INFLUENCE OF STRATEGIC ALLIANCE ON FINANCIAL PERFORMANCE OF COMMERCIAL BANKS IN KENYA

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Abstract

The strategy of allying with other organizations has become increasingly prevalent in order to strengthen their market positions and improve on their financial performance. In Kenya, the banking industry is cut throat competition, financial institutions have had to adopt a myriad of strategies in order to gain competitive advantage and stay afloat in the market. Many commercial banks have adopted got into alliance with other institutions informs of joint ventures, outsourcing among others. Of concern to the study, was to determine whether these alliance are of any importance to the final financial performance of the commercial banks. Questionnaire was used for primary data while secondary data was gathered from bank statement of financial performance and statements of comprehensive income during the period 2013 and 2014. Data was analyzed using Statistical Packages for Social Sciences (SPSS) version 23. Regression and correlation analysis were used to determine the nature and the strength of the relationship between the independent and dependent variables. The findings of this study reveal there exist negative relationship between the banks operational cost and the leverage on performance while the banks market share, efficiency, banks asset base and bank branches had a positive relationship with income. Correlation analysis carried out between the study variables yielded a value of R is 0.726 an indication that a strong relationship existed between the variables.

Keywords: Bank Size, Financial Performance, Operating Cost, Strategic Alliance, Synergy

INTRODUCTION

1.1 Banking sector in Kenya

The Banking Sector is composed of the Central Bank of Kenya, as the regulatory authority and the regulated; Commercial Banks, Non-Bank Financial Institutions and Forex Bureaus. Kenya's banks like other organizations are open systems operating in a turbulent environment; their continued survival depends on the ability to secure a "fit" with the environment. Banking in Kenya is estimated to have started around1896 with the National Bank of India opening its first branch. This was followed by Standard Bank of South Africa, now Standard Chartered Bank opening its first branches in Mombasa and Nairobi in 1911.The prudential oversight is exercised by the Central Bank of Kenya, the Nairobi Stock Exchange and the Capital Markets Authority. Liberalization of the banking sector started in 1995 where exchange controls were subsequently lifted.

1.2 Commercial banks in Kenya

Central bank of Kenya notes that During the period ended June 30, 2015, the Kenyan banking sector comprised 43 commercial banks, 1 mortgage finance company,12 microfinance banks, 8 representative offices of foreign banks,14 money remittance providers, 86 foreign exchange bureaus and3 credit reference bureaus. The Banking Sector registered improved performance in the period ended June 30, 2015, assets increased to KShs 3.6 trillion from KShs 3.0 trillion in June 30, 2014, loans and advances grew to KShs 2.1 trillion compared to KShs 1.7 trillion as at June 30, 2014, the deposit base expanded to KShs 2.6 trillion an increase from KShs 2.1 trillion reported in June 30, 2014 and profit before tax was KShs 76.7 billion compared to KShs 71.0 billion reported in the period ended June 30, 2014 (CBK, 2014).

Players in this sector have experienced and according to CBK (2009) Kenyan banks have exponentially embraced the use of information and communication technologies in their service provision. Some of the major strategic alliance adopted by most commercial banks in Kenya includes licensing agreement with telecommunications companies to enable clients to make payments directly into any bank accounts using the mobile money transfer platform. Franchising agreement with Visa and MasterCard to issue debit cards, credit cards and prepaid cards to clients. The banks have also had outsourcing agreements with companies for card acquiring business where the banks provided point of sale (POS) to merchants.

1.3 Statement of problem

Whereas there exist an extensive body of literature that examines mergers, acquisition, and consolidation activity in commercial banks and other financial services firms, little attention has been paid to examine the different influence of strategic alliances on performance of commercial banks. This study was based on a similar conceptual argument as noted in the previous studies only that the research addressed the influence of strategic alliances on the financial performance of commercial banks in Kenya.

1.4 Research Objectives

The general objective of the study was to establishing the influence of strategic alliance on financial performance of commercial banks

1.4.1 Specific Objectives

This study was guided by the following specific objectives

1. To establish the influence of costs on financial performance of commercial banks
2. To establish the influence of synergy on financial performance of commercial banks
3. To establish the influence of bank size on financial performance of commercial banks

1.5 Scope

The study focused on all the 43 commercial banks in Kenya with emphasis placed on the eleven (12) listed commercial banks and three (3) non-listed commercial banks and covered the financial years ending June 2013 and June 2014. For questionnaire filling purposes the researcher randomly selected 20 commercial banks form the total group of 43.

LITERATURE REVIEWED

The study focused on four literatures;

2.1 Competitive Advantage Theory

The theory focuses on a firm's behavior from a managerial, rather than a marketing approach, explaining that companies are expected to seek cooperative arrangements if they believe those will improve their ability to meet strategic objectives, especially in maximizing profits or in protecting or enlarging market share (Coopers & Lybrand, 2007).

2.2 Competence-Based Theory

In this type of theory, one view is that firms are motivated to acquire knowledge as the means to retain or acquire specific competencies (which are analogous to resource dependency theory) and thereby maximize their ability to adapt to their environment. The alternative view is that firms

acquire knowledge through strategic alliances in order to compete at different levels of the value chain, and thereby alter the industry structure in which they operate (Doz, 2006).

2.3 Resource dependency theory

The resource-based view (RBV) argues that firms possess resources, a subset of which enables them to achieve competitive advantage, and a subset of those that lead to superior long-term performance. Resources that are valuable and rare can lead to the creation of competitive advantage.

2.4 Transaction Cost Theory

The basic tenet of the transaction cost theory is based on the assumption that markets at times fail to allocate factors services and goods efficiently due to among others, natural and government-induced externalities (Kogut 1988). This in turn results in higher costs of organizing exchange through market than organizing exchange internally.

2.5 Research gaps

From the earlier review of relevant literature, it is obvious that research in the area of bank financial performance and strategic alliances has been done but not comprehensively. All the literature reviewed indicates that previous researchers only concentrated on a few variables of strategic alliances and concentrating on influences of alliance to the general organization while this study goes further to determine the influence of the effect of strategic alliance to financial performance of the commercial bank. This makes the study more comprehensive. From survey of relevant literature, it has been found that there are few studies specific to Kenya on the link of strategic alliance and financial performance of commercial banks. This study therefore intends to fill these pertinent gaps in literature by studying the influence of strategic alliance on financial performance of commercial banks in Kenya.

2.6 Conceptual Framework

Dependent variable   **Independent variable**
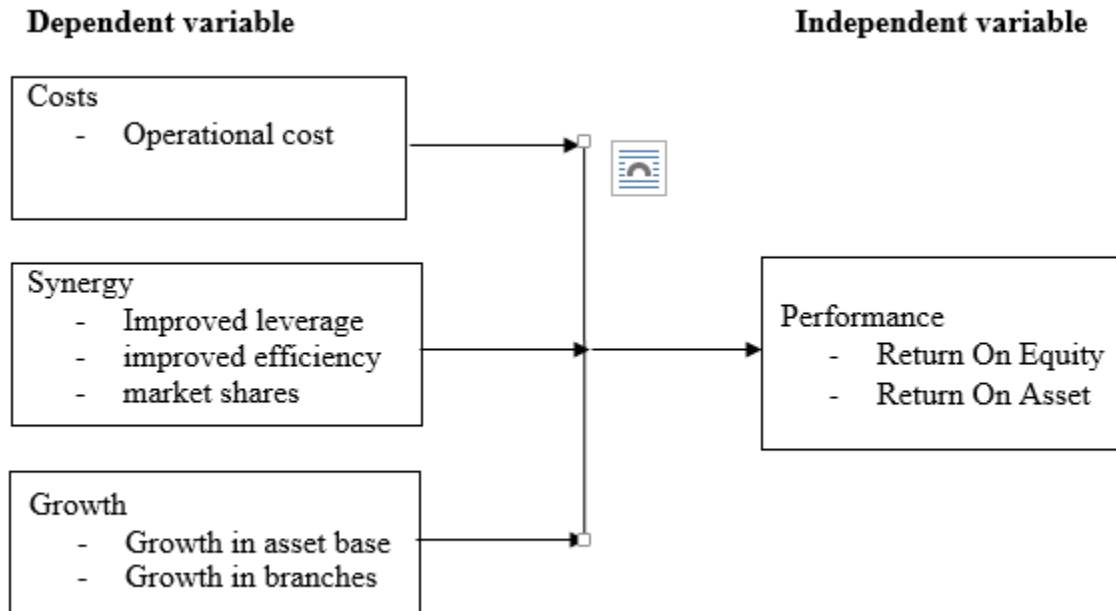
Fig 1: Conceptual Framework

Strategic alliance within the baking has main effects on the organizational costs and result into synergistic effects; growth in resource, increased market share increased efficiency and also growth of the bank. All these cumulatively have both positive and negative impact on financial performance of commercial banks which is measured through ROA and ROE.

RESEARCH METHODOLOGY

The study used questionnaires to obtain qualitative data for analysis which was further validated from analysis results from secondary data quantitative analysis. The sample units was fifteen (15) CBK approved commercial banks (12 NSE listed commercial banks and 3 non-listed commercial banks). This sample of banks was chosen due to ease of access to information especially from listed and Government owned banks. These banks also account for a significant size of over 80% of the Kenyan banking industry in terms of a composite market share index of net assets, total deposits, shareholders' funds, number of loan accounts and number of deposit accounts (CBK, 2012).

Besides having a convenient purposive sample of fifteen (15) banks, the researcher used simple random sampling for distribution of the questionnaires. The selection of fifteen (15) banks represented an effective sample of 34% of the target population of 43 banks. The 20 sampled senior managers represented as sample of 45% of senior managers in the 43 sampled banks. The above sample size of fifteen (15) banks which is a 34% sample and the 45% sample of senior

managers was acceptable in the light of research specialists. Secondary data from the sampled banks was collected on; value of total income, value of total profit before tax, value of total assets, value of total deposits; profits before tax, operating expenses, interest expenses, number of branches, total assets total liabilities, value of debt, and shareholders' equity, The secondary data was collected from the Central Bank of Kenya and annual reports of the commercial banks.

RESEARCH FINDINGS AND DISCUSSION

4.1 Operational costs

The researcher wanted to identify the relationship between the strategic alliance on financial performance and operational costs. Table 4.1 illustrated the results of the study.

Table 4.1 Relationship between Strategic alliance financial performance and operational costs.

		size	Financial Performance
Size	Correlation	1	.32
	Sig. (2-tailed)		.009
	N	11	11
Financial Performance	Correlation	.32**	1
	Sig. (2-tailed)	.009	
	N	11	11

The correlation represented in the Table 4.1 is positive, and the value of 0.32 is significantly different from 0 because the t-value of 0.009 is less than 0.10. The results therefore indicated that operational costs must be incorporated with other factors to measure the strategic alliances performance of the commercial banks. Operational costs alone cannot be relied upon in determining the performance in commercial banks.

4.2 Efficiency

The researcher wanted to identify the relationship between efficiency and the financial performance of the commercial banks. Table 4.2 illustrated the results of the study.

Table 4.2 Relationship between efficiency and the financial performance

		size	Financial Performance
Size	Correlation	1	-1.468
	Sig. (2-tailed)		-3.12
	N	11	11
Financial Performance	Correlation	-1.468[**]	1
	Sig. (2-tailed)	-3.12	
	N	11	11

The correlation represented in the Table 4.2 is negative, and the value of -1.468 is significantly different from 0 because the t-value of 0.009 is less than 0.10. Even though efficiency significantly determine the financial performance, it cannot be solely be relied upon in determining the performance in commercial banks.

4.3 Branches/bank Sizes

The researcher wanted to identify the relationship between the bank size and performance. Table 4.3 illustrated the results of the study.

Table 4.3 Relationship between Strategic alliance and operational costs

		size	Financial Performance
Size	Correlation	1	.177
	Sig. (2-tailed)		.026
	N	11	11
Financial Performance	Correlation	.177[**]	1
	Sig. (2-tailed)	.026	
	N	11	11

The correlation represented in the Table 4.3 is positive, and the value of 0.32 is significantly different from 0 because the t-value of 0.009 is less than 0.10. The results therefore indicated that bank size must be incorporated with other factors to measure the performance of the commercial banks.

4.4 Pearson Correlation Coefficient Analysis

Table 4.4 indicates the Pearson Correlation Coefficient matrix between operational cost, market share, leverage, asset base, efficiency, branches and the financial performance of commercial banks. The findings reveal that there is a strong positive relationship between; performances of

commercial banks, operational cost, market shares, efficiency, leverage and asset base of magnitude 0.864, 0.966, 0.953, 0.613, and 0.926 respectively. On the other hand, there existed a weak correlation between financial performance and bank branches of magnitude 0.051.

Table 4.4: Pearson Correlation Coefficient matrix

		Income	Operatio nal cost	Market share	Efficiency	Leverage	Asset base	Branches
Income	Pearson Correlation	1						
	Sig. (2-tailed)							
Operatio nal cost	Pearson Correlation	.864*	1					
	Sig. (2-tailed)	.001						
arket sha	Pearson Correlation	.966*	.905**	1				
	Sig. (2-tailed)	.001	.000					
Efficiency	Pearson Correlation	.953*	.964*	.978**	1			
	Sig. (2-tailed)	.001	.000	.000				
Leverage	Pearson Correlation	.613*	.384	.110	.294	1		
	Sig. (2-tailed)	.012	.128	.675	.253			
Asset bas	Pearson Correlation	.926*	.704*	.876**	.777**	-.299	1	
	Sig. (2-tailed)	.000	.002	.000	.000	.244		
Branches	Pearson Correlation	.051	.118	.050	.093	.331	-.021	1
	Sig. (2-tailed)	.850	.653	.849	.722	.195	.937	

*. Correlation is significant at the 0.05 level

4.5   Regression Analysis

The coefficients indicate that the correlation coefficient (R) between the independent variables and total income is 0.852 which is a positive strong relationship as indicated in table 4.7. The coefficient of determination (R Square) of 0.726 indicates that the model can explain 72.6% of the variations or changes in the dependent variable of total income. In other words operational costs, market share, improved efficiency, leverage level, improved asset base, and the branches number of a bank can explain 72.6% of changes in total income of commercial banks in Kenya. This numerical evidence is strong enough to support that there exists a strong relationship between the variables

Table 4.5: Model fitness - financial performance and strategic alliance

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.852^a	.726	.520	.038

a. Predictors: (Constant), operational cost, market share, efficiency, leverage, asset base,

branches

Table 4.6 presents the analysis of variance (ANOVA) on the influence of strategic alliance on bank financial performance. The results indicate that the model is statistically significant in explaining the influence of strategic alliance on incomes of commercial banks on Kenya. Put differently, it means that the ANOVA results indicate that the combined influence of strategic alliance is statistically significant in explaining variations in bank incomes at a level of significance of 0.042 and agree that strategic alliance has a positive influence on the financial performance of commercial banks

Table: 4.6 ANOVA: strategic alliance and performance of commercial banks

Model	Sum of Squares	df	Mean Square	F	Sig.
1 Regression	.031	6	.005	3.528	.042[b]
Residual	.012	8	.001		
Total	.042	14			

a. Dependent Variable: income
b. Predictors: (Constant), operational cost, market share, efficiency, leverage, asset base, branches

4.7 Multiple Regression Analysis

Multiple linear regression analysis was carried out using SPSS version 23.0. The analysis was used to determine the relationship between financial performance of the banks and the independent variables.

Table 4.7: Multiple Regression Coefficient

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
1 (Constant)	0.338	.567		.505	.627
Operational cost	-0.517	2.017	.032	.023	.009
Market share	0.173	2.336	.416	.074	.043
Efficiency	-1.468	4.704	-1.921	-.312	.007
Leverage	-.002	.003	-.163	-.812	.440
Asset base	.028	.118	-.053	-.087	.932
Branches	0.177	.065	1.272	2.733	.026

a. Dependent Variable: Income
Source: Research Findings

The resultant regression model is of the form:

$$Y = \alpha + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4 + \beta_3 X_3 + \beta_5 X_5 + \beta_6 X_6 + \varepsilon.$$

The variables of the study where;

Y = income,

$X1$ = operational cost,

$X2$ = market shares,

$X3$ = improved efficiency,

$X4$ = improved leverage,

$X5$ = increase in asset base,

$X6$ = number of branches.

$$Y = 0.338 - 0.517 X_1 + 0.173 X_2 - 1.468 X_3 - 0.002\ X_4 + 0.028 X_5 + 0.177 X_6$$

The beta coefficients in the regression analysis in Table 4.9, explains the relative importance of the independent variables in contributing to the variance of the financial performance (the dependent variable). Thus bank number of branches carried the heaviest weight (Beta = 1.272, significance = 0.026), followed by the banks market share (Beta = 0.416, significance 0.043) and then the operational cost (Beta = 0.032, significance 0.009), banks efficiency carried the least weight (Beta =-1.921, significance = 0.763) followed by banks level of leverage (Beta = -0.163, significance = 0440) and asset base (Beta = -053, significance =.932). According to these results, a positive change in the operational cost, market share and number of branches leads to a positive change in the financial performance of commercial banks while a negative change in the financial leverage of the banks leads to an inverse change in the financial performance.

The study reveals that all the independent variables, are significant predictors of a bank's financial performance at a 5% significance level. Operational cost had significant predictor of performance (t = .023), market shares (t = 0.074), number of branches (2.733), leverage measured by debt equity (t = -0.812), and efficiency (t = -0.312) and the asset base (t = -0.087) In essence, reducing efficiency rate, reducing the leverage ratio, reducing the operational cost and increasing the banks market share expected to improve the financial performance of a commercial bank.

4.8 Interpretation of the Findings

The purpose of this study was to establish the influence of strategic alliance on the financial performance of commercial banks in Kenya. Data collected from financial statements was keyed into SPSS and analysis made. The following regression model was used:

$Y = \alpha + \beta_1X_1 + \beta_2X_2 + \beta_3X_{3} + \beta_4X_{4} + \beta_3X_{3} + \beta_5X_{5} + \beta_6X_{6} + \varepsilon.$

4.8.1   Costs and financial performance of commercial banks

The first objective of the study was to determine the influence of the operational costs on the banks performance. Table 4.8 indicates a regression confident of magnitude (-0.517) between the income and the operational cost. This indicates that a unit increase in the operational cost leads to e decrease in the banks income to a tune of 0.517 with a least weight of (beta = 0.032) and the overall significance of this variable is 0.009 which is at level of significance of 0.05 and conclude that bank operational cost have a negative influence incomes of commercial banks in Kenya.

4.8.2.   Synergy and financial performance of commercial banks

The variable included in the synergy included; the increased market share, increased efficiency and the increased leverage and the table 4.8 indicate regression values of 0.173, -1.468 and -0.002 for these variables respectively. A unit increase in market share lead to an increase in income of magnitude(0.173), while a unit decrease in the efficiency and banks leverage level leads to reduce income of magnitude (-1.468) and (-0.002) respectively, the overall significance of market shares and efficiency variables are 0.043 and 0.007 respectively which are at level of significance of 0.05 thus very significance in explaining the performance of the commercial banks while the banks leverage has significance level of 0.440. The market share, banks efficiency and the leverage level, had the lowest weights of 0.416, -1.921 and -0.163 respectively.

4.8.3.   Banks growth and financial performance of commercial banks

This was the third objective and the concentration of the researcher captured only the asset base growth and the number of branches. From the results showed in table 4.8, asset base and the branch numbers had regression values of 0.028 and 0.0177 indicating that a unit of increase in any of the two leads to an increase in income of the banks by the same magnitude. The number of of branches variable hag a significance of 0.026 which is at a level of significance of 0.005 hence very significance in explaining the performance of the commercial banks it also had the heaviest weight (beta = 1.272)

Nzengya (2013), in his study, Strategic Alliances Among Commercial Banks in Kenya, found out that some commercial banks are not involved in any strategic alliance as indicated in the table below. Table 4.9 shows that 26 (87%) had entered into strategic alliances while 4 (13%) had not. This indicates that majority of the banks surveyed had entered into some form of strategic alliance. Nzengya's results contradicts with this research's findings since the findings of this research indicate that all banks were involved in at least one strategic alliance.

SUMMARY, CONLUSION AND RECCOMMENDATIONS

5.1 Summary of the findings

These study revealed that commercial banks in Kenya have entered into various strategic alliances in order enhance the achievement of their strategic objectives. On average, the banks have at least three strategic alliances. The statistical analysis of the data show that operational costs, banks efficiency, the number of branches, the banks level of leverage, asset base and the banks market share have a bearing on the financial performance of the financial institutions.

5.1.1 To establish the influence of costs on financial performance of commercial banks

The first objective of the study was to determine the influence of the operational costs on the banks performance. The findings revealed that operational cost had a negative influence on incomes of the banks. This finding is supported by the coefficient of determination which showed the variation in banks income explained by the operational cost

5.1.2 To establish the influence of synergy on financial performance of commercial banks

The second objective of the study sought to establish the influence of synergy on financial performance of commercial banks in Kenya. Results revealed that the variables included in the operationalization of the synergy variable had both positive and negative influence on income of banks in Kenya, an increase in market share lead to an increase in income while an increase in the efficiency and banks leverage level leads to reduce income, and are also very significant in explaining the variations in income. The coefficient of variation found through analysis supports these facts

5.1.3 To establish the influence of bank size on financial performance of commercial banks

The third objective of the study was to establish the influence of bank size on financial performance of commercial banks. This was operationalized by looking into the number of bank branches and the total asset base. The study revealed a positive influence of the banks number of

branches and the total asset on the incomes of the banks with the bank's branches being very significant in explaining the variations of banks performance.

5.2 Conclusion

The study concludes that other factors held constant the increased presence of strategic alliances within the banking sector has greatly contributed to the profitability of commercial banks in Kenya. The highest change in pre-tax profit and increase in total assets among the commercial has been recorded within the two study years. While there was 15.6% change in pre-tax profit, the experienced change in total assets was 20%. Between 2012 and 2013, commercial banks experienced an average of 116.4% change in pre-tax profit and a% change in total assets of 20%. An R value of 0.852 and R (squared) of 0.726 is an indication that there exist a strong relationship between the banks operational costs, banks efficiency, the number of branches, the banks level of leverage, banks asset base and the banks market share with financial performance of commercial banks. A strong positive correlation between performances of commercial banks, the banks operational costs, the banks market share, banks efficiency, the banks level of leverage and banks asset base with a magnitude 0.864, 0.966, 0.953, 0.613 and 0.926 respectively. There exist a weak positive correlation between financial performance and the number of bank branches of magnitude 0.051.

5.3 Policy Recommendations

The findings recommends that commercial banks should always strive to ensure that they increase the number of strategic alliances while at the same time ensuring that their financial leverage is kept as low as possible. The research established that most commercial banks were willing to enter into such arrangements in order to get various benefits. However due to a number of challenges encountered the gains were not maximized. It is therefore necessary for those banks already in a strategic alliance to deal with the challenges in order to realize even more gains. Careful choice of the strategic partners is also important so as to avoid conflicts of any sort. This will also ensure a sustainable relationship where the partners can complement each other in more synergistic manner. The reduction of competition was cited as one of the drivers of alliances. This may build monopolies in the industry which could face a lot of government control and reduce the gains.

Information and communication technology (ICT) professionals should invest their time, effort and resources towards innovations. This will mean more income for the professionals if the

innovations become successful. In Kenya there are some citizens who are still unbanked due to poor access to financial services. ICT professionals should explore ways of providing innovative solutions for reaching the unbanked. This can result to more financial deepening and better financial development for the country and hence better profitability for the banks. Mobile phones and internet have been found to have a major influence in delivering technology driven banking services. It is recommended that commercial banks continue to create sustainable business linkages and collaborations with mobile phone service providers as well as the internet service providers

5.6 Suggestions for Further Research

This study finds the need for similar studies to be carried out targeting other financial institutions and should incorporate more financial parameters like deposit growth, loan/deposit ratio, capital ratio and return on equity/return on asset among others. At the same time, there is need for further research targeting narrowing down on how each type of strategic alliance entered into by financial institutions contribute to the financial performance of the organization. Specifically, such studies should analyze each strategic alliance (mergers and acquisitions, joint ventures, outsourcing, affiliate marketing, franchising and product licensing) outside the umbrella of strategic alliances.

Despite the limitations of this study, scholars should be able to utilize these findings to create novel studies for further investigations on other key issues relating to strategic alliances in the banking industry and this study could also be conducted in other player in the banking industries like insurance companies, real estate developing companies among others

Other than banking in order to validate or invalidate the findings of this study. The study findings are according to the firms' management point of view. The scope of the study may also be extended to cover the reviews of other key stakeholders in the banking industry such as the Central bank of Kenya. There is need therefore for more study to be done how the organization need to be prepared if an alliance breaks up and what will be strategies that the organization will take to sustain itself after the break up.

This study did looked at the banks in general but did not include their innovations, a further study is recommended to include these innovations like agency banking, securitization and credit guarantees and their influence on the financial performance of commercial banks and the concentration be on different banks tiers.

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