IMPACT OF OUTSOURCING PRACTICES ON PERFORMANCE
OF COMMERCIAL BANKS IN KENYA

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DECLARATION

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

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

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DATE

07.11.2011

DATE

12.11.11
DEDICATION

I dedicate this paper to my parents Mr and Mrs. Bii for bringing me into this world, bringing me up and always believing in me. Above all I wish to thank the Almighty God who has brought me this far and from whom all good things come.
ACKNOWLEDGEMENTS

I am grateful to the Almighty God for giving me strength and good health while undertaking my studies.

I thank my supervisor Dr. J. Aduda whose guidance and support enabled me to complete my research.

I also thank my family members for the support, inspiration and encouragement they gave me during the pursuit of my MBA degree.

Lastly, I offer my regards and blessings to all those who supported me in any respect while I was undertaking my project.
ABSTRACT

This paper examines the impact of outsourcing practices on performances of commercial banks in Kenya. According to Barako and Gatere, 2008, there is a significant rise in outsourcing (around 50%) in Kenyan banking sector. This is attributed to perceived benefits expected to accrue to a firm from outsourcing and hence enable banks to improve their performance. Shareholders of banks expect good returns in terms of return on assets (ROA), return on equity (ROE) and return on investment (ROI) among other performance indicators. However there are inherent risks that accompany outsourcing practices which if not adequately checked will negatively impact on banks’ performance. Thus the level of risk management practices employed by banks will inevitably determine the degree of success or failure of outsourcing ventures.

Outsourcing is a widely used business practice for organizations that are in an effort to improve firm performance and add firm value. Empirical studies show that IT outsourcing has very limited positive impact on firm performance. However, there is to date no research done in Kenya that has exclusively focused on outsourcing impact on firm performance in the banking industry, which is one of the most technology-intensive industries. This paper attempts to fill this gap and the survey method covered 16 commercial banks which represent 43 of them currently in operation in Kenya. Results obtained from primary and secondary sources indicated positive performance results. The research results suggest that the perceived benefits outweigh perceived failures and hence outsourcing is viewed to have enhanced banks' performance. However, as a suggestion to future research, a more sophisticated performance measurement system ought to be used.
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CHAPTER ONE: INTRODUCTION

1.1 Background of the Study

In today’s world of ever increasing competition, organizations are forced to look for new ways to generate value. The world has embraced the phenomenon of outsourcing and companies have adopted its principles to help them expand into other markets (Bender 1999). Globally, outsourcing usage grew by 35 percent in 1997 and the total market for outsourced services was expected to increase to $200 billion by the year 2001 (Greer, Youngblood, and Gray 1999). Within the ever changing financial world, banks concentrate efforts on particular skills or core business activities or services and letting others provide non-core services. This refers to outsourcing which occurs when a bank uses another party (either a related party or an independent party) to perform business functions that would traditionally have been undertaken by the bank itself. It is a management strategy by which an organization delegates major, non-core functions to specialized and efficient service providers. Banks were pioneers in this field and still accounts for a lion’s share. Outsourcing continues to play a major role in the financial industry (Khan, 2008). Industry research and surveys by regulators show financial firms outsourcing significant parts of their regulated and unregulated activities. These outsourcing arrangements are also becoming increasingly complex. This is because it has the potential to transfer risk, management and compliance to third parties who may not be regulated, and who may operate offshore.
In the Kenyan context, outsourcing is mainly done within the country rather than offshore. It is a trend that has been in existence for quite some time and is not a new phenomenon in the Kenyan banking industry, as it has now been accepted by some of the commercial banks. Current forecasts suggest that this trend towards outsourcing is likely to continue into the near future. Indeed under Vision 2030's economic pillar, the financial services sector is one of the priority sectors alongside tourism, agriculture and livestock, wholesale and retail trade, manufacturing and business process outsourcing (BPO) identified to address Kenya's economic challenges and grow GDP to 10% by the year 2012 (CBK Governor, 2009). However, there is no regulatory framework guiding outsourcing practices by commercial banks in Kenya today according to Central Bank of Kenya (CBK) survey of 2005.

The traditional outsourcing emphasis on tactical benefits like cost reduction (for example, cheaper labour cost in low-cost countries), have more recently been replaced by productivity, flexibility, speed and innovation in developing business applications, and access to new technologies and skills (Greer, Youngblood, and Gary 1999; Bacon 1999). Today, outsourcing is increasingly used as a means of both reducing costs and achieving strategic aims (Basle Committee, 2005). Its potential impact can be seen across many business activities, including information technology (e.g., applications development, programming, and coding), specific operations (e.g., some aspects of finance and accounting, back-office activities & processing, and administration), and contract functions (e.g., call centres). For example, the main purpose for banks to outsource IT is to focus on their core competencies (Gupta, Gupta 1992, Lacity, Hirschheim 1994,
Job division enables different parties to focus on what they are expert in. Banks are good at banking and IT companies are good at information technology. Banking is the core business of banks while technology is the core business of IT companies. The outside vendors are able to provide more efficient and reliable services, which lead to the economies of scale as well as the economies of scope. But, in order to effectively harness the benefits of outsourcing, there is need for bank management to define standards and goals it expects to achieve by means of outsourcing practice so acquired (Bunmi, 2002).

Research reports show that, by outsourcing some or all of their IT and business operations to third-party providers, retail banking institutions can achieve greater transparency and efficiency of their infrastructure and business processes, which facilitates the achievement of their strategic operational goals (Gupta, Gupta 1992, Gonzalez, Gasco & Llopis 2010). IT outsourcing gives banks the opportunities to access world class skills, realize fast project start-up and borrow best examples in the banking industry. All of these translate into lower costs and higher quality, which increase the competitiveness of banks. The need to reduce costs may arise from lower growth opportunities, higher debt, or falling profitability. In such cases, IT outsourcing is part of a larger cost-cutting fort for the entire company (Gupta, Gupta 1992, Lacity, Hirschheim 1994, Ang, Straub 1998). Other reasons for banks to outsource IT include improving corporate efficiency, increasing flexibility, providing better service and enhancing the transparency (Wang et al. 2008, Smith, Mitra & Narasimhan 1998, Kishore et al. 2003). However, besides the benefits brought by IT outsourcing, there are also some adverse
effects associated with this practice. Some argue that instead of cutting cost, IT outsourcing actually brings extra costs such as vendor selection costs, legal contract costs and layoff costs (Barthélemy, Geyer 2005). Some also point out the risks followed by IT outsourcing: loss of management control, loss of intelligent assets, loss of in-house IT capability, loss of innovative ability, loss of key IS employees and the risk of the default of outside vendors (Smith, Mitra & Narasimhan 1998).

A major objective of bank management is to increase shareholders' return epitomizing bank performance. The objective often comes at the cost of increasing risk. The adoption of a strategic process of transferring the responsibility for providing all or parts of business functions to third parties (outsourcers) has strong potentials for creating risks that require identifying, measuring, diminishing, eliminating or managing by the host organization. For example, the risks in outsourcing such as fraudulent use of customer account information, theft of customer funds, or credit and procurement corruption can have a significant negative impact on financial services companies. These are some of the many reasons why managing the outsourcing risks is important to management, the board of directors, and internal auditors. Indeed success in banking itself could depend, to a larger extent on the ability of the given organization to manage the risks associated with outsourced systems. Banks engaging in outsourcing are therefore expected to undertake due diligence and careful planning, using some tested methodology. Risk management has significant effect on bank performance, and vice versa (King and Levine 1993 a, b; Levine 1997).
Successful implementation of an outsourcing strategy has been credited with helping to cut cost (Bowersox 1990; Gupta and Zeheuder 1994; Greer, Youngblood and Gray 1999), increase capacity, improve capacity, improve quality (Lau and Hurley 1997; Kotabe, Murray and Javalugi 1998), increase profitability and productivity (Casale 1996; Sinderman 1995), improve financial performance (Crane 1999), lower innovation costs and risks (Quinn 2000), and improve organizational competitiveness (Lever 1997; Steensma and Corley 2000; Sharpe 1997). However, outsourcing does generate some problems. First of all, outsourcing usually reduces a company's control over how certain services are delivered, which in turn may raise the company's liability exposure.

Companies that outsource should continue to monitor the contractor's activities and establish constant communication (Guterl 1996). Another big problem with outsourcing comes from the workers themselves as they fear loss of jobs (Malhorta 1997). According to a survey 55 percent of outsourcing relationships fail in the first five years. Of these that do manage to stay together, 12 percent are unhappy with their arrangement and regret ever making the deal (Foster 1999).

In Kenya, a considerable number of outsourcing deals have emerged as one of the most important business decisions for firms that want to improve firm performance and add firm value. The increasing pressure for banks to deliver high quality services that can satisfy customers whenever, wherever and however they need, and achieve good returns for shareholders in a competitive environment require banks to use a set of complex and diversified technology to run their business.
1.1.1 Performance Measurement

At a basic level, the concept of performance refers to output results and their outcomes obtained from processes, products, and services that permit evaluation and comparison relative to goals, standards, past results, and other organizations. Performance can be expressed in non-financial and financial terms.

Measurement refers to numerical information that quantifies input, output, and performance dimensions of processes, products, services, and the overall organization (outcomes). Performance measures might be simple (derived from one measurement) or composite.

Since performance measurement system plays a key role in developing strategic plans, evaluating the achievement of organizational objectives and compensating managers, scholars as well as practitioners have paid considerable interest in performance measurement (Benson, Buckley & Hall 1988).

Since the early 1990s, the non-financial measures are receiving more and more attention. Academics suggest that traditional performance measurement systems do not provide a full understanding of the influences on firm performance. Nowadays the increasing dynamic and competitive business environment demands across-the-board measurement.
1.1.2 Commercial Banks in Kenya

A bank means a company which carries on, or proposes to carry on banking business in Kenya and includes the Co-operative Bank of Kenya Limited but does not include the Central Bank. Banking business means the accepting from members of the public of money on deposit repayable on demand or at the expiry of a fixed period or after notice; the accepting from members of the public of money on current account and payment on and acceptance of cheques; and the employing of money held on deposit or on current account, or any part of the money, by lending, investment or in any other manner for the account and at the risk of the person so employing the money (The Banking Act, Chapter 488). In Kenya, commercial banks are licensed and regulated under the Banking Act, Chapter 488 and Prudential Regulations issued thereunder. Currently, there are 43 commercial banks operating in the country (CBK, 2010). Central Bank of Kenya is the regulatory authority.

1.2 Statement of the problem

Studies have been carried out globally to assess the impact of outsourcing practices on firms' performance. These studies show varied results and hence the puzzle still exist. In fact outsourcing has generated much controversy in recent times for various reasons. Key questions being debated are whether outsourcing can enable financial institutions to reach the efficient frontier of risk management and hence enhance their performance or whether outsourcing can be a source of risk. Upon examination, it is clear that it is possible to
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answer both with a ‘yes’ which means the results of outsourcing have not yet been well confirmed by existing research (Jiang, Qureshi 2006).

Li Wang et al. (2008) conducted a research that studied the firm performance after IT outsourcing announcement of 120 companies in all industries from 1993 to 2003. Their research indicated that IT outsourcing has very few positive effects on firm performance compared with the matched control group. However, the impact of IT outsourcing on firm performance can vary significantly across industries. Although the research of Wang et al. (2008) shows very little significant difference on firm performance between the sample group and the control group, there might be a completely different story when taking only the banking industry into consideration. Due to its’ information-intensive attributes, the uses of IT may have more remarkable impact on firm performance of banks.

Objectives of a bank as a business entity include profit maximization, improve shareholders wealth and market share domination. Therefore to achieve them in a competitive Kenyan environment forces banks to adopt strategies geared towards their realization. One of these strategies is embracing outsourcing practices of some of their non-core functions. Outsourcing is a widely used business practice for organizations that are in an effort to improve firm performance and add firm value. However, empirical studies show that IT outsourcing has very limited positive impact on firm performance (Yu Ping 2010). Outsourcing, on one hand, cuts cost, improves performance and adds value to banks; on the other hand, also brings some additional costs and unexpected risks.
This is further compounded by risks inherent in an agency relationship. For example, if both parties to the relationship are utility maximizers, there is a good reason to believe that the agent will not always act in the best interests of the principal. The jury is still out there.

Since a lot of banks are passionate and optimistic about their decisions concerning outsourcing, it would be very necessary and meaningful to find out the impact of this prevailing business practice on the performance of banks. To date there are only very limited number of studies that have examined the performance and the economic implications of outsourcing (Elmuti, 2004; Wang et al. 2008). Very limited number of research has exclusively focused on the financial service industry or the banking industry. ATMs and card processing are the most outsourced IT related functions in the Kenyan banking industry (Barako and Gatere 2008). This paper attempts to fill this research gap by focusing exclusively on the banking industry (commercial banks in Kenya) using non-financial and financial measures.

1.3 Objectives of the study

(i) Establish the impact of outsourcing practices on performance of commercial banks in Kenya.

(ii) Ascertain the adequacy or otherwise of outsourcing risk management practices as currently adopted by commercial banks in Kenya.
1.4 Importance of the study

The study aims to seek evidence from a true representation of some banks in order to establish the impact of benefits and challenges of outsourcing practices facing commercial banks in Kenya. Thus

It will aid individuals, banks and other institutional investors in decision making on the potential outcomes of outsourcing practices.

The government, Central Bank of Kenya and other regulators will find this study useful in drawing up regulatory policy guideline governing outsourcing practices by banks in Kenya.

To academicians and scholars, the study will prove useful for those who may wish to do further research on this subject area and other related aspects of this study.
CHAPTER TWO: LITERATURE REVIEW

2.1 Introduction

This chapter provides an evaluation of two theories namely agency theory and the transaction cost theory in one section. Review of empirical studies section then follows. Outsourcing practices section describes outsourcing with specific emphasis on review of empirical studies in Kenya and elsewhere. Lastly, a summary section of the chapter is given.

2.1.1 Agency Theory

Jensen and Meckling (1976), define an agency relationship as a contract under which one or more persons (the principal(s)) engage another person (the agent) to perform some service on their behalf which involves delegating some decision making authority to the agent. If both parties to the relationship are utility maximizers, there is a good reason to believe that the agent will not always act in the best interests of the principal. The principal can limit divergences from his interest by establishing appropriate incentives for the agent and by incurring some cost. In the case of IT outsourcing, each party in the relationship has their own profit motive and interest, their goals are not congruent according to agency theory. The principal cannot monitor the actions of the agent perfectly and without cost.

The difference between the principal and agent can have many sources and in any case the principal tries to control the agent in such a way as to maximize his own benefits. The
agent on the other hand is assumed to be driven by self-interest as well. Here a conflict can clearly be observed.

A major concern is the problem of different attitudes towards risk. If the agent under performs for example, it often has different consequences for the principal and the agent. As a result it is difficult to align the attitude towards risk between the two.

The agency relationship occurs in many situations. Actually every employer-to-employee relationship resembles an agency relationship. Employers have various modes that enable them to control the employees, many of them facilitated by the fact that actions of the employees can be monitored and used for evaluation of the performance of an employee.

2.1.2 Transaction Cost Theory

Despite for the economic benefits, outsourcing also adds additional costs. Transaction cost theory (TCT) is one of the most frequently referred theories that analyze the added costs of outsourcing. For example, in IT outsourcing activities, transaction costs refer to the effort, time and costs incurred in creating, negotiating, monitoring and enforcing a service contract between buyers and IT outsourcers (Ang, Straub 1998). First of all, the time and effort putting in finding the most suitable and trustworthy outsourcer are the start of the added costs. With any outsourced service, the expense of selecting a service provider can cost from 0.2 percent to 2 percent in addition to the annual cost of the deal (Overby 2003). When the outsourcer is selected, additional time is required to communicate and negotiate with the service provider. All kinds of formal and informal meetings, clause negotiation and contract verification make the added costs even higher.
Since most of IT service companies are operating in different locations from the service receiver, the costs of coordination and monitoring also increase (Grover, Myun & Teng 1994). Some scholars also refer to the agency theory to explain the additional costs brought by IT outsourcing. The agent costs are the sum of the monitoring costs, the bonding costs and the residual loss of the principal (Cheon, Grover & Teng 1995).

Achieving economies of scale is one of the most commonly cited reasons for IT outsourcing that derived from economic considerations. IT outsourcing brings some clear economic advantages such as reduction in overhead expenses, elimination the soaring costs associated with hardware and software maintenance and avoiding the unexpected costs caused by the fast development of information technology (Gupta, Gupta 1992). Since the primary business of an outsourcer is to provide IT services across a large range of companies, the outsourcer are able to offer high standard services at a lower unit costs than a company who chooses to do this in-house. Therefore, IT outsourcing makes the overall cost of IS operations decrease significantly. It is easy for outsourcing companies to achieve greater economies of scale at faster pace than companies who manage IS by themselves.

The transaction cost theory is applicable in risk management as well because it deals with asset specificity, overall cost advantage, the threat of opportunistic vendor behaviour, and the complexity of the transaction (Bahli and Rivard, 2003).
2.2 Review of Empirical Studies

Most academic studies have focused on understanding outsourcing decision determinants and outsourcing process control while the results of outsourcing have not yet been well confirmed by existing research (Jiang, Qureshi 2006). They also generalize that, when researchers measure the financial results of outsourcing, they rely only on managers' estimates other than tangible metrics such as public available accounting data. Generally speaking, two assessing methodologies have been applied to measure the outcomes of outsourcing. One focuses on the assessment of how well the perceived objectives are satisfied after outsourcing. Survey, case study and interviews are the main methods used to gather data (Lacity, Hirschheim 1994, Weeks, Feeny 2008). The other methodology conducts performance based analysis using public available financial data such as stock price (Hayes, Hunton & Reck 2000, Oh, Gallivan & Kim 2006) and financial accounting data (Wang et al. 2008, Jiang, Qureshi 2006). However, most available studies concerning the results of outsourcing rely upon perceived metrics rather than direct measures, which are likely to be influenced by subjective perceptions (Jiang, Qureshi 2006). The interviewees usually only think about their own fields or departments instead of taking the whole picture of the firm into consideration.

Studies that are based on objective financial data are very limited. Using public available accounting data, Jiang et al. (2006) found no significant difference in assets turnover (sales/assets), ROA and net profit margin. They conclude that outsourcing can improve a firm's cost-efficiency but not its productivity and profitability. This research is regarded
as the first one that empirically tests the relation between the outsourcing decision and the firm’s financial performance (Jiang, Frazier & Prater 2006).

The study of Wang et al. (2008) develops a conceptual framework to examine the impact of IT outsourcing on firm performance. They study a sample of 120 companies with IT outsourcing announcement from 1993 to 2003. Their research suggest that IT outsourcing firms have significantly higher SGAS (selling, general and advertising expenses / net sales) and significant lower ROA compared with the non-outsourcing counterparts in year t+1 (one year after IT outsourcing) but there is no significant difference in ROA, ROE, ROI and other measures in the rest of the years (Wang et al. 2008). Similar studies focusing exclusively on the IT outsourcing impact in the banking industry are even fewer. The research methodologies are either case study or survey.

The study by Elmuti (2004) focused on the perceived impact of outsourcing on organizational performance. The attitudinal results presented in the study provide support for the claims of outsourcing proponents that outsourcing allows companies to enhance expertise, improve service quality, reduce staff, streamline the process, lower costs and reduce the administrative burden and saving time. Outsourcing in this sense, is beneficial to organizational performance (Casale 1996; Crane 1999; Quinn 2000). In addition, this study identified current outsourcing strategy trends and practices for randomly selected firms in the United States. One of the important contributions of this study is the revelation that organizations generally considered themselves successful at outsourcing. However, while they achieved significant improvement in organizational performance,
they have not reached the magnitude of improvements ascribed to outsourcing strategies. A number of organizational strategies were also identified as key contributors to outsourcing success. These included strategies with clear objectives, right outsourcing partners, adequate skills, adequate planning, effective communication, and cooperation and collaboration throughout the organization. These strategies are thought to improve quality, deliver, and performance.

2.3 Outsourcing Practices

The need for outsourcing has grown over the last two decades as there is an increase in global competition, downsizing, the move to flatter organizations, the need to reduce costs, improve quality, service and delivery, improve organizational focus, increase flexibility, facilitate change and the emphasis on core competencies (Atkinson, 1985; Dyer and Ouchi, 1993; Huber, 1993; Fan 2000). The organization of market places has shifted from pure hierarchy- and market-based modes to hybrid arrangements involving significant vendor participation (Fritsch and Wullenweber, 2007).

In 1999, Federal Reserve Bank of New York conducted survey on banking industry practices for outsourcing arrangements. Findings suggest that banks outsource financial services for a number of reasons, such as enhanced performance; cost reduction; access to superior expertise; and strategic reasons. In addition the study indicates that although there are many benefits derived from outsourcing of financial services, the arrangement give rise to potential risks. The risks identified are strategic, reputation, credit, compliance, transaction and country risk.
Similarly, in 2004 Federal Reserve Bank of San Francisco, conducted survey on outsourcing by financial services firms, and notes a number of motives for outsourcing, namely, operational efficiency; efficient use of resources; and quick and reliable service delivery. Further, a survey conducted by European Central Bank in 2004 reveals that although the benefits of outsourcing are evident, in practice, many banks believe that outsourcing introduces new challenges and risks.

In a survey study by Baroko and Gatere (2008), perceived benefits and risks associated with outsourcing practices of the Kenyan banking sector were identified. Descriptive analysis results indicated that Automated Teller Machine (ATM) services and card processing are the most outsourced functions in the sector, while customer account processing is the least outsourced function. It was also found that cost saving and profitability are not significant predictors of outsourcing practices in the Kenyan banking sector. Surprisingly, the large number of financial institutions (nearly 50%) involved in outsourcing of certain banking functions, in an environment without a regulatory framework.

According to an internet article by Moses Kemibaro (September 20, 2010) Kenyan banks are set to benefit from outsourcing of credit card processing partnership with Universal Payment Services (UPS) a leading transaction service provider of payment card services in the Middle East and Africa. The banks stand to benefit from a full spectrum of smart card solutions for their customers through third party card sourcing by UPS, allowing them to concentrate on their core business of taking deposits and providing loans.
ultimately cutting down costs considerably on human capital, hardware and software costs. Surprisingly, in a survey conducted by the Central Bank of Kenya, a number of financial institutions have no risk management frameworks, Central Bank of Kenya (2005).

2.4 Summary

Agency theory and transaction cost theory suggest four main risk scenarios that can be associated with outsourcing namely lock-in, contractual amendments, unexpected transition and management costs and disputes and litigation. The term lock-in refers to a situation where a client cannot get out of a relationship except by incurring a loss or sacrificing part or all of its assets to the supplier. However, there are also identified advantages brought by outsourcing like achievement of economies of scale brought about by IT outsourcing.

Most academic studies have focused on understanding outsourcing decision determinants and outsourcing process control while the results of outsourcing have not yet been well confirmed by existing research (Jiang, Qureshi 2006). Methodologies used to measure performance are assessment of how well the perceived objectives are satisfied after outsourcing while another is based on analysis using available financial data. Majority of these studies were done in foreign countries and involving different organizations. There is therefore a need to conduct a study in a developing country like Kenya. The study will enable a researcher to find out the impact of outsourcing on the performance of banks in Kenya.
CHAPTER THREE: RESEARCH METHODOLOGY

3.1 Introduction

This chapter discusses the research design and methodology of the study. It highlights description of the research design, the research variables and provides a broad view of the selection of the population. The research instruments, data collection techniques and data analysis procedure have also been pointed out.

3.2 The Research Design

The methodology for this study employed a survey research method. The survey method involves asking participants questions on how they feel, what their views are, and what they experienced (Babbie, 2002). Survey method is useful when a researcher wants to collect on phenomena that cannot be observed directly. Its main advantage is that, it allows the collection of large amounts of data from a sizeable population in a highly effective, easily and in an economical way, often using questionnaires.

3.3 Target Population

The population for this study is defined as all the commercial banks in Kenya. Currently, there are 43 commercial banks actively operating in Kenya (Source: CBK, 2011).

3.4 Sample Size and Sampling Technique

Determination of an effective sample size limited the study. Some banks that otherwise would have been part of the sample declined to provide research information, citing corporate policy as the reason. The final sample is however representative of the
population of this research. A total of 16 managers participated in the exercise. This research study used purposive sampling technique to select at least one respondent who is either a supplies manager, human resources manager, or finance manager in each of the commercial banks. The choice of the three departments is because of their direct involvement in outsourcing matters. Purposive sampling method is a deliberate non-random method of sampling which aims at selecting a sample of people, settings or events with predetermined characteristics.

3.5 Data Collection Method

The study used primary data which was collected from a sample of all commercial banks operating in Kenya in June 2011. A structured questionnaire consisting of closed-ended questions was developed. Each construct was represented by a set of indicators which form the question in the survey. The attitude/opinion of the respondents was captured on a 5-point Likert scale with very high (5), high (4), neutral (3), low (2) and very low (1) being ratings. Drop and pick method was used to administer the questionnaires.

The secondary source was derived from analysing published journals of banks from their regulatory body, Central Bank of Kenya. The data collection process was both quantitative and qualitative.

3.6 Data Analysis Technique

The data was analyzed using the windows based Statistical Package for Social Sciences (SPSS) version 17. Descriptive statistics such as means, standard deviation and frequency distribution were used to analyze the data. Data presentation was done using tables, pie
charts, bar charts, percentages and frequency tables. The results were presented in
percentages, tables and figures.

3.7 Data Reliability and Validity

This study used content validity to measure the degree to which the sample of the items
represents the content that the test was designed to measure.

To refine and validate questions asked prior to banks’ survey, the questionnaire was
thoroughly checked for accuracy and completeness.

3.8 Ethical Considerations

The respondents were told that all information gathered will be treated with utmost
confidentiality. The researcher had to book appointments with the respondents’ prior to
data collection.
CHAPTER FOUR: DATA ANALYSIS AND FINDINGS

4.1: Introduction

This chapter gives the descriptive analysis of the findings in one section followed by a section on accounting-based performance measures and lastly risk management section.

4.2: Descriptive Analysis

Table 1, presents information relating to personal attributes of the respondents. The respondents are well educated with 75% holding at least a first degree and all the respondents occupying management positions. This suggests that all the respondents were well versed with the policies and operations of the bank, and involve in outsourcing decisions. Thus, the survey response can be relied upon to the extent that all respondents are bank managers with 12.5% in senior management positions, 43.75% in middle level management while 43.75% are in junior management position. Only 12.5% of the respondents were female, an indication of low female representation in banking sector. Overall, the response rate was 37.20%.

Table 1: Respondents’ background information

<table>
<thead>
<tr>
<th>Background</th>
<th>Proportion of the respondents %</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gender</td>
<td></td>
</tr>
<tr>
<td>Male</td>
<td>87.5</td>
</tr>
<tr>
<td>Female</td>
<td>12.5</td>
</tr>
<tr>
<td>Total</td>
<td>100</td>
</tr>
<tr>
<td>Level of Education</td>
<td></td>
</tr>
<tr>
<td>A-Level</td>
<td>6.25</td>
</tr>
<tr>
<td>Degree</td>
<td>93.75</td>
</tr>
<tr>
<td>Postgraduate</td>
<td>25</td>
</tr>
<tr>
<td>Total</td>
<td>100</td>
</tr>
</tbody>
</table>
Table 2 shows the level of outsourcing strategy for each function. The level of outsourcing strategy was captured using constructs, dependent upon whether the bank has already an explicit outsourcing strategy for the identified function or not.

Analysis of the section on the level of outsourcing strategy indicates that majority of the banks do not have outsourcing strategies for all the functions. Internal audit function was found to have least outsourcing strategy with only one respondent sampled indicating to have. This may be explained by critical role the internal audit function plays in the whole business process and hence is least outsourced. It also indicates concerns about service quality of third party in effectively undertaking such an important internal governance responsibility. On the other hand, card processing and debt collection functions were the majority with existing outsourcing strategies.
Table 2: Outsourcing Strategy (in percentages)

<table>
<thead>
<tr>
<th>Function</th>
<th>Yes (%)</th>
<th>No (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>ATM service</td>
<td>50</td>
<td>50</td>
</tr>
<tr>
<td>Card processing</td>
<td>68.75</td>
<td>31.25</td>
</tr>
<tr>
<td>Underwriting services</td>
<td>50</td>
<td>50</td>
</tr>
<tr>
<td>Advisory services</td>
<td>50</td>
<td>50</td>
</tr>
<tr>
<td>Human Resources</td>
<td>12.5</td>
<td>87.5</td>
</tr>
<tr>
<td>Debt collection</td>
<td>75</td>
<td>25</td>
</tr>
<tr>
<td>Internal Audit</td>
<td>6.25</td>
<td>93.75</td>
</tr>
</tbody>
</table>

Source: survey

Chart 2: Outsourcing strategy (in percentages)
The results of the questionnaire responses on reasons for outsourcing are shown on Table 3. The respondents are generally in agreement that outsourcing process brings benefits to a bank. In terms of priority, focus on the core competencies (business) was cited by all the respondents as the main benefit derived from outsourcing arrangement. Improving profitability of the bank was rated lowest by the respondents and hence outsourcing is not expected to enhance profitability of a bank. All other reasons listed were also positively perceived in varying degrees as the benefits that accrue to a bank from outsourcing.

Table 3: Perceived benefits from outsourcing (in percentages)

<table>
<thead>
<tr>
<th>Variables</th>
<th>Ratings</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Very Low</td>
</tr>
<tr>
<td>1</td>
<td>6.25</td>
</tr>
<tr>
<td>Improve customer relationships</td>
<td>6.25</td>
</tr>
<tr>
<td>Improve service levels</td>
<td>0</td>
</tr>
<tr>
<td>Reduce costs</td>
<td>0</td>
</tr>
<tr>
<td>Improve quality</td>
<td>0</td>
</tr>
<tr>
<td>Focus on core competencies</td>
<td>0</td>
</tr>
<tr>
<td>Competitive advantage</td>
<td>0</td>
</tr>
<tr>
<td>Improve profitability</td>
<td>6.25</td>
</tr>
<tr>
<td>Freed resources</td>
<td>6.25</td>
</tr>
</tbody>
</table>

Source: survey
Chart 3: Perceived benefits from outsourcing (in percentages)
From table 4, we determine from the modes that most respondents agree that outsourcing mainly improves service levels, reduces costs, focus on core competencies, and gives a competitive advantage. The skewness measures reveal that the main advantages are improvement of service levels and focus on core competencies, which have strong negative skewness. In these two cases the distribution is presented by pie charts as follows:

Chart 4a:

Chart 4b:

In both cases more than half of the respondents agreed that there is a positive effect of the factors. They selected either “high” or “very high”.
Table 4: Perceived benefits from outsourcing (the distribution of factors)

<table>
<thead>
<tr>
<th></th>
<th>Improves customer relationships</th>
<th>Improves service levels</th>
<th>Reduces cost</th>
<th>Improves quality</th>
<th>Specializes in core competencies</th>
<th>Competitive advantage</th>
<th>Improves profitability</th>
<th>Freed resources</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mean</td>
<td>3.38</td>
<td>3.56</td>
<td>3.50</td>
<td>3.63</td>
<td>4.00</td>
<td>3.63</td>
<td>3.06</td>
<td>3.34</td>
</tr>
<tr>
<td>Median</td>
<td>3.00</td>
<td>4.00</td>
<td>4.00</td>
<td>3.50</td>
<td>4.00</td>
<td>4.00</td>
<td>3.00</td>
<td>3.00</td>
</tr>
<tr>
<td>Mode</td>
<td>3</td>
<td>4</td>
<td>4</td>
<td>3</td>
<td>4</td>
<td>4</td>
<td>3</td>
<td>3</td>
</tr>
<tr>
<td>Std. Deviation</td>
<td>1.025</td>
<td>1.094</td>
<td>.816</td>
<td>1.025</td>
<td>.894</td>
<td>.957</td>
<td>.929</td>
<td>0.946</td>
</tr>
<tr>
<td>Skewness</td>
<td>-.465</td>
<td>-.706</td>
<td>-.420</td>
<td>.040</td>
<td>-.639</td>
<td>-.146</td>
<td>-.136</td>
<td>0.112</td>
</tr>
<tr>
<td>Std. Error of Skewness</td>
<td>.564</td>
<td>.564</td>
<td>.564</td>
<td>.564</td>
<td>.564</td>
<td>.564</td>
<td>.564</td>
<td>.564</td>
</tr>
</tbody>
</table>
Table 5 presents findings on perceived reasons against outsourcing in terms of impact on performance of banks. Banks cite loss of jobs, loss of in-house talent, and loss of confidentiality and security in that order as the main risks associated with outsourcing. Theft of customer funds and hidden costs were perceived to be the least risky outcomes of outsourcing.

Table 5: Perceived risks associated with outsourcing (in percentages)

<table>
<thead>
<tr>
<th>Variables</th>
<th>Ratings</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Very low</td>
</tr>
<tr>
<td>In-house talent is lost</td>
<td>0</td>
</tr>
<tr>
<td>Loss of jobs</td>
<td>0</td>
</tr>
<tr>
<td>Loss of confidentiality and security</td>
<td>12.5</td>
</tr>
<tr>
<td>Fraudulent use of customer account info</td>
<td>18.75</td>
</tr>
<tr>
<td>Loss of managerial control</td>
<td>18.75</td>
</tr>
<tr>
<td>Theft of customer funds</td>
<td>31.25</td>
</tr>
<tr>
<td>Hidden costs</td>
<td>18.75</td>
</tr>
<tr>
<td>Inflexibility creeps in</td>
<td>12.5</td>
</tr>
</tbody>
</table>

Source: survey
In Table 6, the respondents stress on the idea of loss of in-house talent followed by loss of jobs. There is more unanimity on the issue of loss of jobs since the minimum and maximum are 3 and five. Further, the standard deviation (0.719) is relatively smaller. At the lower end, hidden costs are almost unanimously rejected.
| In-house talent is lost | Loss of confidentiality | Loss of security | Fraudulent use of customer account information | Loss of managerial control | Theft of customer funds | Hidde creeps | Inflexibility |
|------------------------|------------------------|-----------------|-----------------------------------------------|---------------------------|------------------------|-------------|
| Median                 | 4.00                   | 4.00            | 4.00                                          | 3.50                      | 3.00                   | 2.00        | 2.00         | 3.00        |
| Mode                   | 5                      | 4               | 4                                             | 4                         | 3                      | 3           | 2            | 3           |
| Std. Deviation         | 1.223                  | .719            | 1.258                                         | 1.360                     | 1.276                  | 1.125       | .873         | 1.088       |
| Minimum                | 2                      | 3               | 1                                             | 1                         | 1                      | 1           | 1            | 1           |
| Maximum                | 5                      | 5               | 5                                             | 5                         | 5                      | 4           | 5            |             |
The following charts illustrate the distribution of the three strong outcomes of outsourcing for comparison purposes.

Chart 6a: Loss of in-house talent

Chart 6b: Loss of jobs

Chart 6c: Hidden costs.

Charts 6a and 6b have higher bars to the right of the neutral bar while chart 6c has higher bars to the left.
Table 7 presents information on Specific Goals for Outsourcing indicating the extent of the perceived impact on bank performance. Analysis indicates that majority of the respondents were of the view that outsourcing improved their banks performance. This was followed by improvement in cost savings and quality. However, respondents shared the view that market share and customer service improvements were least achieved by their banks.

Table 7: Ratings on Achievement of Specific Goals for Outsourcing (in percentages)

<table>
<thead>
<tr>
<th>Variables</th>
<th>Very Low</th>
<th>Low</th>
<th>Neutral</th>
<th>High</th>
<th>Very High</th>
</tr>
</thead>
<tbody>
<tr>
<td>Performance (ROA,ROI,ROE)</td>
<td>0</td>
<td>0</td>
<td>25</td>
<td>62.5</td>
<td>12.5</td>
</tr>
<tr>
<td>Cost Savings Improvement</td>
<td></td>
<td>6.25</td>
<td>31.25</td>
<td>43.75</td>
<td>18.75</td>
</tr>
<tr>
<td>Customer Service Improvement</td>
<td></td>
<td>18.75</td>
<td>25</td>
<td>31.25</td>
<td>25</td>
</tr>
<tr>
<td>Market Share Improvement</td>
<td></td>
<td>12.5</td>
<td>31.25</td>
<td>50</td>
<td>6.25</td>
</tr>
<tr>
<td>Quality Service/Products</td>
<td>0</td>
<td>12.5</td>
<td>25</td>
<td>50</td>
<td>12.5</td>
</tr>
</tbody>
</table>

Source: survey
Chart 7: Ratings on Achievement of Specific Goals for Outsourcing

- Performance (ROA, ROI, ROE)
- Cost Savings Improvement
- Customer Service Improvement
- Market Share Improvement
- Quality Service/Products

Source: survey
From table 8, there is a general agreement that outsourcing has equally led to the five achievements listed. However from the standard deviations, the most agreed achievement is improved performance while the least unanimous is improved customer service.

**Table 8: Ratings on Achievement of Specific Goals for Outsourcing (the distribution of factors)**

<table>
<thead>
<tr>
<th></th>
<th>Performance</th>
<th>Cost savings</th>
<th>Customer service</th>
<th>Market share</th>
<th>Quality of service</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Median</strong></td>
<td>4.00</td>
<td>4.00</td>
<td>4.00</td>
<td>4.00</td>
<td>4.00</td>
</tr>
<tr>
<td><strong>Mode</strong></td>
<td>4</td>
<td>4</td>
<td>4</td>
<td>4</td>
<td>4</td>
</tr>
<tr>
<td><strong>Std. Deviation</strong></td>
<td>.619</td>
<td>.856</td>
<td>1.088</td>
<td>.816</td>
<td>.885</td>
</tr>
<tr>
<td><strong>Minimum</strong></td>
<td>3</td>
<td>2</td>
<td>2</td>
<td>2</td>
<td>2</td>
</tr>
<tr>
<td><strong>Maximum</strong></td>
<td>5</td>
<td>5</td>
<td>5</td>
<td>5</td>
<td>5</td>
</tr>
</tbody>
</table>
4.3 Accounting-Based Performance Measures

4.3.1: Return on Assets (ROA)

ROA is calculated as income before extraordinary Items, divided by total assets, multiplied by 100. Generally speaking, ROA represents a total picture of the profitability of a firm. ROA gives a quick indication of whether the business is earning profit on each shilling invested. A rising ROA across periods is generally favourable. ROA for the studied banks varies substantially and ranges from -5.17% to 5.58% on average for the period 2006-2010.

As banks outsource part or all of their services to more experienced vendors, they can focus more on their core business, which can generate more profit. At the same time, outsourcing enables the outsourcing receiver to realize economies of scale and scope, which will help to cut operational costs.

Table 9a: Return on assets over the years for sampled banks.

<table>
<thead>
<tr>
<th>YEAR</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
<th>Average</th>
</tr>
</thead>
<tbody>
<tr>
<td>B1</td>
<td>4.40%</td>
<td>4.20%</td>
<td>4.70%</td>
<td>5.30%</td>
<td>6.24%</td>
<td>4.97%</td>
</tr>
<tr>
<td>B2</td>
<td>1.20%</td>
<td>0.60%</td>
<td>0.30%</td>
<td>0.41%</td>
<td>0.18%</td>
<td>0.54%</td>
</tr>
<tr>
<td>B3</td>
<td>2.30%</td>
<td>1.40%</td>
<td>(0.20%)</td>
<td>1.69%</td>
<td>(0.32%)</td>
<td>0.97%</td>
</tr>
<tr>
<td></td>
<td>NIO</td>
<td>NIO</td>
<td>(9.60%)</td>
<td>(3.42%)</td>
<td>(2.50%)</td>
<td>(5.17%)</td>
</tr>
<tr>
<td>---</td>
<td>-----</td>
<td>-----</td>
<td>---------</td>
<td>---------</td>
<td>---------</td>
<td>---------</td>
</tr>
<tr>
<td>B4</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>B5</td>
<td>1.70%</td>
<td>1.30%</td>
<td>0.80%</td>
<td>0.18%</td>
<td>1.07%</td>
<td>1.01%</td>
</tr>
<tr>
<td>B6</td>
<td>0.10%</td>
<td>2.70%</td>
<td>3.20%</td>
<td>4.16%</td>
<td>4.34%</td>
<td>2.90%</td>
</tr>
<tr>
<td>B7</td>
<td>2.60%</td>
<td>3.10%</td>
<td>3.00%</td>
<td>3.57%</td>
<td>5.17%</td>
<td>3.49%</td>
</tr>
<tr>
<td>B8</td>
<td>1.30%</td>
<td>3.10%</td>
<td>4.00%</td>
<td>4.13%</td>
<td>4.49%</td>
<td>3.40%</td>
</tr>
<tr>
<td>B9</td>
<td>4.90%</td>
<td>4.30%</td>
<td>6.10%</td>
<td>5.66%</td>
<td>6.95%</td>
<td>5.58%</td>
</tr>
<tr>
<td>B10</td>
<td>2.10%</td>
<td>3.10%</td>
<td>1.50%</td>
<td>1.35%</td>
<td>1.96%</td>
<td>2.00%</td>
</tr>
<tr>
<td>B11</td>
<td>2.30%</td>
<td>3.20%</td>
<td>3.40%</td>
<td>3.30%</td>
<td>4.41%</td>
<td>3.32%</td>
</tr>
<tr>
<td>B12</td>
<td>1.00%</td>
<td>0.70%</td>
<td>2.00%</td>
<td>2.63%</td>
<td>6.20%</td>
<td>2.51%</td>
</tr>
<tr>
<td>B13</td>
<td>1.60%</td>
<td>3.00%</td>
<td>3.70%</td>
<td>3.26%</td>
<td>3.61%</td>
<td>3.03%</td>
</tr>
<tr>
<td>B14</td>
<td>2.80%</td>
<td>2.60%</td>
<td>(5.60%)</td>
<td>(3.76%)</td>
<td>1.44%</td>
<td>(0.50%)</td>
</tr>
<tr>
<td>B15</td>
<td>2.60%</td>
<td>2.80%</td>
<td>3.10%</td>
<td>3.44%</td>
<td>4.90%</td>
<td>3.37%</td>
</tr>
<tr>
<td>B16</td>
<td>0.70%</td>
<td>2.00%</td>
<td>0.70%</td>
<td>1.53%</td>
<td>1.81%</td>
<td>1.35%</td>
</tr>
</tbody>
</table>

Source: Central Bank of Kenya

NIO ....... Not in operation
4.3.2: Return on Equity (ROE)

ROE is calculated as income before extraordinary items, divided by common equity, multiplied by 100. ROE represents the earnings that return for each shilling of average shareholder equity in the company. Equity normally constitutes only a small portion of banking assets, so ROE is usually much higher than ROA, ranging from 2.51% to 39.06% on average for the studied banks. B4 seemed to differ with the rest may be because it started to operate in 2008 and definitely with low market share. ROE is the ultimate measure of success in meeting shareholder requirements. This shareholder value-oriented measure provides a summary level picture if a bank is contributing to or detracting from shareholder value.

For example, one of the advantages of IT outsourcing is that it brings the cutting-edge technology to outsourcing receiver at a relatively low price. In such an information-intense industry as the banking industry, emerging technology is usually accompanied with business process change, which will lead to value creation. In addition, other benefits brought by IT outsourcing such as cost deduction and risk control can also contribute to shareholder value. All in all, it can be assumed that banks with IT outsourcing activities contribute more to shareholder value compared with their non-outsourcing counterparts.
Table 9b: Return on equity over the years for sampled banks.

<table>
<thead>
<tr>
<th>YEAR</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
<th>Average</th>
</tr>
</thead>
<tbody>
<tr>
<td>B1</td>
<td>44.57%</td>
<td>40.30%</td>
<td>39.00%</td>
<td>37.18%</td>
<td>34.25%</td>
<td>39.06%</td>
</tr>
<tr>
<td>B2</td>
<td>5.08%</td>
<td>3.39%</td>
<td>1.60%</td>
<td>1.94%</td>
<td>0.56%</td>
<td>2.51%</td>
</tr>
<tr>
<td>B3</td>
<td>15.24%</td>
<td>10.89%</td>
<td>(1.20%)</td>
<td>10.55%</td>
<td>(3.70%)</td>
<td>6.36%</td>
</tr>
<tr>
<td>B4</td>
<td>NIO</td>
<td>NIO</td>
<td>(39.6%)</td>
<td>(22.93%)</td>
<td>(28.24%)</td>
<td>(30.26%)</td>
</tr>
<tr>
<td>B5</td>
<td>15.17%</td>
<td>10.95%</td>
<td>7.00%</td>
<td>1.92%</td>
<td>11.32%</td>
<td>9.27%</td>
</tr>
<tr>
<td>B6</td>
<td>1.25%</td>
<td>20.44%</td>
<td>23.60%</td>
<td>26.37%</td>
<td>26.24%</td>
<td>19.58%</td>
</tr>
<tr>
<td>B7</td>
<td>26.44%</td>
<td>30.07%</td>
<td>26.90%</td>
<td>28.69%</td>
<td>28.23%</td>
<td>28.07%</td>
</tr>
<tr>
<td>B8</td>
<td>24.28%</td>
<td>32.41%</td>
<td>28.90%</td>
<td>23.87%</td>
<td>27.17%</td>
<td>27.33%</td>
</tr>
<tr>
<td>B9</td>
<td>49.99%</td>
<td>15.85%</td>
<td>24.20%</td>
<td>21.59%</td>
<td>32.90%</td>
<td>28.91%</td>
</tr>
<tr>
<td>B10</td>
<td>22.70%</td>
<td>27.59%</td>
<td>18.40%</td>
<td>26.11%</td>
<td>20.96%</td>
<td>23.15%</td>
</tr>
<tr>
<td>B11</td>
<td>22.24%</td>
<td>22.13%</td>
<td>26.70%</td>
<td>10.35%</td>
<td>30.60%</td>
<td>22.40%</td>
</tr>
<tr>
<td>B12</td>
<td>11.92%</td>
<td>7.78%</td>
<td>20.70%</td>
<td>23.76%</td>
<td>47.35%</td>
<td>22.30%</td>
</tr>
<tr>
<td>B13</td>
<td>25.64%</td>
<td>33.61%</td>
<td>23.90%</td>
<td>16.37%</td>
<td>27.52%</td>
<td>25.41%</td>
</tr>
</tbody>
</table>
4.3.3: Return on Investment (ROI)

ROI is calculated as income before extraordinary items, divided by total invested capital, multiplied by 100. Total invested capital is the sum of total long-term debt, preferred stock, minority interest and total common equity. ROI measures how effectively a firm uses its capital to generate profit. For example, it is undeniable that IT outsourcing is an investment activity. ROI measures the monetary benefit of the investment. On average, ROI for the studied banks varies substantially and ranges from -30.29% to 37.87% for the period 2006-2010. Outsourcing banks are assumed to have strategic-related, economic-related and technology-related advantages.

**Table 9c: Return on investment over the years for sampled banks.**

<table>
<thead>
<tr>
<th>YEAR</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
<th>Average</th>
</tr>
</thead>
<tbody>
<tr>
<td>B1</td>
<td>53.53%</td>
<td>38.73%</td>
<td>32.14%</td>
<td>32.59%</td>
<td>32.35%</td>
<td>37.87%</td>
</tr>
<tr>
<td>B2</td>
<td>5.03%</td>
<td>3.47%</td>
<td>1.70%</td>
<td>1.94%</td>
<td>0.50%</td>
<td>2.53%</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>---</td>
<td>---</td>
<td>---</td>
<td>---</td>
<td>---</td>
<td>---</td>
<td></td>
</tr>
<tr>
<td>B3</td>
<td>15.23%</td>
<td>10.90%</td>
<td>(1.18%)</td>
<td>10.55%</td>
<td>(3.84%)</td>
<td>6.33%</td>
</tr>
<tr>
<td>B4</td>
<td>NIO</td>
<td>NIO</td>
<td>(39.61%)</td>
<td>(22.93%)</td>
<td>(28.32%)</td>
<td>(30.29%)</td>
</tr>
<tr>
<td>B5</td>
<td>18.04%</td>
<td>12.83%</td>
<td>8.40%</td>
<td>2.32%</td>
<td>11.43%</td>
<td>10.60%</td>
</tr>
<tr>
<td>B6</td>
<td>1.34%</td>
<td>20.50%</td>
<td>23.55%</td>
<td>26.02%</td>
<td>26.23%</td>
<td>19.53%</td>
</tr>
<tr>
<td>B7</td>
<td>33.10%</td>
<td>38.45%</td>
<td>33.32%</td>
<td>36.36%</td>
<td>32.70%</td>
<td>34.79%</td>
</tr>
<tr>
<td>B8</td>
<td>26.78%</td>
<td>34.89%</td>
<td>30.63%</td>
<td>29.19%</td>
<td>28.56%</td>
<td>30.01%</td>
</tr>
<tr>
<td>B9</td>
<td>49.98%</td>
<td>13.41%</td>
<td>23.89%</td>
<td>24.77%</td>
<td>36.78%</td>
<td>29.77%</td>
</tr>
<tr>
<td>B10</td>
<td>19.17%</td>
<td>24.12%</td>
<td>17.19%</td>
<td>12.65%</td>
<td>17.09%</td>
<td>18.04%</td>
</tr>
<tr>
<td>B11</td>
<td>23.47%</td>
<td>24.45%</td>
<td>27.31%</td>
<td>26.77%</td>
<td>33.17%</td>
<td>27.03%</td>
</tr>
<tr>
<td>B12</td>
<td>12.27%</td>
<td>7.85%</td>
<td>20.86%</td>
<td>21.66%</td>
<td>47.31%</td>
<td>21.99%</td>
</tr>
<tr>
<td>B13</td>
<td>25.82%</td>
<td>38.11%</td>
<td>24.80%</td>
<td>24.33%</td>
<td>30.21%</td>
<td>28.65%</td>
</tr>
<tr>
<td>B14</td>
<td>17.12%</td>
<td>18.66%</td>
<td>(41.81%)</td>
<td>(26.51%)</td>
<td>9.73%</td>
<td>(4.56%)</td>
</tr>
<tr>
<td>B15</td>
<td>22.67%</td>
<td>20.27%</td>
<td>23.14%</td>
<td>25.09%</td>
<td>36.02%</td>
<td>25.44%</td>
</tr>
<tr>
<td>B16</td>
<td>7.77%</td>
<td>18.63%</td>
<td>8.68%</td>
<td>14.53%</td>
<td>18.05%</td>
<td>13.53%</td>
</tr>
</tbody>
</table>

Source: Central Bank of Kenya
4.4: Risk Management

The banks sampled were asked to state whether or not they have an explicit outsourcing risk management strategies/policies governing their outsourcing practices. Results are shown on Table 10.

Analysis of the section indicates that slightly over 50% of the banks surveyed have in place outsourcing risk management strategies/policies. This shows the importance banks attach to risks associated with outsourcing and would want to reduce the negative impact on their business performance.

Once the outsourcing decision has been taken it becomes necessary, to justify the decisions, identify the risks, plan for control as well as evaluate the criteria for selecting vendors. These activities are important as they help in finding out the possible difficulties that may arise during implementation and the definitions of strategic objectives. Risk management is necessary as it would enable banks to have standards and procedures to support these strategies.

Table 10: Prevalence of Outsourcing Risk management strategies/policies

<table>
<thead>
<tr>
<th></th>
<th>Yes</th>
<th>No</th>
</tr>
</thead>
<tbody>
<tr>
<td>Risk management strategies/policies</td>
<td>56.25%</td>
<td>43.75%</td>
</tr>
</tbody>
</table>

Source: survey
CHAPTER FIVE
SUMMARY, CONCLUSIONS AND RECOMMENDATION

5.1 Summary

The research objective was to determine the impact of outsourcing practices on performance of commercial banks in Kenya. As discussed earlier, banking industry plays a very important role in today’s business world which is dynamic and is greatly influenced by economic, social, political and technological advancements. Thus in a bid to survive in a competitive business environment, most banks have adopted outsourcing as a strategy to improve their performance and meet the expectations of shareholders. Research findings indicate that slightly over 50% of studied banks have outsourcing strategy for their outsourced products. It is critical to include outsourcing strategy in the overall corporate strategy of an organization. This is the only way to ensure success and effectiveness of outsourcing in the business environment.

The sources of information in this research study were both primary and secondary data. Most of the data collected was primary data, which was in terms of the perceived benefits and risks of outsourcing and their impact on banks’ performance (see attached interview guide in appendix 1). Results indicate that there are varied extents to which both benefits and risks impact on banks’ performance. To a large extent, most respondents agree that outsourcing mainly improves service levels, reduce costs, enable focus on core competencies, and gives a competitive advantage. Further, there was a general agreement that outsourcing has equally led to achievements of specific goals of outsourcing namely performance, cost savings, customer service, market share and quality of service.
However from the standard deviations, the most agreed achievement is improved performance while the least unanimous is improved customer service. On the other hand, in terms of the impact of risks on the performance, the respondents stressed on the idea of loss of in-house talent followed by loss of jobs in that order.

The secondary data was obtained from published journals of Central Bank of Kenya for the period 2006-2010. Generally, all the studied banks indicated increase in ROA, ROE and ROI over the period.

These findings complement previous studies (Casale 1996; Jennings 1996; Quinn 1999; Lau and Hurley 1997; Steensma; Kevin and Corley 2000), that found a positive relationship between outsourcing activities and performance.
5.2 Conclusions

The main focus of this study was to determine the impact of outsourcing practices on firm performance in the banking industry in Kenya and adequacy of outsourcing risk management strategies/policies. This paper focuses exclusively on commercial banks in Kenya using non-financial measures based on perceptions obtained from questionnaires.

As per data analysis and findings, respondents identified cost saving, specialization of core competencies and improved service levels as the leading positive outcomes of outsourcing. According to them, these variables contributed to their banks' performance. However, results also indicate that there is no significant link between outsourcing and profitability of a bank because most respondents seemed to be indifferent (neutral). Further, data findings also indicate that respondents perceived loss of in-house talent and loss of jobs as the leading negative outcomes of outsourcing. However when perceived impact levels of both benefits and risks on performance are compared, the former outweigh the latter. Therefore, according to the research result of this paper, the conclusion that outsourcing can enhance firm performance of banks is drawn.

The attitudinal results in this study provide support for the claims of outsourcing proponents that outsourcing allows companies to enhance expertise, improve service quality, lower costs and saving time. Outsourcing in this sense is beneficial to banks performance.

One of the important contributions of this study is the revelation that banks generally considered themselves successful at outsourcing.
5.3 Policy Recommendations

The implication of this research study is that it will enable managers to identify benefits and risks of outsourcing and their possible impact on the performance of their banks. It is imperative that cost-benefit analysis is done before undertaking any outsourcing exercise to maximize on the benefits and minimize its potential risks. The risk-benefit analysis in decision theory compares the risks associated with and the benefits expected of a decision that is made, in order to achieve an optimal result. This concept was discussed by Jurison (1995). When the concept is applied to outsourcing, it means that the manager or decision maker has to assess all the potential risks and benefits that may arise from outsourcing process. This will aid managers in decision making regarding prioritization of services to be outsourced.

While this study may not have covered this aspect, it is of interest to the regulatory authorities to examine how banks achieve a balance in risks and benefits associated with outsourcing taking into consideration interests of other stakeholders such as depositors.

The fact that all the studied banks which are representative of other banks get involved in outsourcing of certain banking functions, in an environment without a regulatory framework is another interesting finding. Outsourcing arrangements are increasingly becoming complex and have the potential to transfer risk, management and compliance to third parties who may not be regulated, and who may operate offshore. This therefore calls for urgent measures to institute a regulatory framework in place in the form of an outsourcing guideline to the banking sector.
5.4 Limitations of the Study

Like any study, the findings of this study should be viewed in light of a few limitations:

First, there are generally several types of outsourcing activities. However, this paper does not study all different types of outsourcing activities which may have different influence on banks' performance. The aggregation of all outsourcing activities gives a general position and lacks specificity. It might be meaningful to know which type of outsourcing has the most impact on banks' performance, which can serve as guidance of the outsourcing practice in the banking industry. This is because banks are in business to improve their performance through maximization of their returns and would want to know the most rewarding investment.

Secondly, there are obvious limitations to the perceptual and self-reported data collected in this study. There is an understandable degree of skepticism on the part of the respondents who are, after all, interested parties who risk losing their jobs or as the case may be, control over a part of their responsibilities. How well the perceived objectives are satisfied after outsourcing, is likely influenced by subjective perceptions (Jiang, Qureshi 2006). The use of questionnaire to gather relevant information on the perceived impact of benefits and risks on outsourcing must be noted.

Lastly, the study is limited to the extent that its focus is on a specific country and industry, Kenya and banking sector respectively. There was not really any benchmark from within the country in terms of previous study of similar nature.
Despite these limitations, this exploratory investigation provides tentative avenues for increasing the probability of success of outsourcing projects and identifies areas that need further research.

5.5 Suggestions for Further Studies

There is need for further research to be done on this area of impact of outsourcing practices on the performance of commercial banks in Kenya. This is because the operations of banks have various dimensions in that outsourcing as a strategy is being introduced in different departments. In other words, the successes or failures of outsourcing should be evaluated at the departmental level so that a bank is in a better position to judge the impact objectively.

Another important extension of this study is to replicate this research to other countries, and more importantly conduct comparative country studies. This will either validate or not the findings and hence give it a universal face. In the process other important findings may be unraveled given the changes that are taking place globally.

The nature of this research in terms of measurability requires a relatively longer period of time to conclusively determine the impact of outsourcing on performance of commercial banks in Kenya due to the ever changing environmental factors.
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The Banking Act, Chapter 488, Laws of Kenya


APPENDIX 1: QUESTIONNAIRE

SURVEY FORM


Dear Respondent

This is a survey study conducted courtesy of School of Business, University of Nairobi. Please spare your time to answer the following questions appropriately. All information gathered will be treated with utmost confidentiality.

CONTACT DETAILS

1. Bank...................................................................................................................................
2. Name....................................................................................................................................
   Gender...................................................................................................................................
   Position.................................................................................................................................
   Level of Education............................................................................................................
   Professional Qualification..............................................................................................
   Email address....................................................................................................................
   Telephone...........................................................................................................................
Section 1: Outsourcing strategy

For the following questions, please tick as appropriate.

1. Does your bank have an explicit outsourcing strategy for the following commonly outsourced products?

<table>
<thead>
<tr>
<th>Yes</th>
<th>No</th>
</tr>
</thead>
<tbody>
<tr>
<td>i) ATM service</td>
<td>[ ]</td>
</tr>
<tr>
<td>ii) Card processing</td>
<td>[ ]</td>
</tr>
<tr>
<td>iii) Underwriting services</td>
<td>[ ]</td>
</tr>
<tr>
<td>iv) Advisory services</td>
<td>[ ]</td>
</tr>
<tr>
<td>v) HR function</td>
<td>[ ]</td>
</tr>
<tr>
<td>vi) Debt collection</td>
<td>[ ]</td>
</tr>
<tr>
<td>vii) Internal audit</td>
<td>[ ]</td>
</tr>
</tbody>
</table>

Section 2: Impact of Outsourcing

A] Reasons for Outsourcing

For the following questions, please tick as appropriate.

1. In which ways do you think outsourcing could affect your bank? Please prioritize in terms of impact (5 highest impact to 1 lowest impact)

   a) Improve customers relationships
      
      | 1 | 2 | 3 | 4 | 5 |
      |---|---|---|---|---|
   
   b) Improve service levels
      
      | 1 | 2 | 3 | 4 | 5 |
c) Reduce costs
   1 2 3 4 5

d) Improve quality
   1 2 3 4 5

e) Specialize in core competencies
   1 2 3 4 5

f) Competitive advantage
   1 2 3 4 5

g) Improve profitability
   1 2 3 4 5

h) Freed resources
   1 2 3 4 5

B) Reasons against Outsourcing

  a) In-house talent is lost
     1 2 3 4 5

  b) Loss of jobs
     1 2 3 4 5

  c) Loss of confidentiality and security
     1 2 3 4 5

  d) Fraudulent use of customer account information
     1 2 3 4 5

  e) Loss of managerial control
     1 2 3 4 5
f) Theft of customer funds
1 2 3 4 5

g) Hidden costs
1 2 3 4 5

h) Inflexibility creeps in
1 2 3 4 5

C. Specific Goals for Outsourcing

1. Performance (e.g. profit margins, Return on Investment, sales per employee, stock values, etc.)
1 2 3 4 5

2. Cost Savings (e.g. cost per unit of product or service compared to competitors)
1 2 3 4 5

3. Customer Service (e.g. customer satisfaction rates, retention rates, etc.)
1 2 3 4 5

4. Market Share (e.g. compared to past years and to competitors)
1 2 3 4 5

5. Quality (e.g. percentage of defects of outsourced items)
1 2 3 4 5

Section 3: Risk Management

1. Does your bank have an explicit Outsourcing Risk Management Strategy/Policy?
   a) Yes
   b) No
Section 4: General

Questions here may not be all embracing and comprehensive. They may not have afforded you an opportunity to say some things you want to say about the impact of outsourcing practices on performance of your bank. Please make any additional comments in the space provided.

----------------------------------------------------------------------------------------------------------------------------------

----------------------------------------------------------------------------------------------------------------------------------

I sincerely thank you for your time and cooperation in filling this questionnaire. Please check to make sure that you have not inadvertently skipped any question.
APPENDIX 2: LIST OF STUDIED BANKS

1. Bank of Africa Ltd
2. Barclays Bank of Kenya Ltd
3. CFC Stanbic Bank Ltd
4. Co-operative Bank of Kenya Ltd
5. Diamond Trust Bank Ltd
6. Dubai Bank Ltd
7. Equatorial Commercial Bank Ltd
8. Equity Bank Ltd
9. Fina Bank Ltd
10. First Community Bank Ltd
11. Giro Commercial Bank Ltd
12. Habib Bank Ltd
13. Kenya Commercial Bank Ltd
15. National Bank of Kenya Ltd
16. NIC Bank Ltd
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