CEO Chat September Edition

Market Competition and the Cost of Credit

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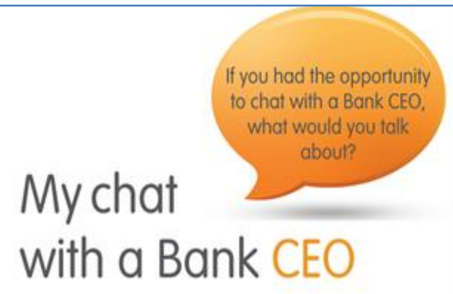
"My Chat with a Bank CEO"



John Gachora, Group CEO NIC Bank
Chat Summary
Friday 26th September 2014
Topic: Market Competition and the Cost of Credit
Time: 10:00am-11:00am

Content

Market Competition and the Cost of Credit

John Gachora: Good morning, welcome to the KBA organized CEO Chat.

I see already we have received a number of questions which we shall be addressing shortly... We shall try to restrict ourselves to the main topic at hand, which is competition in the banking industry and how that relates to the cost of credit…but certainly any other questions will be welcomed.

KENNETH NJERU: Good morning, bold step to chat with customers either to get a feedback or improve services. Why have hidden charges but when signing forms no indications? Two, how best can you handle my first home and car loan, let me know.

John Gachora: Hi Kenneth, the good thing about the new APR regime is that it creates full transparency for all charges relating to your loan whether those charges are from the bank or from other third party service providers such as lawyers, and government offices.

Going forward you will be able to see all these hidden charges reflected in the rate so called APR or annual percentage rate that should be disclosed to you by your bank...As for your first home and car...please contact us customercare@nic-bank.com

KENNETH NJERU : Thanks for the ARP hint.

Tony Shilako: Morning Guys ….Why do banks charge customers exorbitant loan processing fees (in %) while Saccos don't, when both are in the same business of lending?

John Gachora: To answer Tony's question about SACCOs versus banks...SACCOs and banks are fairly different in the type of loans they are able to issue. For instance, whereas SACCOs will often require you to have up to 10 co-signers, banks will typically not ask for co-signers but will need therefore to spend a bit more money to protect the bank in the legal and security documentation process upfront.

Karimi Nthiga: Morning, do you think it would be a good strategy for financial institutions to offer business mentorship services especially to customers who have accessed credit for their first business venture in a move to encourage more people to take up credit for entrepreneurship ventures?

John Gachora: Morning Karimi......I fully agree with Karimi in that banks need to do more to enhance financial literacy.

In fact, through KBA we have a number of programs, including this one (CEO Chat) that is aimed at engaging with customers to educate them at all levels of their engagement with banks.

Also many banks have business clubs for small business owners...through which they disseminate training, and facilitate networking. For example, at NIC we have the Entrepreneurial Club through which we hold training conferences to educate our clients.

nuru Mugambi: Admin...please note a tweet has come in...Good morning @nicbankkenya @JohnGachora @KenyaBankers what's your opinion do established firms accommodate competition from innovative firms?

John Gachora: I see a question that came up on Twitter...regarding competition.

There are 44 banks operating in this market, seven micro finance banks, and over 150 SACCOs. Clearly this demonstrates that we have the right level of competition and a lot of room for any new, innovative solutions.

Patrick Opiyo: Morning John, what do you foresee happening in the banking landscape with Equity's entry in the mobile space with the acquisition of an MVNO license and potential rollout? Paradigm shift in the way we transact with banks?

John Gachora: Morning Patrick...good to see you online.

Kenya has been ranked as one of the most innovative countries when it comes to mobile money. I view the entry into the MVNO business as just another step in this journey of giving customers more choices in the mobile money business.

ADAM Muthama: Morning John, Competition among banks has increased...making consumers choose a bank based on benefits. My question is the banking industry facing unfair competition...and what are the implications on Kenyans? What are the stake holders doing to address this unfair competition?

John Gachora: Hi Adam, I see your question...but can you please clarify? From whom is the unfair competition? Thanks.

Kelvin Mbaabu: Dear Mr. Gachora, kindly advise whether the KBRR rate shall have an effect in reduction of interest rates in the long run?

John Gachora: Morning Kelvin…The idea of KBRR is to create more transparency and enable comparison of pricing across banks.

KBRR alone will not reduce interest rates because pricing depends on a number of factors, including macroeconomic environment, government borrowing, inflation, and customer credit risk.

Currently, macroeconomic indicators support a long term reduction in interest rates.

STEPHEN MUSUNGU: Good morning John, KBA together with various stake holders have introduced various pricing mechanisms that were thought to bring the cost of credit down. However this has not happened. What really constitutes the cost of credit?

Secondly what are the likely implications on the cost of credit, interest rates by the proposed or rather anticipated increase by all banks of their capital reserve from the current 12% to 14.5% by 31.12.2014.

John Gachora: Morning Stephen, the cost of credit is made up of a number of factors, namely, cost of funds, operational costs, cash reserve cost, third party costs and credit risk costs. A number of these also depend on the macroeconomic situation as well as inefficiencies in terms of third party services, for example legal costs, judicial costs, government process, etc.

Regarding the point on capital reserve, while it adds pressure on return on capital, it also creates the need to lend more or to deploy the capital more urgently...The two should, in my opinion, balances out and therefore should not have a significant effect on the interest rate.

Meredith Njenga: One important thing about Market Competition is on how one defines the market size: in the Kenyan context, the banking sector can be grouped into three tiers: large, midsized and small banks. Given that the numbers of banks in the large sized tier are few, what are your thoughts on these banks abusing their dominance to charge unfair credit rates?

John Gachora: Dear Meredith...That is a very insightful question. There are six banks that are considered to be large tier banks...six is still a large number of banks given our market size. And the rest of the banks are very aggressive, therefore, I don’t particularly think that the large banks can abuse their dominance.

Lena Sitoyo: Morning John, Should we expect to see banks merging owing to the increased competition?

John Gachora: Hi Lena...to Lena's point about banks merging due to competition...in the short term I believe there are enough opportunities for the banks in this market. In the long term, we may certainly see a number of banks deciding to merge or align to go after larger opportunities.

JACKSON OKOTH: How do factors like cost of living index or inflation and the exchange rate position, feed into cost of credit?

John Gachora: Hi Jackson...To answer your question about inflation and exchange rate...on inflation, that determines where the central bank sets the monetary policy, the CBR, and where the market trades the T-bills. Today, KBRR is determined by these two factors directly. And therefore that translates into the industry base interest rate. As for exchange rate, it is a good indicator of inflation, not to mention a number of banks have funded themselves using foreign currency (an exposure that they must cover).

JACKSON OKOTH: Thank you for the insights.

JACKSON OKOTH: Hallo Sir, more than 50 per cent of all profits made by the entire banking industry is generated by only the 5 top banks while the rest scramble for the remaining crumbs? What does this say about state of competition in Kenya's banking sector?

John Gachora: Thanks Jackson, you also make a good observation about the top 5 banks...but one must reflect, only a few years ago we talked about only the top 3 banks...and the landscape has changed, we now talk about top 6, and there is good reason to believe other competitors are closing in on these top six. Luckily this situation is not unique to Kenya. As in most countries, there is always the top four or top 5 banks that control the market share.

Angela Nyabera: Hi John, thanks for conducting the chat. I am a big fan of the current direction of competition and diversification in credit services. Do you think the level of competition and diversification will affect stability of the market? And is the play ground level for everyone involved to participate freely and market forces determine overall performance?

John Gachora : Hi Angela...thanks for joining us...I believe the current competition augers well for the stability of the financial markets. An efficient market also creates a level playing field for everyone involved.

Benjamin Muli: Morning Mr. John, very many changes have been witnessed in the banking industry in the recent past, do we expect to see the small banks exiting the industry due to the increased competition and is the consumer likely to benefit from the same?

John Gachora: Hi Benjamin, the good news is that the Kenyan banking market as a whole has been expanding therefore I believe there is enough opportunity, even for the smaller banks, to find their right niches.

JACKSON OKOTH: With inflationary pressure on the upward trend over the last four months, do you think this might force monetary policy committee to adjust the CBR at their next meeting?

John Gachora: Jackson, you are right. Inflation and short term rates have been on an upward trend in the last couple of months. However, the MPC will certainly consider the fiscal position of the government, and its contribution towards monetary tightening before they can decide on the direction to take on the CBR.

JACKSON OKOTH: Interesting views I must say from a conservative banker.

JACKSON OKOTH: Hallo sir, I have always wondered why with 43 commercial banks, cost of credit remains high with little product differentiation between the players. Why is this so?

John Gachora: I think Jackson, to address your question on cost of credit it is worth noting that interest rates overall have been coming down in the last many years. Except for the spike that we saw in 2012, interest rates have generally trended downwards. Between 2012 and today, average loan rates have dropped from over 20 percent to the current 15 percent. On the other hand, deposit rates have actually gone up. For savvy customers, fixed deposit rates offer a very good investment option. And generally high rates. A lot of this has been aided by the stiff competition among banks, Micro Finance Institutions and SACCOs.

JACKSON OKOTH: Good stuff.

Tony Shilako: Banks are required to provide a loan applicant with a breakdown of the Total Cost of Credit has this started already?

John Gachora: I saw Tony's point from earlier about the new disclosures. Banks are eager to do so but as with anything new, it is a continuous process.

Tony Shilako: Thanks Sir for the insight.

Other Comments

KENNETH KATIECHI: What prompted you to choose banking over Engineering yet you had a Masters degree from the great MIT?

John Gachora : Kenneth...I see your question about my career choice...it's a long story! ...Maybe we will touch on it as we wrap up.

KENNETH NJERU: I thank you for the insights.

John Gachora: We at KBA are eager to engage to ensure that we are continuously improving the banking sector. While competition remains stiff, we are aware that the only way to survive is to partner with you our customers. Please continue to engage with your bank to ensure that your concerns are addressed and more importantly, to continue building on financial literacy. I thank KBA for organizing this session.

John Gachora: I wish all of you a great weekend.

KENNETH NJERU: Too short, Nice weekend too. A branch in Marsabit will offer competition.

Chat Admin: Ladies and Gentlemen, allow me to take this opportunity to thank Mr. John Gachora for being with us today and for his insights. We would also like to thank you all for your questions and interaction that has made this session a success. This is our third and final chat session in this series on the Cost of Credit. You can however get copies of the transcript, podcasts and other information relating to this and all past chats in the Archive page of the chat.kba.co.ke website. Please also visit http://www.costofcredit.co.ke/ for more information on the Cost of Credit and don't forget to download the mobile app!!

Unanswered Questions

Angela Ngethe: Morning, great way to interact with bank CEO- my question is similar to Kenneth's on how best to handle my first home loan, however in my experience over the last 2 years I have found owning a home is still too expensive for middle income earners. Is NIC bold enough to come up with a more affordable mortgage facility? What justifies these high rates anyway?

End….