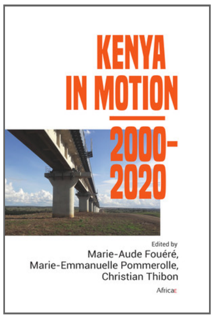

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Kenya in Motion 2000-2020

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Focus no. 1

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Focus no. 1

The World of Banks and Finance in Kenya

Adeline Pelletier

Translated by Morgan Carmondy

Kenya is the dominant banking centre in East Africa with 43 commercial banks (as of 2014). This sector evolved considerably over the course of the last decade with the regional expansion of African banks, along with financial innovations and regulatory banking changes. As a result, the banking industry is particularly dynamic and is characterised by the coexistence of several types of banks; local Kenyan banks (31), subsidiaries of foreign banks (including global banks in developing countries, 4), emerging banks (mostly from Asian countries, 4), and regional African banks (4).

Between 2010 and 2015, some local banks, such as Kenya Commercial Bank and Equity Bank, experienced strong growth of their assets, to the point of exceeding the subsidiaries of multinational banks, such as Barclays or Standard Chartered.[1] These big domestic banks have expansion strategies in East Africa, and more generally in Sub-Saharan Africa, opening subsidiaries in Uganda and Tanzania—thereby emulating the expansion of Nigerian banks (i.e. the United Bank of Africa) and Sub-Saharan banks (i.e. Standard Bank). With new models based on technological platforms, integrated mobile payment and bank branches[2] (*agency banking*), these banks have rapidly developed and made large profits. A fieldwork conducted at the end of 2013 in Nairobi, including interviews with senior credit and risk managers, as well as managers of subsidiaries of 26 banks, sheds light on the credit practices of these banks.

1. In 2012, Standard Chartered's total assets in Kenya were 195 billion KES, compared with 91 billion KES in 2007. For Barclays, these figures were 185 billion KES in 2012, compared with 158 billion KES in 2007. Total assets of Kenya Commercial Bank amounted to 304 billion KES in 2012, compared with 120 billion KES in 2007, while for Equity Bank, these figures were 216 billion KES in 2012, compared to 53 billion KES in 2007 (source: Banking Survey 2013, Kenya Bankers' Association).

2. Non-banking entities that provide, on behalf of a financial institution, transaction and payment services. Small businesses, pharmacies, postal agencies, etc. can play this role.

1. Who Do Kenyan Banks Lend to?

The large majority of the banks surveyed lend primarily to the manufacturing, trade, construction and real estate sectors. While most bank managers interviewed highlighted the fact that there is currently a boom in the construction and real estate sector, the financing of this sector is mainly done by the domestic banks. The "global" foreign banks are more reluctant to finance it, because of a different risk appetite. The agricultural sector is largely forgotten financially by banks despite being one of Kenya's most important sectors.

Concerning the composition of the lending portfolio of banks, loans to large companies generally make up the largest share (42% in total for the banks surveyed) followed by loans to Small and Medium-sized Enterprises (SMEs) (35%) and individuals (18%). The remaining 5% concerns loans to cooperatives (savings and credit cooperatives) or microfinance. However, domestic banks tend to offer more individual loans than the other types of banks, whereas foreign banks are more exposed to large businesses (more than 50% of loans for subsidiaries of regional African Banks, 61% for global banks, versus 36% for domestic banks). Regarding SMEs, subsidiaries of African regional banks have a level of exposure similar to domestic banks—representing on average, for these two groups of banks, about one third of their loan portfolio. In comparison, the share of SME loans in the portfolio of global banks' subsidiaries is about 20%. It should be noted, however, that banks' definition of SMEs can vary considerably. The classification is often based on the turnover or the amount of the loans, but, depending on the bank surveyed, this amount varies between 3,000 USD and 1 million USD. Finally, it should be noted that the "business model" of some domestic banks is very focused on SMEs, as is the case for Equity Bank. Meanwhile some large foreign banks, such as Citi, do not participate in this sector, focusing instead on large companies or institutional clients.

2. Favourable Perception of the SME Finance Sector by Banks, but Important Constraints

Banks generally have a favourable impression of the SME segment, with 92% of respondents considering it offered good financial opportunities. However, banks face significant constraints concerning their SME lending operations, which some believe limits the growth of their loan portfolio to this sector. Among the most cited problems for banks was insufficient or lack of collateral (24% of responses), lack of information (24%) and managerial insufficiencies for some SMEs (29%). Despite these obstacles, some respondents indicated that their bank had initiated a reallocation of their loan portfolio towards SMEs, due to the intense competition for loans to large companies, and the potentially high returns offered by the SME segment. In addition, given the banking restrictions on the concentration of loans,[3] the small domestic banks do not have the capacity to offer large loans, contrary to large domestic banks, such as Kenya Commercial Bank, and the subsidiaries of foreign banks.

3. Banking Innovations and Evolution towards Automation of Lending Practices

The large majority of banks surveyed operate a centralised organisation for credit functions, and for 89% of them all decisions concerning loans are executed by this central office. Some of the banking managers interviewed explained that this practice increases the operational efficacy of their bank. In addition, the development of credit bureaus[4] facilitates banks' screening of loan applicants.

To evaluate the demands of loans, the majority of banks concentrated on the "character" of loan applicants (through an analysis of the management of bank accounts), a criteria which could be subjective. But numerous banks have also established, or are in the process of establishing, Credit Core systems.

Generally, financing SME requires systems of screening and monitoring loans which can be expensive to set up for small banks. Equity Bank is an interesting model. Originally a mortgage bank, it became a microfinance institution before operating as a commercial bank. One of the peculiarities of Equity Bank is its *Universal Banking Software*, which automates the majority of decisions and helps client advisors in their lending work. Coupled with a remuneration system for their staff based on performance, this system allows for efficient evaluation and monitoring of the customers, private individuals, and SMEs.

One of the latest successful banking innovations is mobile payment. Half of the banks surveyed offer this service (100% for African bank subsidiaries), although this may have forced banks to rethink their business model by encouraging them to establish partnerships with telecommunications companies.

3. The loan limit is set at 25% of the bank's own funds per borrower.

4. Credit Reference Bureau Africa Limited (2010) and Metropol Credit Reference Bureau Limited (2011).

4. A Competitive Environment Marked by Judicial Slowness but a Benevolent Regulator

The intensity of competition and the difficulty to access customer deposits are the two challenges most cited by the banks surveyed. 80% of bank executives interviewed considered that the competition for deposits was strong or intense. The competition between banks for SME loans is equally high, with 66% of banks considering it as strong or intense. But this figure is even greater in the corporate lending sector, rising to 75% of banks surveyed. The vast majority of banks (70%) consider that banking regulations do not constitute, or constitute a minor obstacle to their activity. However, the legal system and the slowness of tribunals are often mentioned by banks as a hurdle to their activities (62% of people surveyed consider it to represent an important or extreme obstacle). The judicial procedures are often long and this route is used only as a last resort because it is difficult for banks to recover collateral in this way.