

**EFFECTS OF SPEED OF INTERNATIONALIZATION ON  
PERFORMANCE OF LISTED INDIGENOUS FINANCIAL  
SERVICES COMPANIES IN KENYA**

**RAPHAEL KOOME GIKUNDI**

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## **DECLARATION**

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

Signature:..... Date:.....

**GIKUNDI RAPHAEL KOOME,**

**D61/80412/2012.**

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

Signature:..... Date:.....

**DR. JOHN YABS,**

**SENIOR LECTURER,**

**DEPARTMENT OF BUSINESS ADMINISTRATION,**

**SCHOOL OF BUSINESS, UNIVERSITY OF NAIROBI**

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## **DEDICATION**

I wish to dedicate this study to my family. I know that you had to make huge sacrifices during this period of my studies. Your sacrifice and love have not been in vain.

## **ABSTRACT**

The internationalization of firms can affect firm growth, survival and competitive position, but also influence a nation's economic growth and development. The financial services sector in Kenya has sought opportunities internationally more than any other sector in Kenya. The Kenyan financial system comprises banks, non-bank financial institutions, insurance companies, microfinance institutions, stock brokerage firms, fund managers. The banking industry with asset base of over Kshs. 2.3 trillion as at 2013 is the largest sector in the Kenyan financial sector. There are currently 20 listed financial services companies at the Nairobi Securities Exchange (NSE) comprising of 11 banks, 6 insurance companies and 3 investment firms. Of these, 17 are indigenous companies while three are subsidiaries of international finance companies. Internationalization refers to the process through which a firm becomes a multinational enterprise. Often, this happens in a series of stages. In the first stage, the firm sells its products and services in the domestic market. In the subsequent stages, the firm may start selling its products abroad and/or establish an international sales network, and in advanced cases of internationalization an individual firm establishes a manufacturing, sales and Research & Development (R&D) operations in a number of countries, effectively becoming a multinational firm (Levitt, 1986). Incremental internationalization process theory builds on knowledge accumulation and experience while international new ventures thrive on their lean structures, lack of structural inertia and quick turnaround of ideas to thrive internationally. This study set out to determine the effects of speed internationalization on performance of listed indigenous financial services firms in Kenya. The objectives were to establish the effects of speed internationalization on performance of listed indigenous financial services firms. This study is very important in generating new knowledge and contributes to academic research and those it's supposed to serve including managers, policy makers and investors in the financial services companies. To answer the research question, a census study of nine listed financial services firms with significant international operations were studied. Secondary data was collected from the companies' annual financial reports, CMA and NSE. Regression analysis was used to analyze the data and descriptive statistics were computed. The study finds that the speed of internationalization has a positive effect on performance of listed indigenous financial services firms. This was indicated by the ROA P value of 0.014 and the R Squared value. A Pearson coefficient measure showed a strong, significant, positive relationship between ROA and internationalization speed of listed financial services firms in Kenya. Therefore basing on these findings the study rejected the null hypothesis that speed of internationalization has no effect on the financial performance of listed indigenous financial services companies and accepted the alternative hypothesis that speed of internationalization has an effect on performance of listed indigenous financial services firms in Kenya. Speed of internationalization by the firm seems to be related to the degree of firm's performance. The study concludes that firms should consider the speed at which they internationalize if they want to improve performance. It concludes that faster internationalizing financial firms in Kenya have benefited from higher returns for every shilling invested. The study recommends that more indigenous financial services firms in Kenya seek growth opportunities in the region since expansion internationally affects positively on their overall financial performance.

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## **LIST OF ABBREVIATIONS**

|               |   |   |
|---------------|---|---|
| <b>CBK</b>    | - | Central Bank of Kenya                         |
| <b>COMESA</b> | - | Common Market for Eastern and Southern Africa |
| <b>EABS</b>   | - | East Africa Building Society                  |
| <b>EAC</b>    | - | East African Community                        |
| <b>EPA</b>    | - | Economic Partnership Agreement                |
| <b>EU</b>     | - | European Union                                |
| <b>FDI</b>    | - | Foreign Direct Investment                     |
| <b>GDP</b>    | - | Gross Domestic Product                        |
| <b>KCB</b>    | - | Kenya Commercial Bank                         |
| <b>NBFI</b>   | - | Non-Banking Financial Institutions            |
| <b>NSE</b>    | - | Nairobi Securities Exchange                   |
| <b>ROA</b>    | - | Return on Assets                              |
| <b>ROE</b>    | - | Return on Equity                              |
| <b>USA</b>    | - | United States of America                      |
| <b>WTO</b>    | - | World Trade Organization                      |

# CHAPTER ONE

## INTRODUCTION

### 1.1 Background of the study

The internationalization of firms has generated interest not just because of the benefits to firm growth, survival and competitive position, but also because of its positive influence on a nation's economic growth and development (Rutashobya and Jaenson, 2004). While internationalization can be a source of growth for firms, it can also be a risky venture that can generate losses which may adversely affect the long term survival of a firm.

Any company seeking to be an industry leader in the twenty-first century must not focus on domestic market leadership only, but must also focus on global market leadership. Ekai (2010) and Guracha (2008) justified that global competition for African businesses is not an option but an economic priority. In order to remain pertinent in the global market, Kenyan firms need to compete globally. Similarly, in order to create a globally and vibrant competitive financial sector as highlighted in the Vision 2030 for the financial services, the local Kenyan banks need to internationalize. The Kenya government needs to not only aim at attracting foreign investors, but also promote internationalization of indigenous firms (Gacoki, 2014)

Kenyan financial sector has realized tremendous growth in the last ten years and firms have significantly increased their presence within the Eastern Africa region through FDIs. Over the same period, the financial industry in Kenya has involved itself in automation moving from the traditional banking to better meet the growing complex needs of their customers and globalization challenges. Both push and pull factors have contributed to this increased

interest in the region by local finance services companies. For instance, the independence of the Republic of South Sudan in 2011 attracted many Kenyan companies to focus more on the country for opportunities but also as a diversification strategy due to increased local competition.

Increased integration within East African community (EAC) member countries has been a big pull factor for many local financial service companies to venture into other countries in the region. Other factors include advancement in communication technology, improved infrastructure in the region and general globalization trends that are first transforming the world economy into a global village. Increased local competition within the sector has also pushed these institutions to seek growth outside Kenya. The EAC treaty has allowed for free movement of goods and services, free movement of people, created a regional judicial and political system, with negotiation for a monetary union and political integration at advanced stages. Advancement in communication technology has made it easy to link regional offices and allowed for exchange of timely information for decision making.

Firms operate in an environment, which consists of uncontrollable and controllable forces. The uncontrollable factors affecting the operating environment of international business according to Yabs (2006) are physical forces, economic forces, socio-cultural forces, financial forces, political forces, legal forces, labour forces and ecological forces. The controllable forces are the factors of production and the organizational activities. Management of organizations has some command over the controllable elements unlike the uncontrollable ones.

### **1.1.1 Concept of Internationalization**

International trade has a rich history and has evolved from the initial barter trade system, through mercantilism in the 16<sup>th</sup> and 17<sup>th</sup> centuries, to trade liberalism in the 18<sup>th</sup> century. Adam Smith, the father of economics, is among the first contributors in the subject through his famous book of 'The Wealth of Nations' in which he defined the importance of specialization in production. Later, David Ricardo developed the Comparative advantage principle which stands true to date (Management Study Guide, December 2012).

Johanson and Vahlne (1977) describe internationalization as the process by which firms gradually increase their international involvement. They opine that internationalization is the product of a series of incremental decisions. On their part, Welch and Loustarinen (1988) define internationalization as a dynamic concept as a result of increasing involvement in international operations; while Coviello and Munro (1997) see internationalization as the process by which firms both increase their awareness of the direct and indirect influences of international transactions on their future and conduct transactions with other countries. From these definitions therefore, the consensual concept of internationalization can be said to include many incremental decisions and strategies, various inward and outward product and services, or resources transferring across national boundaries (Asira, 2013)

International expansion can enhance a firm's knowledge base and capabilities through the experiential learning it gets from operating in foreign markets. Industrial organization arguments have also been used to postulate that firms can gain greater market power over suppliers, distributors, and customers by expanding overseas. Some researchers have

suggested that firms can diversify risks by operating across several international markets (Kim, Hwang, and Burgers, 1993). The benefits from the exploitation of economies of scale and scope, organizational learning through exploration and greater market power implies that firms with greater international diversification should experience higher financial performance.

As firms operate in more diverse market environments, they face a greater need to integrate their activities and logically therefore, encounter an escalation in the cost of coordinating their activities. At higher levels of international expansion, diseconomies can set in due to escalating costs of coordination and from the greater information processing demands on managers and administrative systems. With continued international diversification, the complexities of managing information and communication among widespread units imply that extensive international diversification is likely to result in net costs (Gomes and Ramaswamy, 1999).

### **1.1.2 Concept of International diversification**

International diversification is often referred to as geographic diversification, geographic scope, internationalization, or global diversification. These terms refer to ‘a process in which firms gradually increase their international involvement’ (Johanson and Vahlne, 1977: 23), ‘a firm’s expansion beyond its domestic market into other regions or countries’ (Ghoshal, 1987). Thus, on the surface it would appear that the construct of international diversification includes all foreign aspects of a firm’s value chain, from the geographic markets where it sells its products/services to the global locations where it produces its products/services and the geographic locations where its capabilities reside. All of these

are strategic decisions that define the geographic scope of the firm and, thus, its degree or extent of international diversification (Wiersema and Bowen, 2011).

The increasing economic integration of markets associated with globalization has not only driven the internationalization of companies, it has also influenced the nature of their strategies. Technological change and the ease of trade have enabled managers to effectively monitor and control their company's global activities and have resulted in major changes in organizational configuration and strategy. While historically many companies have had foreign sales operations, the ability to conduct business efficiently and effectively across the globe has enabled managers to make strategic decisions on where to geographically locate the different activities that constitute a firm's value chain (Wiersema and Bowen, 2011)

A firm's international diversification strategy can be multifaceted and, hence, international diversification is more than just a firm's multinational presence. Researchers have conceptualized international diversification as: 'international diversification is a strategy through which a firm expands the sales of its products or services across the borders of global regions and countries into different geographic locations or markets' (Hitt, Ireland, and Hoskisson, 2007). Research has predominantly focused on the selling component of a firm's international diversification strategy and has operationalized the construct of international diversification using the foreign sales ratio, defined as the ratio of a firm's foreign sales to its total sales (Tallman and Li, 1996). Given its widespread use, this study has adopted the same as measure of international diversification.

### **1.1.3 Speed of internationalization process**

Rapid internationalization by the firm seems to be related to the degree of firm's performance (Vermeulen and Barkema, 2002). According to Luo, Zhao and Du, (2005), the determinants of early internationalization may differ from traditional progressive models like the Uppsala Model or the Resource-based view that explain how foreign market risks are managed by the acquisition of knowledge about foreign markets and progressively change their commitment to those markets.

We have already been introduced to the concepts of internationalization and international diversification which according to Wiersema and Bowen (2011) are one and the same thing. Speed always has to be viewed in the context of time meaning that the introduction of a time dimension to international diversification will give us the speed of the process. Oviatt and Mcdougall (2005) define internationalization speed as the time between the discovery of an opportunity and the first entry into a foreign market, the speed of entry into the selected countries and the speed of the commitment. The speed of commitment is an important measure especially in a situation where firms are facing similar environmental conditions or markets and are in the same industry.

In this study, we define speed of internationalization as the rate of international diversification during a given time period. Therefore if international diversification is measured by the ratio of a firm's foreign sales to its total sales, then speed of internationalization can be measured by adding a time scale to this measurement. This is especially useful in comparing firms in the same industry because a higher increase in this ratio during the period under consideration will indicate a faster internationalization speed.

Speed of internationalization is conceptualized as the rate at which international revenue grows vis a vis domestic revenue in a given time period. In other words it the international revenue's increase in share of total revenue over a period of time. The age of the firm is ignored in this case because in the developing world context, the market situations firms were facing when founded are different from the democratic, free market and integrated economies faced by firms founded recently. Although Welch and Luostarinen (1988: 84) criticized the foreign sales ratio for not providing much information about a firm's international operations and suggested the need for a broader perspective for assessing the 'extent of increased international involvement, the researcher is satisfied that using revenue that incorporates all income from subsidiaries is sufficient enough in giving an understanding of a firms pace of international commitment.

One reason for the widespread use of the foreign sales ratio is the fact that data on a firm's sales in foreign markets is readily available from secondary sources and it enables researchers to make comparisons across firms (Wiersema and Bowen, 2011). The foreign sales ratio captures the extent of a firm's international diversification in terms of its dependence on foreign sales.

While these sales-based measures predominate, other measures of international diversification have also been used. These include the number of countries in which a firm sells (Tallman and Li, 1996), the number of foreign subsidiaries, the ratio of a firm's foreign subsidiaries to the total number of subsidiaries, the ratio of exports to total firm sales, the ratio of foreign to total firm employees (Kim, Hwang, and Burgers, 1989), the ratio of foreign to total firm assets (Ramaswamy, 1993), and foreign direct investment announcements



#### **1.1.4 Financial Services Sector in Kenya**

Kenya has long recognized the benefits of inward investments and has welcomed overseas companies looking to do business in and with Kenya for decades. For instance, there are currently 13 foreign owned banks in Kenya while 31 are indigenous. With its stable, pro-business government, and a strategic access to the lucrative emerging markets of Eastern Africa, the country has served as a perfect investment destination for investors and business seeking an entry into the region.

As the strongest economy to date in East Africa, Kenya offers a sizeable domestic market of close to 40 million people as per the 2009 national census. This means that successful local firms can amass enough resources to expand and compete in the smaller regional markets. The country is a member of the EAC, providing an easy access to a population of about 120 million people living within the five nation community and backed by a Customs Union Protocol (Rubadiri. 2012). Kenya is also part of the Common Market for Eastern and Southern Africa (COMESA), with a population of more than 385 million consumers.

The Kenyan financial system comprises banks, non-bank financial institutions, insurance companies, microfinance institutions, stock brokerage firms, fund managers. The banking industry with asset base of over Kshs. 1.3 trillion is the largest sector in the Kenyan financial sector. There are currently 20 listed financial services companies at the Nairobi Securities Exchange (NSE) comprising of 11 banks, 6 insurance companies and 3 investment firms. Of these, 17 are indigenous companies while three are subsidiaries of international finance companies. 8 of these indigenous companies have internationalized through FDIs in the region albeit at different paces.

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 growth within the sector. The Kenyan financial sectors' continued expansion into the East African region will foster its growth momentum. Equally, the sector is expected to play a pivotal role in financing initiatives key to propel Kenya to a middle-income country as envisaged in the Vision 2030 (Bank Supervision Annual Report, 2010).

The sector has been for a long time been dominated by foreign firms before the emergence of innovative and ambitious indigenous companies like Equity Bank, Diamond Trust Bank and KCB. These firms challenged the status quo using innovative products to overtake the foreign banks in terms of customer numbers and profitability.

#### **1.1.5 Internationalization of Listed financial services firms in Kenya**

The pace of integration in the Eastern Africa region has gained momentum in the recent past with the most significant impact been felt in the financial sector. This is fueled by cross-border labour mobility, economic growth, increased manufacturing output, substantial oil discoveries in Uganda and Kenya and the establishment of the newest state in the world, the Republic of South Sudan, with its own oil resources.

Established financial institutions in one country are seeking to expand into neighboring markets through acquisition or organic growth, with the prospect of a strong regional economy enticing some of the world's biggest banks to invest-in the region for the first time. For instance, HSBC was recently granted an operating license by the CBK and opened a representative office to act as its sales and marketing base in the region, while the Russian investment bank, Renaissance capital was granted a banking license after acquiring the troubled Francis Thuo & Partners investment in 2007.

However, the African Banker (May 2011) argues that the biggest trend in the regions finance industry at present is the expansion of established East African financial services companies into neighboring countries. Some of the firms that have moved across borders include KCB with operations in Tanzania, South Sudan, Rwanda, Burundi and Uganda; Equity bank with branches in Uganda, South Sudan, Tanzania and Rwanda; National Industrial Credit (NIC) bank with branches in Tanzania and Uganda; and Diamond Trust bank with operations in Uganda, Tanzania and Burundi. Others include Centum with investments in Uganda, Olympia Capital with investments in Botswana and Jubilee insurance in Uganda, Tanzania, and Mauritius.

## **1.2 Research Problem**

Globalization transformed the whole world into just one big market famously referred to as the global village. Advancement in telecommunication technologies, the invention of the internet, development of transport systems, liberalization of world markets, trade cooperation's and recently the invention of the social media, among others have made it easy for firms to do business across borders. This globalization of the business environment has increased opportunities for trading beyond national borders (Rugman, 2000).

However, while it is true that barriers to globalization have continued to fade over the years, firms from emerging and less developed markets have had varying experiences after choosing to internationalize. This is much so for firms operating in heavily regulated industries like the financial industry. Due to inadequate information about the effects of internationalization especially in developing economies, many institutions have not appreciated the fact that there is a relationship between these factors and firm performance.

Although it has long been recognized that organizations face constraints with respect to their growth and development (e.g., Penrose, 1959), little research has directly examined how different rates and patterns of expansion may result in performance differences between firms. The effects of the speed of internationalization on performance are less understood in developing economies given that internationalization is a fairly new phenomenon in these countries and specifically in Kenya. In order to solve the dilemma posed by the inconclusive performance results of both incremental and new venture theory (Vermeulen & Barkema, 2002), researchers have suggested that internationalization should not only be considered from content but also through a process lens. This includes the rates and patterns by which firms organize their internationalization processes and incorporates the notion of time (Jones & Coviello, 2005). Differences in speed of internationalization among firms in the same sector suggest new ways of accounting for different internationalization processes that are likely to entail performance differentials.

This study sought to address the knowledge gap in understanding the effects of internationalization speed on performance of listed indigenous financial service firms in Kenya. The research question for the study therefore is: What are the effects of internationalization speed on the performance of indigenous financial services firms in Kenya?

### **1.3 Research Objectives**

To determine the effects of internationalization speed on the financial performance of listed indigenous financial services firms Kenya.

#### **1.4 Value of the Study**

This study is very important in generating new knowledge and contributes to academic research that it's supposed to serve. For finance managers and other industry players in Kenya, the findings of this study are an eye opener on how to successfully internationalize financial service firms in Kenya, to come up with effective strategies to compete with multinational companies for the emerging new markets of Eastern Africa.

Policy makers and the government of Kenya will find the results of this study useful in designing policy framework and creating the enabling environment that supports indigenous financial service firms to internationalize.

Investors in financial services will enjoy higher returns if they invest with the understanding of how internationalization strategies by firms affect performance. Academicians will find a source of reference for future research as well as opening frontiers for future research and study.

## **CHAPTER TWO**

### **LITERATURE REVIEW**

#### **2.1 Introduction**

Internationalization refers to the process through which a firm becomes a multinational enterprise. Often, this happens in a series of stages. In the first stage, the firm sells its products and services in the domestic market. In the subsequent stages, the firm may start selling its products abroad and/or establish an international sales network, and in advanced cases of internationalization an individual firm establishes a manufacturing, sales and Research & Development (R&D) operations in a number of countries, effectively becoming a multinational firm (Levitt, 1986). Internationalization can therefore be described as a movement of a firm's operations beyond the borders of the home country through the increase of firm's implication in complex operations outside national borders.

The renaissance of Edith Penrose's (1959) scholarship has influenced many domains of study in recent years, notably including research on internationalization as a "strategy of fast growth". It has long been accepted that firms' operations beyond domestic boundaries enable them to reap the benefits from foreign market engagements and increase profitability. While empirical support for this assumption has been mixed (Tallman and Li, 1996), the recent literature has suggested a link between performance and the type of internationalization process (Vermeulen and Barkema, 2002).

##### **2.1.1 Incremental internationalization process theory**

While various streams of research have investigated the nature of foreign market entry, incremental internationalization and accelerated early cross-border engagements have

come to form the dominant paradigms in internationalization process research (Zahra, 2005). The first, the Uppsala, or internationalization stage school, purports that firms enter into markets gradually, once they have established their home base (Bilkey & Tesar, 1977). In contrast, the international new venture theory suggests that firms adopt an accelerated foreign market entry process right from inception (Oviatt & McDougall, 1994). Both theoretical approaches have provided succinct explanations on the process of foreign market entry but not sufficiently, the underlying differences in the manner in which firms establish and consolidate their competitive advantage and their impact on performance.

Incremental internationalization process theory builds on knowledge accumulation and experience. It incorporates several related approaches, which are similar in their explanatory power. Both the Uppsala internationalization model and the innovation-related internationalization model contend that firms become international in a slow and incremental process with a limited number of targeted geographic markets (Bilkey & Tesar, 1977). To explain internationalization across countries, authors hypothesize that firms have to compensate between market knowledge, resource dependency, and uncertainty.

The internationalization of a firm is described as being necessarily path-dependent based on prior knowledge acquisition. Thus, internationalization is a process built upon the reduction of uncertainty by knowledge accumulation. Knowledge of the firm increases with time and experience so that firms choose an incremental pattern of internationalization, gradually seizing opportunities on a country-by-country basis. All in all, a strong underlying assumption of the gradualist approach is that firms initiate their first international entry once they have a strong domestic market base, i.e., at an older age. Internationalizing at an older age supposes building on the referential knowledge base of

the home market and competitive advantage in foreign markets is gained by exploiting current home-based advantages.

The incremental view of internationalization has not been without its critics. As the environment has changed significantly since the traditional internationalization theories were developed, firms have quite often been required to speed up their foreign market entry processes. The increased level of globalization in many industries may further lessen the perceived risk of entering foreign markets and partly explains the observed increase in the speed of internationalization.

Technological innovation aside, the presence of an increasing number of people with international business experience has established new foundations for multinational enterprises (Oviatt & McDougall, 1994). Crick & Jones (2000) found that many firms were set up by managers with previous experience in international markets, who had already dealt with the complexities of international operations, appreciated the risks and resource implications, and even more important, developed a network of customers and contacts on which to build for setting up their own firms. Not surprisingly then, given this criticism, a new theoretical approach has started to develop since the late 1980s.

### **2.1.2 The International New Ventures Theory**

Due to environmental changes and the limited explanatory potential of the incremental process theory of internationalization, Johanson & Mattson (1988) have pointed out that some firms might follow a different pattern of internationalization than suggested by the stage models. More recently, several authors have emphasized a new phenomenon of small and medium enterprises that are becoming international soon after being founded. This



idea gave the impetus for the concepts of “born globals” and “international new ventures” with the latter providing the name for the theory (McDougall, Shane & Oviatt, 1994, Zahra, 2005)

The born-global approach presents a unique challenge to incrementalism and stage theory. If internationalization were possible only by knowledge accumulation and experience, then new ventures could not be international and successful from inception. Older firms with the necessary resources and skills that enable investments in learning and thus effective adaptation were clearly in a superior position. Yet those established firms are often subject to structural inertia that prevents or limits their ability to grow quickly abroad. In this vein, internationalizing at an earlier stage may have advantages as compared to an established company whose ability to learn and develop its operations may be limited (Oviatt & McDougall, 1994).

## **2.2 Speed of Internationalization**

Time is a central issue in the internationalization of the firm, and speed of international development is arguably the most important time-based dimension (Prashantham and Young, 2009). Timing and internationalization speed are important distinctive aspects between traditional internationalization studies and other approaches to internationalization. The increase of the early internationalization phenomena led academics to explore drivers of international development relying especially on their progressive dimension, viz. precocity and speed (Zucchella, Palamara and Denicolai, 2009). Although this concept has attracted plenty of attention, it still lacks of accepted definitions, variables and methods (Cieslik and Kaciak, 2009).

Oviatt and Mcdougall (2005) characterize internationalization speed as the time between the discovery of an opportunity and the first entry into a foreign market, the speed of entry into the selected countries and the speed of the commitment. Some authors define ‘speed of internationalization’ as the founding date of each firm and the date of its first international exports (Cieslik and Kaciak, 2009), whereas others delineate the question as the amount of elapsed time (in years) between the year of firm founding and the year of its first international venture (Acedo and Jones, 2007).

Despite the lack of consensus in the definition, there has been a proliferation of studies about speed of internationalization; most notably those seeking to identify which determinants are more relevant to foster internationalization speed (Acedo and Jones, 2007). This theme is particularly relevant because rapid internationalization by the firm seems to be related to the degree of firm’s performance (Vermeulen and Barkema, 2002). In this process the determinants of early internationalization may differ from traditional progressive models like the Uppsala Model or the Resource-based view (Luo et al., 2005) that explain how foreign market risks are managed by the acquisition of knowledge about foreign markets and progressively change their commitment to those markets. Since these approaches are concentrated on traditional external behavior and not on rapid internationalization, additional factors supporting precocity in international growth have to be added (Zucchella et al., 2007).

### **2.3 The Effects of Internationalization on performance**

Research has shown that firms gain benefits from internationalization by realizing economies of scale due to spreading fixed costs of production, marketing, and research and

development (R&D) over a larger global market, as well as by exploiting and leveraging firm-specific intangible assets into international markets (Bartlett and Ghoshal, 1989).

Firms can gain exploration benefits from geographic diversification while international expansion can enhance a firm's knowledge base and capabilities through the experiential learning it gets from operating in foreign markets (Barkema and Vermeulen, 2001). Industrial organization arguments have also been used to postulate that firms can gain greater market power over suppliers, distributors, and customers by expanding overseas. Some researchers have suggested that firms can diversify risks by operating across several international markets (Kim, Hwang, and Burgers 1993). The benefits from the exploitation of economies of scale and scope, organizational learning through exploration and greater market power implies that firms with greater international diversification should experience higher financial performance.

Researchers have also proposed that there can be costs associated with international diversification. As firms operate in more diverse market environments, they face a greater need to integrate their activities and, as a result, encounter an escalation in the cost of coordinating their activities. At higher levels of international diversification, diseconomies can set in due to escalating costs of coordination and from the greater information processing demands on managers and administrative systems. With continued international diversification, the complexities of managing information and communication among widespread units imply that extensive international diversification is likely to result in net costs (Gomes and Ramaswamy, 1999) and consequently lower profits.

Firms that set up foreign subsidiaries face time compression diseconomies because there are limits to their capacity to absorb expansion, in terms of the novel experiences this produces and its consequences. A firm's absorptive capacity however, is not necessarily constant. For instance, it is influenced by the extent to which it is utilized. Specifically, overload caused by a very high speed may reduce a firm's capacity to further absorb expansion, as does prolonged non expansion or slow speed. Along these lines, the profits that firms can realize from their foreign expansions are not only influenced by the pace and dispersion of the internationalization process, but also by the regularity of the process, or the rhythm at which new subsidiaries are established. Firms that follow a constant, rhythmic pace are better able to benefit from internationalization than firms that expand in an irregular, ad hoc fashion.

Return on Assets (ROA) provides a more balanced view of profitability compared to traditional metrics. Metrics like Return on Equity (ROE) disregard risk that financial leverage creates. An increase in leverage commensurately improves asset balances through the cash it provides. Any changes in leverage, therefore, are equally reflected in assets. Another advantage of ROA is its ability to holistically measure business operations. A move to artificially improve net income would create a much smaller change in ROA since the measure weighs net income as a proportion of assets. The choice to compare net income to assets is a significant one. ROA reflects the cumulative outcome of decision making. It gives ROA the benefit of holding management accountable for the cumulative decisions made in deploying assets. If resources are used in projects that consistently yield little value, ROA will stagnate. Alternatively, if management utilizes its assets in projects that more optimally create value, ROA will rise (Hagel, Brown, Samoylova and Lui, 2013).

ROA is not a perfect measure, but it is the most effective, broadly available financial measure to assess company performance. It captures the fundamentals of business performance in a holistic way, looking at both income statement performance and the assets required to run a business. Commonly used metrics such as return on equity or returns to shareholders are vulnerable to financial engineering, especially through debt leverage, which can obscure the fundamentals of a business. ROA also is less vulnerable to the kind of short-term gaming that can occur on income statements since many assets, such as property, plant, and equipment, and intangibles, involve long-term asset decisions that are more difficult to tamper with in the short term (Hagel *et al*, 2013)

#### **2.4 The Globalization of Financial Systems**

The global financial system is the collective financial institutions that facilitate and regulate flows of investment and capital worldwide. Cavusgil, Knight and Riesenberger, 2008, justified that a global financial system is built on activities of banks, financial institutions and firms engaged in an ongoing international financial activity. The key players in the global financial system are finance ministries, national stock exchanges, commercial banks, central banks, the Bank for International Settlements, the World Bank and the International Monetary Fund.

The integration of the financial and monetary activities is growing globally due to the evolution of financial and monetary regulation worldwide, new technological development payment systems and Internet use, increasing global and regional interdependence of financial markets, and growing role of single currency system (Cavusgil *et al*, 2008). Revolution in communication, information processing and the growth in cross-border trade and capital flows has enhanced the evolution of international institutions and agreements.

This is the same for international banking, where today, banks take and hold deposits in any currency, regardless of bank location. The speed and efficiency of transfer and settlement has increased leading to geographic location being irrelevant.

## **CHAPTER THREE**

### **RESEARCH METHODOLOGY**

#### **3.1 Introduction**

This chapter describes the research design, the population of study as well as the sample size. Data collection and analysis techniques are also discussed in this section.

#### **3.2 Research Design**

A descriptive census study design was used to describe both the quantitative and qualitative features of the study. This was appropriate as the study sought to collect and review quantitative and qualitative secondary data on the internationalization strategy and process of listed financial services firms in Kenya with significant international operations.

#### **3.3 Population of the study**

The population consisted of publicly quoted indigenous financial service companies in Kenya. There are currently 20 listed financial services firms on the Nairobi Securities Exchange. These companies are listed on the Nairobi Securities Exchange, details of which are contained in the NSE Handbook, 2014. However, there are firms that have no significant international presence and as such only firms with significant operations involving cross border activities as at 31<sup>st</sup> December 2012 were studied. This was a census study of the 8 publicly quoted indigenous financial service companies in Kenya that have international operations.

#### **3.5 Data collection**

The study utilized secondary data collected from the Nairobi Securities Exchange, The websites of selected firms, Central Bank of Kenya and the Kenya Bankers Association and

the Insurance Regulatory Authority. Data on foreign and domestic revenues/sales and Return on Assets (ROA) was collected. In cases where public information was inaccessible or ambiguous, the companies were contacted for clarification. Data on domestic and foreign sales between 2004 and 2012 was collected and used to calculate the speed of internationalization by determining the growth in a company's foreign sales ratio during the said period. The average annual growth of the foreign sales ratio between 2004 and 2012 is the speed of internationalization. ROA data of the nine firms from 2004 to 2012 was collected as a measure of performance.

### **3.6 Data analysis**

Data derived from the secondary sources was analyzed using linear regression analysis so as to determine the effect of speed of internationalization on performance of listed indigenous financial service companies in Kenya. The researcher used the Statistical Package for Social Scientists (SPSS) to generate reports and descriptive statistics for various variables in the study.



## **CHAPTER FOUR**

### **DATA ANALYSIS AND INTERPRETATION**

#### **4.1 Introduction**

This chapter presents the analyzed data from the secondary sources clustered along the main objectives of the study. Also, the chapter discusses the findings and draws comparison with existing research findings on the study area. Data from the study was statistically analyzed using regression analysis.

#### **4.2 Effects of internationalization speed on performance**

Regression analysis were used on a panel data for the 9 listed financial services firms that have significant international operations for years 2004-2012. The financial data used are Return on Assets (ROA) for 9 listed financial services firms with significant international operations . For the measurement of speed, the rate at which foreign sales ratio has increased between 2004 and 2012 was used. Table 4.1 presents the results of regression analysis using ROA as the dependent variable and amounts speed as independent variable. In order to establish the relationship between independent and dependent variables, a simple regression was conducted. The analysis applied the statistical package for social sciences (SPSS) to compute the measurements of the multiple regressions for the study. The findings were as shown in the Table 4.1.

**Table 4.1 Model Summary**

| Model | R                 | R Square | Adjusted R Square | Std. Error of the Estimate | Change Statistics |          |     |     |               |
|-------|-------------------|----------|-------------------|----------------------------|-------------------|----------|-----|-----|---------------|
|       |                   |          |                   |                            | R Square Change   | F Change | df1 | df2 | Sig. F Change |
| 1     | .858 <sup>a</sup> | .584     | .503              | .45309                     | .434              | 5.357    | 1   | 7   | .014          |

a. Predictors: (Constant), Speed

In order to explain the percentage of variation in the dependent variable (ROA) that is explained by the independent variable, the researcher used coefficient of determination obtained from the model summary in table 4.1. Coefficient of determination explains the extent to which changes in the dependent variable (ROA) can be explained by the change in the independent variable or the percentage of variation in the dependent variable that is explained by the variable (Speed of internationalization). From the analysis, the independent variable (Speed) in this study contributed to 58.4% of the variation in ROA as explained by adjusted R<sup>2</sup> of 0.584. The study conducted an Analysis of Variance, in order to test the significance of the model. The findings were as shown in Table 4.2:

**Table 4.2 ANOVA**

| Model |            | Sum of Squares | df | Mean Square | F     | Sig.              |
|-------|------------|----------------|----|-------------|-------|-------------------|
| 1     | Regression | 1.100          | 1  | 1.100       | 5.357 | .014 <sup>a</sup> |
|       | Residual   | 1.437          | 7  | .205        |       |                   |
|       | Total      | 2.537          | 8  |             |       |                   |

a. Predictors: (Constant), Speed

b. Dependent Variable: ROA

From the ANOVAs results, the probability value of 0.0054 was obtained implying that the regression model was significant in predicting the relationship between profit before tax and the predictor variables as it was less than  $\alpha=0.05$ . By use of the F-table, the F (5%, 1,

2) tabulated was 4.7571 which was less than  $F= 5.357$  indicating that the model was significant.

**Table 4.3 Coefficients**

| Model        | Unstandardized Coefficients |            | Standardized Coefficients | t     | Sig. |
|--------------|-----------------------------|------------|---------------------------|-------|------|
|              | B                           | Std. Error | Beta                      |       |      |
| 1 (Constant) | -.025                       | .169       |                           | -.150 | .885 |
| Speed        | .928                        | .129       | .658                      | 2.315 | .014 |

a. Dependent Variable: ROA

The researcher conducted a regression analysis to determine the relationship between ROA (dependent variable) and the internationalization speed (independent variable) by the financial services firms. The following regression equation was obtained:

$$Y = -0.025 + 0.928X + \epsilon$$

From the regression model obtained above, holding all the other factors constant, ROA would be -0.025. A unit change in speed holding the other factors constant will lead to change in ROA by 0.928. These imply that speed has a significant influence on ROA in respect to the current performance of listed financial services firms and the speed at which they internationalize.

The obtained regression equation further implied that there was a direct relationship between speed and ROA of listed financial services firms. The analysis was undertaken at 5% significance level. The criteria for comparing whether the predictor variables were significant in the model was through comparing the corresponding probability value obtained and  $\alpha=0.05$ . If the probability value was less than  $\alpha$ , then the predictor variable

was significant otherwise it wasn't. Internationalization speed was significant in the model as its corresponding predictor variables was 0.014.

Further the study carried out the hypothesis testing between internationalization speed variable and financial performance. The Pearson coefficient measure for ROA showed a strong, significant, positive relationship between internationalization speed and financial performance of listed financial services firms in Kenya. Therefore basing on these findings the study rejected the null hypothesis that there is no relationship between internationalization speed and financial performance of listed financial services companies and accepted the alternative hypothesis that there exists a relationship between internationalization speed and financial performance of financial services companies in Kenya.

## **CHAPTER FIVE**

### **SUMMARY, CONCLUSIONS AND RECOMMENDATIONS**

#### **5.1 Introduction**

This chapter aims at answering the research questions, comparing the findings with the previous studies and making conclusions based on the research. This section also includes areas for further research based on questions left unanswered and new issues which are important for others to address

#### **5.2 Linkage between speed and performance**

Speed of internationalization is correlated to ROA of financial services firms in Kenya. This explains why many of the firms are aggressively venturing outside of Kenya. The results of regression analysis showed that there is a significant positive relationship between speed and financial performance of listed financial services firms in Kenya as shown by P value of 0.014% for ROA as well as the adjusted R Squared figure and the positive coefficients.

The study findings on the effects of internationalization speed on ROA show a positive relationship. As performance indicator therefore ROA are affected positively by speed of internationalization. Although there are many performance indicators that can be used, the researcher feels that the two parameters are best for this study because of their universality and availability of data.

Previous research indicates that internationalization will improve the company's profitability and financial performance. Firms' operations beyond domestic boundaries enable them to reap the benefits from foreign market engagements and increase

profitability (e.g. Barkema and Vermeulen, 1998). Previous research has suggested that the relationship between internationalization and firm performance is contingent on foreign expansion speed (Autio et al., 2000; Wagner, 2004; Barkema and Vermeulen, 1998) and this study upholds this view. It shows that internationalizing rapidly facilitates experiences which help to break up inflexible structures and check for new challenges. This has been associated with higher growth rates.

ROA is a long term measure of performance and is less vulnerable to artificial increases in profits in the short term. If management inflates earning in the short term while deploying resources badly, ROA will eventually decline. The study indicates that in the long run, faster internationalization is good for financial services firms in Kenya.

### **5.3 Conclusions**

Financial services firms can increase their performance by internationalizing at a faster pace. Firms that don't internationalize fast experience lower returns on assets and equity compared with firms that internationalize faster. Despite the limitation, this study has investigated the relationship between internationalization speed and performance and has upheld previous research findings on this emerging and important research area. The study demonstrates that speed impacts the success of financial services firms and therefore they need to align their internationalization speed with performance.

Ultimately, companies need to earn a healthy return on assets invested in order to stay in business. ROA captures how well a company used its assets to create value. Thus, ROA is a more effective measure of fundamental business performance. Internationalization is a long term investment that may take a while to show returns. The results of this study

indicate that investing in internationalization has a positive effect on ROA for financial services firms in Kenya.

#### **5.4 Recommendation**

This study has shown that there is a strong positive relationship between firm performance and speed of internationalization of financial services firms in Kenya. It is now upon policy makers and regulators to put in place laws and regulations that encourage firms to internationalize fast. It is clear that firms that expand internationally faster enjoy better returns than those that do so at a slower pace and therefore faster internationalization should be encouraged.

Managers need to understand that when the decision to internationalize is made then speed becomes of essence. Lessons learnt in one market should be quickly applied in other markets therefore ensuring that losses are minimized and profits realized at a faster pace in order to maximize returns.

This study offers opportunities for research especially given that only nine financial services firms listed on the NSE have significant international operations. The study should be expanded to include even unlisted firms as well as firms in other sectors. Future research should also evaluate different measures of financial performance that may include (a) measures of monopoly power; (b) other measures of profitability; (c) measures of fixed asset intensity; (d) measures of growth opportunities, and (e) measures of financial risk, efficiency and size (Kim & Lyn, 1990).

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## APPENDICES

### Appendix 1: List of publicly quoted financial services firms in Kenya

| <b>List of publicly quoted financial services firms in Kenya</b> |                              |                        |
|--|------------------------------|------------------------|
|  | <b>Company</b>               | <b>Sub Sector</b>      |
| 1  | Barclays Bank                | Banking                |
| 2  | CFC Stanbic Kenya Holdings   | Banking                |
| 3  | Diamond Trust Bank           | Banking                |
| 4  | Equity Bank                  | Banking                |
| 5  | Housing Finance Company      | Mortgage Finance       |
| 6  | I&M Holdings                 | Banking                |
| 7  | KCB                          | Banking                |
| 8  | National Bank of Kenya       | Banking                |
| 9  | NIC Bank                     | Banking                |
| 10   | Standard Chartered Bank      | Banking                |
| 11   | Co-op Bank of Kenya          | Banking                |
| 12   | British American Investments | Insurance              |
| 13   | CIC Insurance Group          | Insurance              |
| 14   | Jubilee Holdings             | Insurance              |
| 15   | Kenya Re Corporation         | Insurance              |
| 16   | Liberty Kenya Holdings       | Insurance              |
| 17   | Pan Africa Insurance         | Insurance              |
| 18   | Centum Investment Company    | Diversified invesments |
| 19   | Olympia Capital Holdings     | Diversified invesments |
| 20   | Transcentury Limited         | Diversified invesments |