



EFFECT OF COMPETITION ON FINANCIAL PROFITABILITY IN THE BANKING INDUSTRY IN RWANDA: A CASE STUDY OF BANK OF KIGALI

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Abstract:

The aim of the study was to examine the effect of competition on financial profitability in the banking industry in Rwanda. This study employed both quantitative and qualitative techniques in data collection process, analysis, presentation and discussion of findings. The study sample included 100 customers and 20 key informants in the Bank of Kigali. Data were analyzed using descriptive analysis. The study findings indicate that 55 percent of the respondents were male while 45 percent were female. The results also revealed that the areas that have improved as results of competitiveness in Bank of Kigali are bank expansion and customer loyalty. It was revealed that competition has improved the confidence of customers in the Bank of Kigali, 48percent of the respondents were agreed while 20percent of the respondents strongly agreed. The study concluded that competitiveness includes promotion activities encourage customers to consume Bank of Kigali products on the market thus increasing customer satisfaction, transaction speed in the bank, business transactions between the bank and customers and bank expansion and the economic development of Rwanda.

Index Terms: Effect, Competition, Financial Profitability, Banking Industry & Rwanda

Introduction:

Competition is desirable for maximization of social welfare and existence of Pareto efficiency. In other words, in a competitive market setting, there is allocative and productive efficiency as well as dynamic efficiency. As in other industries, competitiveness in banking system is also needed for efficiency and maximization of social welfare. Competition is defined as a process of rivalry between firms seeking to win customers' business over time (Whish, 2005).

Therefore, the banking sector has specific features that make it of particular importance to an economy and properties that may distinguish it from other industries. Banks contribute greatly to economic growth by playing an intermediating role between borrowers and lenders and providing financial resources to other industries and hence facilitating production (Schaeck & Cehaem, 2007).

Banking system is also important since any in profitability in the banking system has the potential to lead to a financial in profitability and economic crisis. Hence, a well-functioning banking system is regarded as a cornerstone of a market economy and policymakers try to ensure that the banking system is stable besides ensuring that it is competitive and efficient (Northcott 2004).

The Banking industry in Rwanda is governed by the Companies Act, the Banking Act, the Bank of Rwanda Act and other various prudential guidelines issued by the Central Bank. All of the policies and regulations that administer the entire banking industry centers in lifting the controls towards the management and equitable services. Along with the various developmental changes in the environment, Rwanda's banking industry recognized the growth in assets, deposits, profitability, and adoption of

banking services and products. As a result of the growth in the financial streams and increased innovative programs, the competitiveness in the banking industry tightened.

There were 16 licensed commercial banks currently operating in Rwanda: Access Bank, I&M Bank, Bank of Kigali (BK), Rwanda Development Bank (BRD), Cogebanque, Ecobank and Guaranty Trust Bank. Others were Banque Populaire du Rwanda (BPR), Urwego Opportunity Bank (UOB), Commercial Bank, Equity Bank, Unguka Bank, Crane Bank, Agaseke Bank, Kenya Commercial Bank of Africa and Zigama Credit and Savings Bank (ZCSB). Rwanda National Bank (BNR) is Rwanda's Central Bank and, since 1994, has made significant progress in controlling inflation while stabilizing the foreign exchange market (National Bank of Rwanda, 2015).

As in other industries, competitiveness in banking system also matters for efficiency and maximization of social welfare. From the traditional industrial organization perspective, competitiveness among banks results in allocative, productive and dynamic efficiencies. Hence, as a first-order effect, it is expected that increased competitiveness in banking sector leads to lower costs, lower loan rates and wider supply of loans, greater product innovation and improved quality of services. Even though financial services have some special properties, the channels through which competitiveness affects efficiency are similar to other industries (Northcott, 2004).

With regards to the allocative efficiency, two aspects are important: the quantity of credit supplied and its efficient allocation. In a perfectly competitive banking market, the profit maximizing behaviour of banks results in equilibrium where the greatest quantity of credit is supplied at the lowest price and where it is efficiently allocated. In terms of productive efficiency, if there are no economies of scale in banking services, productive efficiency is obtained in perfect competitiveness since outputs are produced at minimum cost.

As for dynamic efficiency, rivalry among banks leads to product innovation, development of new business processes, usage of higher level of technology in providing banking services, constant increase in the quality of financial products, etc. All these efficiencies in turn lead to increase in social welfare and economic development (Claessens & Laeven, 2004; Northcott, 2004).

First of all, banks contribute greatly to economic growth by providing financial resources to other industries and hence facilitating production. They play a crucial intermediating role between borrowers and lenders through facilitating the transfer of resources from savers to borrowers. (Carletti and Hartmann, 2002; Berger et al., 2004; Boyd and De Nicolo, 2005; Beck, 2008).

Given the role of banking in an economy, the role of competitiveness in this industry is of particular importance. Commercial banks in Rwanda are operating in a hostile competitive environment especially with the entry of other new foreign owned commercial banks like Kenya Commercial Bank, Equity Bank and Eco Bank among others. This competitiveness has implications for efficiency, innovation, pricing, and availability of choice and customer. It is not clear as to what contributed to this trend of affairs and this study thus intends to provide the effect of competitiveness on the profitability of commercial banks with specific reference to Bank of Kigali (B.K).

Methodology:

Description of Study Areas:

The study focused on two branches of the bank located the city centre; these being the busiest branches. The study population was the top 50 customers per branch and key bank employees of the two selected Bank of Kigali (Kigali city central branches). On average each branch has an active customer base of about 14,500 (Bank of Kigali,

2011); but this being big, the researcher strictly considered the top 100 customers as the target population in the two branches from which the sample was selected while the total staff (key informants) population in this study was 20 objects, senior managers inclusive.

Data Sources and Collection Methods:

A survey research method of data collection to be adopted in this study was questionnaires and interview guide. The questionnaire was selected to collect data for the research because it may ensure quantifiable responses for the same items from all respondents (Gabriellian, 1999). Furthermore, it saves both time and cost to distribute and analyse. Interviews were arranged for bank managers to provide a deeper understanding of the issues being investigated, and to complement and provide deeper insights into the findings of the quantitative analysis. The data to be used in this study were primary, collected from the Bank of Kigali employees and customers in selected branches of Bank of Kigali (Kigali city branches) using self-administered structured questionnaires and oral interviews. The questionnaires were designed to ascertain customers' perceptions on the effect of competitiveness on financial profitability of the bank. The responses were measured with a five-point Likert-type rating scale, where strongly Agree (SA) = 5; Agree (A) = 4; Neutral (N)=3; Disagree (SD) = 2; Strongly Disagree (D) = 1.

An interview guide was designed for managers in the banks. The researcher interviewed the senior managers and technical staff employees to ascertain the level of competitiveness in the banking sector in Rwanda, how it affects financial profitability of banks and the level of financial profitability by their respective banks.

Results and Discussion:

Descriptive Statistics:

This study analyses the empirical data from the Bank of Kigali. The interpretation, discussion and assessment of the data were carried out in relation to the objective of the study and in comparison with the cited literature review. To present the findings, the researcher has used tables and figures. Quotations from primary data have also been used to present a richer perspective to the findings. After data collection, data was edited and entered using a Statistical Package for Social Sciences (SPSS) software. Quantitative data was analyzed using percentages and frequencies. Thereafter, descriptive statistics were employed in the presentation and analysis of results. Factor analysis was used to examine the competitiveness and extent of financial profitability. In this study, findings from self-administered questionnaires are combined with analysis and assessment of interview guides. The researcher received responses from 100 respondents (through self-administered questionnaires) and interviewed 20 key informants (through face-to-face interview guides). Gender, Age, presented the demographic characteristic of the respondents.

Background Characteristics about the Main Sample:

The study established that the distribution of gender among the sample. See Table 1 for the results. Respondents' distribution of according to gender is shown in the table below.

Table 1: Distribution of respondents by gender

Gender	Frequency	Percentage
Male	66	55
Female	54	45
Total	120	100

Source: Field Research

The frequencies in the table1 indicate that 55percent of the respondents were male while female were 45percent. However, on the general outlook of the results, both male and female respondents had an equal chance to be represented in the study.

Table 2: Distribution of respondents by age

Age	Frequency	Percentage
Below 20 years	2	2
21-25 years	18	15
26-30 years	31	26
31-40 years	25	21
41-45 years	28	23
46-50 years	16	13
Total	120	100

Source: Field Research

The findings from the table2 indicate that the majority of respondents were 26-30 years old 26percent. This is in comparison to other categories, 41-45years 23percent, 31-40years 21percent, 21-25years 15percent, and 46-50years 13percent. Respondents below 20 years of age were very few indeed 2percent.

Table 3: Areas that have improved as results of competitiveness in Bank of Kigali

Area improved	Frequency	Percent
Quicker financial transactions	24	20
Customer loyalty	32	27
Improved business transactions	22	18
Bank expansion	26	22
Security of customers' money	4	3
Economic growth	4	3
Others	8	7
Total	120	100

Source: Field Research

From table 5 above, 27percent said that competitiveness in banking had improved customer loyalty to Bank of Kigali followed by 22percent who noted that the bank had significantly expanded to other areas by opening up branches in most towns in Rwanda. On the other hand, 20percent said that it had led to quicker financial transactions in the banks for customers while 18percent said that competitiveness had led to improved business transactions for the Bank of Kigali and its customers in various branches across Rwanda. It was also mentioned that competitiveness had led to security of customers' money and general economic development of Rwanda (3percent respectively). Finally, other effects of bank competitiveness included: increase in number of savers in the bank, creation of quality products and services, going on the stock exchange and general wellbeing of communities benefiting from Corporate Social Responsibility (CSR) company. Key informants in the Bank of Kigali also added to the above effects of competitiveness and thus mentioned different ways in which competitiveness costs affect the performance of the organization. These included but not limited to: bank performance, ability to upgrade technology and introduce internet banking, corporate banking and also recognition of the bank through national banking awards by the Central Bank of Rwanda. This they noted have been good indicators for improving the profitability and good performance.

On the other hand, one of the key informants in the bank noted that the employment and use of Information Technology (IT) as a competitive strategy has built

more confidence in the customers owing to the security of the customers and their possessions. In this case there is an increased number of customers who open bank accounts hence increased profitability of the financial institution. The respondents were asked whether competition has improved the confidence of the customers in the bank and the following table shows the responses.

Table 4: Whether competition has improved the confidence of the customers in the bank

Improved confidence	Frequency	Percentage
Strongly agree	24	20
Agree	58	48
Not sure	14	12
Disagree	19	16
Strongly disagree	5	4
Total	120	100

Field Research

48 percent of the respondents agreed, 20 percent strongly agreed, 16 percent disagreed, 12 percent were not sure while 4 percent strongly disagreed.

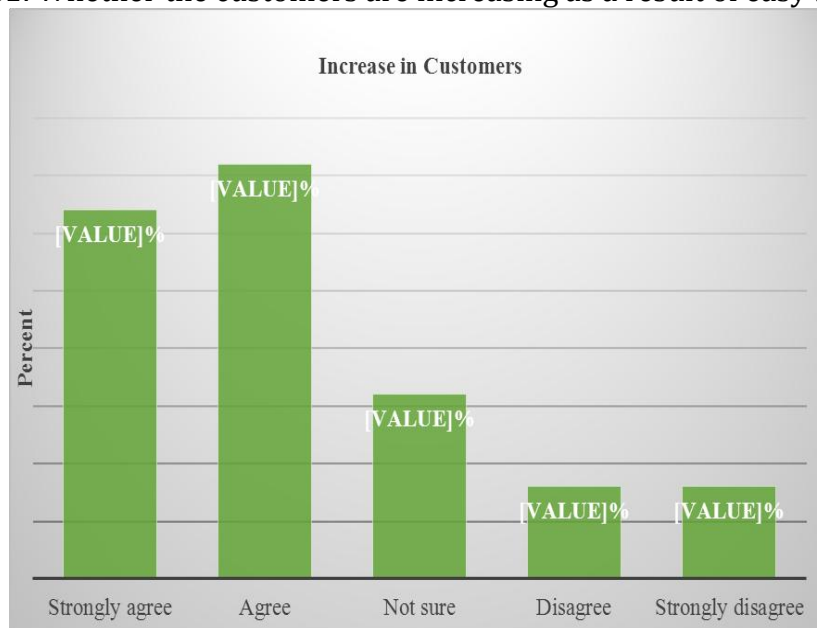
Table 5: Whether competition has improved genuine transaction in the bank

Improved Genuine Transaction	Frequency	Percentage
Strongly agree	77	64
Agree	24	20
Not sure	14	12
Disagree	5	4
Total	120	100

Source: Field Research

From the table11, majority of the respondents (64percent) strongly agreed, 20percent agreed, 12percent were not sure while 4percent disagreed. Lastly the respondents were asked whether competition saves a lot of time in banking and the table below summarizes their responses.

Figure1: Whether the customers are increasing as a result of easy banking



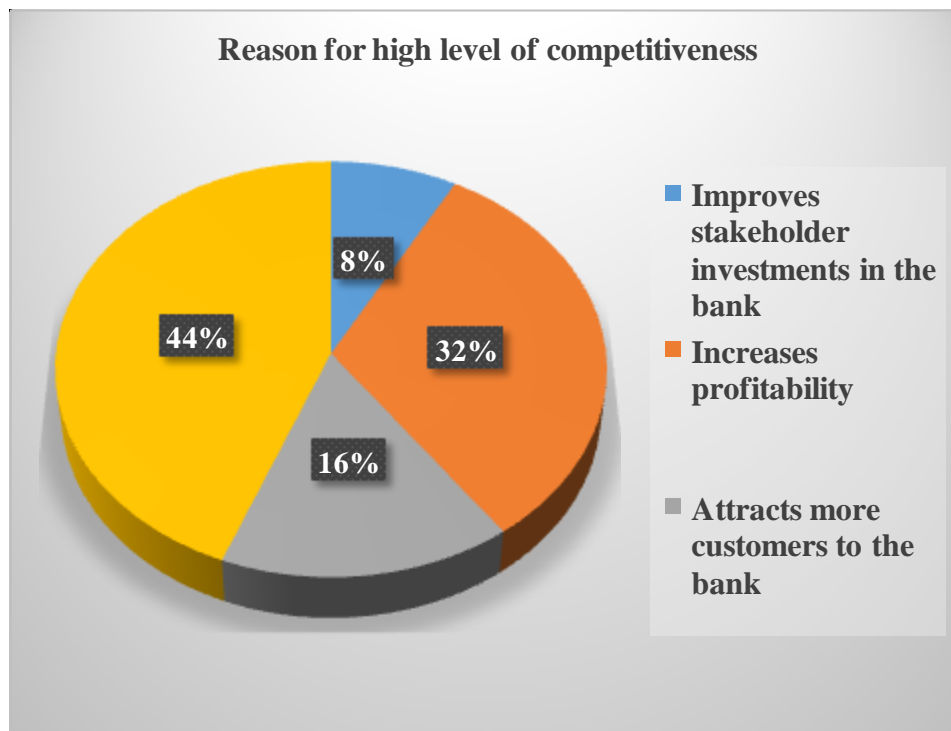
Source: Field Research

Figure1 summarizes the responses as 36 percent having agreed, 32 percent having strongly agreed, 16 percent being not sure while those disagreeing and strongly disagreeing being equal and taking up 8percent each. A powerful force drives the world towards a converging commonality, and that force is technology. From the early beginning of human error, technology has been one of the most essential and most important factors for development of mankind. During the last two hundred years, technological change has been often related to the economic growth in form of new types of goods and services. The use of machines was strength of the capitalist system, because it allowed vast increases in productivity. Competition is the cornerstone of self service banking. It gives vending machine convenience to consumers for deposits and withdrawals of cash transactions that have historically played a key role in bank branching decisions (Levitt 2002).

The Reasons for High Level Competitiveness Application in Bank of Kigali:

The researcher asked the respondents the reason that could have led the bank to choose to use competitiveness. The following responses were given.

Figure2: Reasons for high level competitiveness application in Bank of Kigali



Source: Field Research

Figure 2 indicate that the reasons for high level competitiveness application in Bank of Kigali 44percent said that shows the market size of the bank, 32percent said that increases profitability, 16percent said attracts more customers to the bank while the remaining 8percent said improves stakeholder investments in the bank.

Table 6: Showing other factors that contributed to increase in profitability of Bank of Kigali other than competitiveness

Other factors	Frequency	Percentage
Market research about competing banks	30	25
Good service delivery	17	14
Good customer care	20	17
Social responsibility	13	11
Wide bank coverage in Rwanda	12	10

Competence of bank employees	28	23
Total	120	100

Source: Field Research

Table 6 shows the responses for what contributed to increase in profitability of Bank of Kigali other than competitiveness. Market research about competing banks indicated 25 percent, 23 percent indicated competence of the bank employees, 17 percent indicated good customer care, 14 percent indicated good service delivery, 11 percent indicated social responsibility while 10 percent indicated wide bank coverage in Rwanda. This concludes that increase in profitability in Bank of Kigali was also contributed by other factors other than competitive activities of the bank.

Conclusion and Recommendations:

The study findings as per the study objective, conclusion based on those findings and recommendations which are based on both the study findings and other relevant literature considered necessary and vital to be used in future to improve the study situation. The study sought to examine the effect of competition on financial profitability. Bank of Kigali was taken as a case study from where different data relating to the study subject was gathered.

It was further revealed that competition contributes significantly to the profitability of Bank of Kigali. This was reported in ways such as: Quicker financial transactions, Customer loyalty and Improved business transactions. The study suggests that through ability to identify and exploit large number of interdependencies, favorable offers to savers in the bank, promotions, timely availability of financial information as the processing of transactions is very fast, reliability of information assuming the input data are correct and relationships established are valid, the results are reproducible, lower costs of human resource training, and the ability to performance of sophisticated and sensitive analyses. Thus, the study has shown that to increase in profitability of Bank of Kigali other than competitiveness, was also contributed by other factors other than competitive activities of the bank like market research about competing banks and competence of the bank employees.

The study concluded that competitiveness includes promotion activities induce customers to consume Bank of Kigali products on the market thus increasing customer satisfaction, transaction speed in the bank, business transactions between the bank and customers and bank expansion and the economic development of Rwanda. Hence, management should intensify initiatives to encourage greater understanding and acceptance of competitiveness components that boosts profitability in their banks. The study implies that the Bank of Kigali should consider locating in rural areas where even competition for Banks is limited due few financial intermediaries in rural areas. This would help the rural poor to access financial services that are in most cases lacking in these areas.

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