to use the home country currencies.</li> </ul>	<ul style="list-style-type: none"> <li>-Diaspora banking model;</li> <li>-Cooperation/collaboration with State actors to establish Coop Bank of South Sudan;</li> <li>-Sell their cooperative approach model;</li> <li>-Diaspora customers highly segmented into their needs like education, investment, mortgages, remittance, and current accounts for business transactions.</li> <li>-Heavy reliance on information technology for diaspora banking;</li> <li>-Encourages the group model and therefore has a diaspora SACCO developed.</li> </ul>

Source: Compiled by the Researcher (2015)

The KCB and Equity's entry in South Sudan was based on follow the customer model. Equity bank has been effective in developing agencies in diaspora and in the EAC; a strategy has been replicated by the other two banks. The strategy for foreign entry is mixed for the banks; KCB applies both Greenfield as evidenced in South Sudan, Tanzania and Rwanda, while in Uganda the attempted acquisition which does not go by the bank's parent name KCB. The Equity bank has acquired other banks in DRC and Uganda while Tanzania it was through agency banking. In Rwanda and South Sudan, the entry is Greenfield for Equity. The Cooperative bank's main subsidiary in South Sudan was adopted the inter-governmental perspective (networking model) where the costs were shared strategically between government of South Sudan and Cooperative Bank of Kenya. Lastly, the banks through their diaspora banking division have established SACCOs to ensure sustainability and through this SACCOs the clients are assisted on investment back home in Kenya. KCB is affiliated to Kenya SACCO while Coop Bank has a SACCO too based in United States saving people in Canada and United States.

### **3.8. Chapter Summary**

The GDP for Kenya has been on great growth trajectory since 2011 (Figure 3.1). Growth in financial sector in Kenya is driven by innovation and market forces. To remain competitive most banks have formed agencies to compete with MFIs, SACCOs, and Mobile Money Transfer. Loan book has grown and the asset is appreciating exponentially (Figure 3.2 and Figure 3.3). Comparative analysis for Kenya with other countries in SSA in terms banking assets as percentage of GDP, Kenya is ranked third after S.A and Namibia recording estimated 60 percent. Performance of the three Kenya case banks (KCB, Equity, and Equity) is higher in dividend advanced, ROA, and ROA compared to the national average and other banks

(Table 3.2). This explains a strong association between internationalization of banking services and financial performance. Kenyan banks have a strong presence in Uganda, Tanzania and Rwanda based on number of branches though limited in Burundi (Figure 3.5). Growth in Assets is high in EAC and all EAC countries based on increasing rate of deposits (Figure 3.6). The proportion of Kenyan banks as a share of host economies financial system is comparatively higher (figure 3.7). Regulations in Kenyan banks are a bit flexible with the capital requirement lower than all other countries (table 2.3). Kenya is making great strides in improving regulations. There is a Kenya Banks Reference Rate for interests. It's the average of Central Bank Reference and 91 day Treasury bill rate. There are challenges in supervision for Kenya as a home country with the 282 branches of Kenya bank's subsidiary across EAC. Contribution of subsidiaries to profitability has been positive at least for the last 3 years (Table 3.3 and 3.4). For 2012, 2013, and 2014 performance of the three case study banks has been increasing and high compared to Barclays Bank Kenya. The entry strategies to internationalization of bank differ by bank and dependent on company strategy. It is worth noting that internationalization of the case banks is highly institutionalized and drives growth (table 3.6).

## CHAPTER FOUR

### DISCUSSIONS, CONCLUSIONS AND RECOMMENDATIONS

The chapter presents the discussions, conclusions and recommendations. It will have information from corroborated findings from literature.

#### 4.1. Discussions of Findings

The reasons why the banks would decide to internationalize were variable but the study has clustered them into: First, World Bank and IMF reports and individual reports have projected a strong connection between the customer belonging to a particular country and the international banking activities from their home country banks. Both the indigenous banks and foreign bank follow their customers who work abroad. The African indigenous banks have used this as a strategy to conquer foreign lands of Americas, and Europe and now they eyeing Middle East (Dubai), India and China. Follow-the-customer hypothesis is equally exhibited by the foreign banks when they target customers in the other continents. Secondly, foreign banks have been attracted to Kenya by business opportunities. Highly differentiated products influence many banks to get to destinations with low level of innovation. Kenyan banks have explored East Africa region as the neighbouring countries were uncompetitive or outdated technologically. The foreign banks have invaded East Africa because of laxity in regulations regime and market that is highly liberalised. Foreign banks especially from West Africa because of their level of market capitalization coin a motive to internationalize as way of risk diversification. Profit maximization and increase of portfolio was exhibited by both indigenous and foreign based banks. It is therefore necessary to believe that proactive and reactive motivation, internal and external change agents and barriers to internationalize are indeed central in facilitating internationalization process of banking.



There are several arguments for foreign bank entry. Many banks go for increasing, diversification of available funds or just spreading the risks. The presence of foreign banks is a blessing to the host countries' markets as capital inflow is facilitated through triggered foreign investment. Most foreign banks have an edge over local banks in handling of international financial instruments needed to network internationally. As presented in the case of Uganda (table 2.1), foreign banks are malleable in their operations, spreading risks, diversifying capital and funding bases which explains the disparity in interest rates charged by them contrasted with local indigenous banks. In countries experiencing economic meltdown, the intervention internationalization of banks becomes handy as they diversify their investment into these countries improving economies of scale and scope of domestic markets. If this scenario is protracted then entry of foreign banks becomes crucial in rebuilding and restructuring domestic banking systems.

Entry of foreign banks is seen to be enhancing competition and efficiency in banking. Liberalization of financial policies and trade was highly attributed to the foreign banks were seen to be improving the benefits for both savers and lenders thereby deepening access to financial services through banks. Technological innovation in banking industry in most emerging economies is attributed to benchmarking, technology transfer, responding to clientele needs in foreign lands. Financial regulation or deregulation policies as well even though existent where domestic banks are dominant are usually strengthened or accelerated to respond to foreign market entry. In the EAC, the thought about setting up a single currency monetary union has been strengthened by cross border banking operations. The quest for harmonization of banking regulation for Africa has been necessitated by a fast growing Pan-African banking platform that is largely viewed as a pillar in African renaissance.

Protectionism of domestic systems directly is necessitated by the internationalized banks and this is a blessing to the domestic banks as they are given a window to enhance competitiveness. Research has shown that dominance of foreign banks in market share diminishes the profitability and the overall expenses incurred by domestic banks. Kenyan banks that exclusively localized are comparatively having low return performance compared to the internationalized banks. National Bank of Kenya, a localized state-owned banking institution is performing dismally compared to its peers of KCB, Equity Bank, and Coop bank. Even NIC Bank and DTB which have expanded in the region exhibit higher performance ratios comparatively (table 3.2). This has positive overall welfare implication to the domestic economy as trade is enhanced and greater efficiency is witnessed in the functioning of national banking markets. Fundamentally, the entry of foreign banks directly leads to development of financial markets and market infrastructure. The innovativeness to branchless banking emerged as result of cost incurred in developing infrastructure. Professional expertise is exported for local foreign currency markets where it has been lacking or is less developed. Internationalization of banking encourages adoption of best practices that could not only improve banking supervisory and legal framework but also trigger the strengthening of prudential guidelines and regulations. The possibility importation or exportation of financial system supervision and supervisory skills from home country regulators is a feature in internationalization of financial services.

On arguments against internationalization of banking and foreign bank entry, the issue of weakening of infant domestic banks features prominently. Most domestic banks because of capitalization and investment portfolios cannot readily absorb the short of cut throat competition in banking and some may just be liquidated and file for bankruptcy. New entrants are therefore suppressed and this could act as a disincentive

to business growth. Restrictions put on foreign bank entry are guised subsidy to the existing banking industry and temporarily minimizes the cost of restructure and adjusting the banking sector. This propounds social costs as the inefficiency in banking continues hurting the general economy. Marketing dynamics following the entry of foreign banks implies that “best customers” exodus for where is the better efficiency and therefore the local banks will be left with high risk customers and therefore low return. The practice by foreign banks or internationalized banks following their clients abroad is common but does not enhance the capacity of local banks to handle “unique” needs and this inhibits growth. There is the risk of importing bad banking practices as well. Most foreign banks owe allegiance to their country banking systems and the remittances bank home could create instability in the market as transferred capital will create a dent in the economy. Foreign banks could open up a new channel for the transmission of disturbances from the mature to emerging market. The experience of Baltic States-Estonia, Latvia, and Lithuania explains this. By inference, the emergency of Pan-African banking where West Africa based and South African banks are moving towards Eastern Africa markets because of the emerging economy and less saturated markets comparatively.

Regulatory framework in regard to banking guidelines, policies, and incentives presented huge disparities globally and even regionally for Sub-Saharan Africa and EAC countries. There no country that has wholly complied to the Basel II stipulation for harmonized banking frameworks and therefore entry into one country definitely still destabilizes the foreign banks as the regulations are not congruent to what they have back home. In Kenya for instance, a banking institution incorporated outside Kenya but operating within and a domestic (indigenous) bank maintaining branches must regularly submit their consolidated audited balance sheet, profit and loss account

to the central bank. The findings further show Kenya was not explicit on cases on equal applicability of domestic high standards to establishments of foreign banks but has defined a bank to be a company or financial institution that operates or performs banking functions in Kenya. For cases on authority having contracts and exchanging supervisor information with, and allow on-site inspection by, foreign financial supervisory agencies, Kenya is a central banks may disclose information to any monetary or financial regulatory authority, within or outside Kenya, especially where the information necessary for execution of functions of Central bank or the requesting monetary authority or financial authority. This practice is not exhibited in other markets in the region that have flexible rules thus their home regulation systems do not interfere or affect their international business operations.

## **4.2. Conclusions**

### **4.2.1. Internationalization of Banking**

Kenya internationalization model is quite different from the other African countries. The strategies employed by Kenyan banks to internalize can be seen to be double-edged. First, the banks have subsidiaries mainly in Eastern and Central Africa region. In these areas they have physical branch networks but beyond Africa the banks rely on diaspora agencies and some have invested in technology. The other foreign banks exert a physical presence in Kenya by ensuring they develop their traditional banking style. All the domestic banks follow their clientele aboard while the foreign banks are flexible they just delve into competition by owing locals strongly (Table 3.6). Secondly, they use their differentiated products such as diaspora banking platforms or agency banking operations to extend their banking services beyond border.

Decision to internationalize must be considered critically by the banks. One foreign bank failed to buy a local bank now internalised at a modest rate in 1995 (about 20

years ago) and opted to develop the bank from scratch (Greenfield). Now the two banks are worlds apart with the local bank being more profitable while the foreign bank barely struggling. The other foreign bank did an acquisition in Kenya and is performing well as in the other areas where it just started from scratch. Even though the domestic banks still have their fair share of challenges with instability in neighbouring countries hampering diaspora banking.

The foreign entry to Kenya or internationalization to other countries by domestic banks is not as complex comparatively as other market destinations. A domestic bank its reporting indicated that Kenya has flexible rules because of a highly liberalised market. The neighbouring countries have stringent rules aim at protecting their banks especially human resource related.

The internationalization for service sector is not easy as monetary policies are a challenge and unique to different countries(Table 2.3). The cross border banks are at mercy of the host country, as the monetary restrictions, guidelines on movement of capital and issue of nationalization of businesses in some countries.EAC trading block has policies on cross-border banking are not harmonized. In Kenya at the moment, there are no restrictions but policies on industry associations prevail. The role of Kenya Bankers' Association in influencing the human resource welfare has direct impact on internationalisation of banking. The government of Kenya however has limitation of export of capital as it creates imbalance of trade most a times. The liberalization and deregulation of banking as is propounded by Central Bank of Kenya (CBK) makes it easy for banks from outside Kenya to join the Kenya market. Once a bank meets the local threshold they can internationalize to Kenya but CBK guides. The government does not have monopoly over controls of banking activities. Any banking entities that are registered outside Kenya enter foreign laws and therefore

Kenyan government has no influence except where interests of common trading bloc like EAC, COMESA or AU are compromised. The implication is that the banks coming to Kenya have their clearances to make on their country of origin just same as the Kenyan originated banks in other countries. The banks do not have incentives but have regulations that can influence their decision to internationalize. The exemption could be on development banks that are given incentives like tax rebates or holidays based on developments they finance targeting marginalised areas. The banks usually have different products and accounts to their destination countries but dividends and capital gains are registered. Value proposition is what the governments lately consider; Kenyan government in particular, is regulating entry to financial environment based on the employments likely to create and targeted appreciated capital. In this case, the thresholds for international banks capitalization is high and even the localised banks have a higher threshold comparatively.

The rate of internationalization among Kenyan Banks is not uniform (Table 3.6). The entry strategy depends on the banks internal strategy. KCB started with branching, then formed subsidiaries, then has enjoined the diaspora banking model. Equity bank started with Agencies, then diaspora banking model, and now has established subsidiaries and acquired some bank in Democratic Republic of Congo. State owned government banks are slow. The timing is reliant on strategy of entry. Role of ICT and new banking innovation have accelerated entry of Kenyan banks in last three years. On the other factors influencing internationalization of banking a part from politico-economic factors, the language and level of skills of the host countries matter. Many countries emphasise the building of local capacity with expatriates being given limited and fixed period to strengthen local human resource base. The other factor is the level of monopoly and regulation within the destination markets. The intended

purpose apart from the business aspects of the banks, for instance, the expansion of Cooperative Bank of Kenya in Southern Sudan was viewed as reconciliatory intervention and reconstruction of the war torn newly independent country through triggering investment and economic development. The expansion of Equity was purely to extend good practice of micro-financial or targeting lower segments in the region. The internationalization is controlled by forces beyond the national issues most a times, speculations, external forces and black money issues.

#### **4.2.2. Performance of Internationalized Banks**

The entry of several foreign banks in Kenya has triggered a lot of investment of local banks in readiness for internationalization. Many local banks now are consolidating the customer base by deepening their brands by adopting one-stop shop model in competition with their foreign counterparts who have either conglomerates or products diversified. Efficiency for banks and stability of the banking system has been improving. For instance, Equity bank and Kenya Commercial Banks have maintained super profits despite losses in other industries in service sector like transport and hospitality (Figure 3.4). Even though the push and pull political factors might differ depending on country contexts, the expansion to neighbouring countries by Kenyan domestic banks has blossomed as much foreign investment in banking industry has appreciated with entry of foreign banks. Bottom line, profitability is a crucial factor in the decision making model for internationalization of banking (Table 3.2).

The marginal rate of returns for Kenyan internationalized banks is high. Cross-border banking in East Africa has experienced higher rates of returns as is explained by the findings on contribution of subsidiaries (table 3.3 and 3.4). The greatest motivation however is profits as risk is good if there is room for profit. It must be noted that

Kenya has the largest services as the economic environment is stable and Nairobi is becoming a financial hub (figure 3.4).

#### **4.3.3. Responding to the Research Questions**

The study has adequately responded to the three research question. Research question one, required the study to cover the global context of Internationalization of banking, trends and outcomes. The study has established that the expansion of banking in Africa offers great potential as the market is less saturated. The innovative approaches in banking like Islamic banking, information technology, mobile and agency banking have accelerated Pan-African Banking.

The second research question has adequately been addressed. The section on Kenya provides an exposition of the Kenyan banking performance scope. Three banks used as case studies have been examined on their strategies. The third research question has adequately been addressed. The study finds a direct association between internationalization practices and financial performance. The subsidiaries were found to contribute significantly to the performance of the Group banks. This was true for KCB, Cooperative Bank and Equity Bank. The results of Ecobank Transnational confirm this except for Kenyan subsidiary that has struggled.

#### **4.3.4. Responding to Research Hypothesis**

The study postulated the following: 1). Internationalization of banking follows the theories of theories of internationalization. 2). Internationalization of banking is associated to financial performance of banks.

All the hypotheses were tested by implication as no inferential analysis was done to statistical prove or disapprove the hypothesis. The study has established that a greater



proportion of banks globally have adjusted their international policies for banking and regulations. This was found true for SSA and even Kenya as most countries are striving to comply with Basel II and III. The study has established that internationalization process is market driven and banks globally, in Africa, and East Africa region. Pan-African banks expansion is driven by strategy and market innovation which is similar to what is in India, China and Japan. Strategy for entry into internationalized market was found to be unique to individual banks. The study has deduced that internationalization of banking has a consistency with the theories of internationalization. Most banks follow the Uppsala model that is step wise process to internationalization. The influence of networks was found to be exhibited by Pan-African banks and especially their entry to diaspora (out of Africa) markets. The inter-governmental model has been seen to accelerate growth of cross-border banking in Eastern Africa. The Cost-Transaction model is implied for most banks as the orientation to go cross-border or to be international is based on investment at least cost and maximization of profits.

The second hypothesis was found to hold. The internationalised banks reported strong association between international operations and financial performances. The Kenyan banking cases were all found to positively correlate their international banking activities and financial performance. The EAC banks with subsidiaries in EAC were found to be highly profitable. KCB, Equity and Cooperative Banks all attributed their performance to contribution of subsidiaries and their international engagements through diaspora banking (table 3.2, 3.3, and 3.4 and figure 3.5) .

#### **4.3.4. Linking Findings to Internationalization Theories**

Cross-border banking of Kenyan takes two orientations; it is either by design or default. By design, cross-border cooperation is a principal agenda of the EAC

particular for financial intermediation, its regulation and supervision. As stipulated on the Article 85 of the EAC treat, who main focus is banking and capital market development, development and integration of financial markets and the complementary legal and regulatory framework is vital for final establishment of East Africa Monetary Union and culmination into political federation. The kind of cooperation envisaged for financial integration in the EAC protocol is all inclusive as it encompasses capital markets, insurance, and pension scheme. Coincidentally, the banking agenda is even propelling the agenda of EAC integration. EAC has institutionalized supervisory cooperation among the five member countries. Monetary Affairs Committee which brings together Central Bank Governors from the member countries has existed since 1997. The signing of a multilateral memorandum of understanding (MOU) by EAC central banks in 2008 set a stage towards cross-border trade witnessed as neighbor countries were asked to harmonize on the policies for banking. This promotes information sharing and collaboration in banking supervision which has enhanced regional financial integration. EAC MOU has facilitated cross-border banking as the common onsite assessment of banks and set standards for standardization in compliance Basel II stipulations. The MOU ignores the methodology for addressing crisis management issues. Cross-border banking is well thought out in the Kenya's second medium term expenditure framework 2013-17 (MTEF II). There are clear indicators for diaspora remittances and growth of cross border banking. The Kenya Institute of Bankers is mandated to provide capacity building for banking staff in Kenya and across the EAC even the latter has not taken off serious.

By default, the sampled Kenyan banks have been operating in Kenya for more than 25 years. It is evidenced through the Uppsala and networking model that there reaches a

stage that they have to expand and grow beyond the domestic market. Although the study could not directly attribute the transaction cost model to cross border banking activities, all the three principal theories of Internationalization are satisfied by the study. Following the Uppsala model, all the three banks have taken a stepwise approach of moving from operating domestically, to pre-internationalization where they get in through subsidiaries, to full entry and now stabilization and sustainability of cross-border operations. This is a clear demonstration of learning perspective as explained by Vahlne and Johansen (2009). The networking aspect is manifested in the role played by Central bank of Kenya and its EAC counter parts in supervisory activities through supervisory colleges. The support accorded Cooperative Bank of Kenya by Government of South Sudan to establish Coop Bank South Sudan is a demonstrable case of how networking and cooperation improves internationalization. This mirrors the inter-governmental perspective as studied by Petersen and Marquart (2013)

Finally, the internal and external forces as stipulated in the strategic competition perspective are fundamentally put a case for cross-border banking in Kenya. Internationalization of banks in Kenya is market drawn. The Kenyan banks have innovations that help tap into the external market and improve on competitiveness through product differentiation. The cross-border banking for Kenyan banks enhances their comparative and competitive advantage simultaneously. Agency and mobile banking is strategically unique to Kenya as they are inventions that have been experimented and worked in Kenya. By default, the emergence of Pan African banks from West Africa could have created competition for spread in East Africa and beyond. The need to keep and follow customers like in diaspora is a factor contributory to internationalization of banks. Islamic banking influence is a game

changer and many banks have joined the Shariah compliant banking which is likely to hasten the cross-border banking especially to recovering Somalia. Lastly, transaction cost theory even though not verified empirically in this study, could be implied as banks cannot externalize if their domestic costs outweigh benefits. The cost to benefit ratio must be better to involve in external operations. This is however implied as the study has established association internationalization activities of banks and financial performance.

### **4.3. Recommendations**

#### **4.3.1. Recommendations for Action**

When approaching internationalization due diligence must be to ensure the banks adopt the right approaches. The banks should have an informed choice in acquisition, mergers or making a nascent entry. Market segmentation and product diversification is a requisite and this will promote profitability and improve significantly the customer thereby enhancing competitiveness in the foreign or host countries. Acquiring an existing bank is seen as a way of avoiding the high cost of customer acquisition and raising deposits from a new operation. It also eliminates the regulatory burdens associated with a new banking operation, including acquisition of a license.

Prominence of foreign banks in a particular country allows for strengthening of financial services policy and development of effective cross-border prudential supervision which is vital in rationalizing and stabilizing financial markets. The study recommends that because of incongruence in financial policies and supervisory guideline, any bank being granted consent for cross-border operations should involve both home and host authorities. In that case, the trading blocs like EAC, SADC, ECOWAS and even AU should work towards review and harmonization of supervisory responsibilities. More specifically the countries involved can share

supervisory responsibilities where one authority initiates the consultation with the other to explicitly monitor the activities or just takes the primary supervisory responsibilities. Similar channeling or protocol should be followed to review the intention to change the banks' or banking groups' structure or activities. Capacity building the supervisors in emerging countries like necessary to understand the nature of financial conglomerates by providing necessary information on financial derivatives and ability to analyze implications.

In summary, the study recommends two broad area that would benefit from policy intervention for internationalized banks by address the persistence in market and government failure: creation of the right framework conditions like legal and regulatory, trade and investment, education trading and culture; and secondly more specific banking policies and initiatives that reduce the administration of burden across border activities; support for appropriate financial instruments; facilitation of quality and targeted advisory services for new entrants and those "small" banks; and fostering regional integration either through economic or political federation to ease business. This will also encourage common currency and monetization that will increase profitability by minimization of expenses in currency exchange.

There is need to contextualize the issues around national banking policies both at national and international levels. The use of intermediaries must be interrogated and clear guidelines placed so improve transparency in the whole internationalization process. Clear guidelines should be issued to relevant agencies in sharing information on destination markets; financial incentives for businesses that what import capital as well as policies and laws protecting the domestic banks must be reinforced.

### **4.3.2. Recommendations for Further Studies**

The study suggests the following areas for further studies on internationalization of banking. Firstly, in terms of study gaps, there is need to study the effects or impact of internal banking policy and business strategies and how they impact on performance of the internationalised banks. The current study has just highlighted on the perception of the various stakeholders on the process of internationalization of banking. To clearly understand the pull and push factors of internationalization of banking and theorize effects, a longitudinal study is appropriate. Through time series trends, the effectiveness of internationalization of banking will be established and therefore be used to generalize or use as standard practice. The study has relied on internationalization theory of business with the basic assumption that banking is a ‘normal business’ while in actual sense banking is unique and require its own contextual theorization. The internationalization theories are also not Africa contextualized and further studies should advance this.

This study recommends further empirical evidence in either developed or other developing countries to theorize the model. Lastly, the academia needs to investigate long-term consequences for the international allocation of capital with laid emphasis on the existence of tax distortions and export of internally generated capital in emerging countries.

### **4.4. Challenges in the Study**

The comparative analysis of internationalization of banking is a nascent area of research therefore finding African contextualized academic literature was hard. Reliance on secondary information especially those computed by different organizations are not easily generalizable as the methodologies of data collections are highly variegated. There is a very thin line between factors affecting

internationalization and the macro-economic indicators. There is a lot of bureaucracy in conducting banking related researches because of the sensitivity of information therein and therefore gathering primary data for especially on duration given within the academic calendar is highly prohibitive. Foreign banks have to seek information from their parent bank management to get the data and to disseminate information. This study replaced two foreign banks with other foreign banks following the technical hitches. Lastly, the procedure for acquiring research permit from NACOSTI is too cumbersome and is not very easy students with short periods to deliver research.

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