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THE EAST AFRICAN BUILDING SOCIETY - A CASE HISTORY ON ESTABLISHMENT AND PROGRESS

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THE EAST AFRICAN BUILDING SOCIETY - A CASE HISTORY ON ESTABLISHMENT AND PROGRESS[1]

Introduction

1. The East African Building Society is the only building society in Kenya, registered under the Building Societies Act of 1956. There are two other financial institutions conducting business similar to that of a building society, but both are registered under the Banking and Companies Act. One is a limited company and the other one is a public corporation set up jointly by the Kenya Government and Commonwealth Development Corporation.

2. Before Kenya achieved independence in 1963, there were three other building societies in Kenya. But in 1960, after the London Conference on Kenya's independence, in some quarters confidence concerning Kenya's economy was lost and people, particularly those of the immigrant communities, withdrew their funds from financial institutions such as banks and building societies in order to send them out of the country. The financial institutions operating then were of long establishment and financially sound, but the rush of withdrawal of funds was so great that they ran short of ready cash to meet the demand of their depositors. The Commonwealth Development Corporation, the Kenya Government, banks, and insurance companies together injected approximately £4 million into the building societies' industry. As a result of this fortunate and timely assistance, I believe that not one investor lost any money invested with a building society. The capital loss of three of these building societies was so great that they were later turned into limited companies and were made subsidiary companies of the Commonwealth Development Corporation. All of the three building societies have ceased operations and their assets are now managed by the above-mentioned public Corporation named the Housing Finance Company of Kenya Limited. Another limited company, which is a subsidiary of an insurance company recovered its initial loss of deposits, but to the best of my knowledge at present has ceased any mortgage operations and is not accepting new deposits. This is not reflecting a poor state of affairs, but is a decision by the parent company, which is based abroad.

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[1] Prepared by Mr. L. Pandit, Managing Director, East African Building Society, Nairobi, Kenya. The secretariat of the Commission does not necessarily agree with the views expressed in this paper.

3. The East African Building Society was established in 1959. It never had the opportunity to "get off the ground" because only a year after its incorporation it encountered the same difficulties as the other societies and faced heavy withdrawals of funds by its members.

4. However, in view of its size and capital structure, it was able to weather the storm and was the first to resume lending money on mortgages after recovery of its capital. The Society did not have to borrow any money either from the Commonwealth Development Corporation or Kenya Government and met its obligations from its own resources.

5. From a modest capital of approximately K.Shs.500,000/= in 1959, today the Society's assets are over K.Shs.25,000,000/=.

6. An attempt will be made in this paper to discuss the motives of the founder members of this Society in its formation, its initial difficulties, its revival and success today as a sound building society.

7. It is assumed that the participants of the conference are aware of the structure of a building society, and since this has been discussed in various papers previously, I do not propose to write more about it. Suffice it to say that a building society is defined by Section 2 of the Kenya Building Societies Act as "formed for the purpose of raising by subscriptions of the members a stock or fund from which to make advances to members and registered in accordance with the provisions of this Act."

Motives

8. As stated before there were three building societies operating in this country in 1958. Because two were foreign companies and one a local building society which served largely the interest of one community, it was felt at the time that a local building society with local management to serve the interest of all communities would be ideally placed, and with these intentions in mind the East African Building Society was formed and established in business in 1959.

9. A building society, as is well known, raises its capital by issue of shares and accepting of money on deposits from the general public. The shares in a building society, unlike in a limited company, are not fixed and are withdrawable either on demand or at notice, depending upon the amount of investment. The capital structure of a building society is, therefore, completely dependent upon the amount of deposits placed with it or withdrawn from it.

10. As far as the receiving of money on deposit is concerned, the amount that could be accepted by a building society is restricted by Section 22 of the Kenya Building Societies Act, which provides that,

> "Subject to the provisions of this Act, a building society may receive deposits or loans at interest from its members or other persons to be

> applied to the purposes of the Society. The total amount so received on deposit or loan and not repaid by the Society shall not at any time exceed two thirds of the amount for the time being secured to the Society by mortgages from its members."

As a result of the above provision in the Act, a building society must, therefore, strange as it may seem, create mortgage assets first in order to accept deposits from the general public.

11. The East African Building Society upon its establishment issued two classes of shares,

(i) Saving Shares, and

(ii) Investment Shares.

The Saving/Investment Shares respectively, were issued in the denomination of Shs.20/- 500/=. No preference Shares were issued. The Society had no difficulty in finding borrowers but, unlike the bank, the building society is strictly limited to lend out of its capital not multiple of liquid reserve. The capital available in our case was, therefore, shares, deposits, less management expenses and each reserves to meet withdrawals by members. Later on, the profit the Society makes is of course, added to its capital but another snag is that the Building Society can pay out dividend only out of the profits of the Society, as otherwise it would contravene Section 30 of Kenya Building Societies Act which interalia reads, -

> "Not withstanding anything to the contrary contained in its rules, no building society shall pay any dividend or interest on any of its shares otherwise than out of profits earned by the Society."

12. A newly established building society, therefore, faces among other problems, before it commences its business, the problems of competition from established financial institutions, banks and building societies and paying of dividends and interest at the same rates, at least, as offered by other financial institutions in order to attract funds. However, a Building Society is restricted from this because of the legislation as above mentioned. In other words, if a new building society is unable to make profit the first year and, therefore, fails to pay dividend at the market rate, the society will suffer a great capital loss in the following year as the shareholders would remove their capital as the amount of shares is withdrawable. If a society makes a loss during the year, it is required by the Act to provide in its rules "the manner in which profits and losses are to be ascertained and dealt with or provided for" (Section 10 (i)), whereby, generally, the losses will be debited to the shareholders' account in proportion to the amount of investment in each shareholder's credit. As a result, a shareholder's capital is likely to depreciate at the end of the year, rather than appreciate.

13. It was on this adverse background that this Society commenced its business operations. It had no large capital nor did it have the support of any insurance company or any other local or foreign Building Society.

14. The Society was, however, able to attract a capital of K.Shs.840,000/- during the first year and after paying out withdrawals and other expenses, was able to advance K.Shs. 460,000/- on mortgages. The Society was not, as could be expected, able to make a profit during the first year and as a result, the directors of the Society undertook the responsibility of the payment of dividends, in order not to lose the confidence of its share-holders. But the first year's operations proved hopeful and the Society's directors were becoming confident that the Society's business would be profitable the following year. This was where we ran into other adverse conditions:-

15. The year 1960 proved disheartening and discouraging. Due to the political situation at the time, members of the public started withdrawing their funds from financial institutions to be sent out of the country, as there was no legislation at the time to curb this outflow of money. Building societies, in common with other financial institutions, were affected and their liquid reserves could not meet the heavy demand of withdrawal of funds by their members. The Kenya Government and Commonwealth Development Corporation offered assistance to building societies and approximately £4 million were injected by way of capital into these institutions. Attached to this report is Annex I to show the assistance given to each individual institution and to signify the serious situation in which building societies were placed at the time.

16. This was a shock to the Society's directors, Our Society too had to face demands of withdrawal of funds by its members. No new capital came into the Society and by the end of the year, both the share capital and membership of the Society declined. Only one mortgage application was completed during the year.

17. We were hopeful that after the initial rush of withdrawal, the situation would improve, but by the end of 1961, the Society's capital declined by 1/3 and the situation reached a point where it could not any longer meet its obligations to pay out withdrawals of funds in time. The greatest shock came when four of the richest founder members - who were also directors of the Society - resigned from it, to leave the writer and his brother as the only directors of the Society.

18. The Commonwealth Development Corporation offered to give some assistance to this Society, but their terms at the time were so rigid that the Society could not accept them. Meanwhile, however, we were able to arrange over-draft facility on favourable terms with our bankers in order to meet our commitments. Another building society, although being in difficulty, offered to take over this Society. A difficult decision had to be made, for the Society had incurred losses, it had loans to repay and was short of cash to

meet its liabilities. A decision had to be made. It was actually a question of projecting the future if things were to settle and new confidence in the country was to build up, then the decision to remain independent would be the right one. On the other hand, if political instability prevailed our difficulties would be even greater and the decision to "sell out" would be the right one. There were now only two Directors left and very few interested in joining in the responsibilities of an inviable society. The decision I made was that I should run the Society single handed (my brother then having his own business to attend to) and see through its difficult period, perhaps I being over-optimistic in making such a decision. However, our confidence in Kenya and its future was such that we were prepared to take the risk. Times changed in our favour as will be apparent from the following, but, at the time, two other building societies turned into limited companies and became subsidiaries of the Commonwealth Development Corporation and another one ceased mortgage operations entirely due to the heavy repayment of funds which were borrowed.

19. In 1962, things were brighter, though far from satisfactory, and it was felt that the Society should make an all out effort to attract fresh capital. Immediate steps were taken to:-

(i) Move the Society's offices to a more central and prominent location,

(ii) Advertise widely the Society's existence and conditions for lending and borrowing,

(iii) Organize agencies,

(iv) Provide a mobile van service.

Location

20. The Society's premises at the time were not centrally located. They were in a bazaar shopping area and not attractive enough to create confidence in the depositors. The Society's offices were, therefore, moved to a more prominent location. With the change of offices the Society initially lost some business, but through advertising, it was made known, and in a short period, steady investment of funds came into the Society. It seems that even though the new premises were more expensive to rent the investment in proper accommodation paid off.

Advertising

21. The Society embarked on extensive advertising campaign in vernacular newspapers and radio. The Society looked for its capital from the indigenous population of Kenya and, therefore, advertisements were drafted in simple and informative forms, to attract the man in the street and his investment. Informative leaflets giving simple details of rates of interest, facilities of withdrawals, etc. were printed and freely distributed. The radio announcements were in national languages, simple but emphasizing high

rates of interests paid to a depositor by the Society. The Society had to sell the idea of saving to small depositors by offering the highest rate of interest on deposits in the country. It had to educate them about the benefits of saving and they came in large numbers - to place their few shillings in the Society. It worked like a miracle, because it was the small depositors of the Society who saved it from collapse and turned it into a "citadel of saving." The small depositors are still the back-bone of the Society.

Agency organization

22. The advertising campaign brought in a lot of inquiries from up-country towns, where people were interested to open accounts with the Society. Although postal services were available, it was felt that if the Society appointed agents in these towns, personal service could be offered to prospective investors. Agents were, therefore, appointed in five principal towns of Kenya and as a result of their own contacts and Society's advertising campaign, a steady flow of investments came into the Society.

23. In later years, three of these agencies were closed down during an economy-drive, as the cost of running them was too high. However, in 1969, one agency was turned into a proper branch office of the Society. In fact, the Society bought its own building to accommodate this branch. One agency still operates.

24. In order that the Society's account holders may not suffer any inconveniences, arrangements were made through the Society's bankers, whereby any account holder was able to deposit money in the Society through any branch of the Society's bank and was able to cash withdrawal cheques issued by this Society without any delay. The bank has over 100 branches in Kenya, and Uganda and, therefore, the Society was able to provide wide and better services and thus the need for agencies became insignificant.

Mobile van service

25. In order to attract the employees of industrial and large concerns, who could not come to the Society's offices to deposit of their savings, a mobile van service was provided in Nairobi. The Society's representative visited factories and large firms on their wage day, distributed leaflets, issued receipts and passbooks for deposits to people on the spot. Withdrawals of small amounts were even paid on demand. This scheme was successful initially and brought much needed capital into the Society. In later years during the economy-drive this scheme, however, had to be abandoned.

1962-1963 operations

26. As can be observed from above, the Society made great efforts to popularize its services and to bring in more capital from new sources. The central office, publicity, agencies, and personal mobile van services all

had its impact and the Society's cash position improved considerably. After only three months of operation in the new premises, the Society was able to pay out all withdrawal notices that were in arrears and at the same time was able to meet new demands in time. At the end of 1962, the Society's membership had increased by 2,549 members, and capital went up by 125 per cent over the year 1961. The mortgage account which had declined over the years, showed appreciation and went up by 60 per cent over the previous year. The Society was able to resume lending money after a lapse of over three years and before any other society could. This was a good beginning after three difficult years. Again, the year ahead looked hopeful.

27. But the Society's directors were at this time all members of the writer's family which was not altogether desirable and in order to strengthen its Board of Directors and give it a proper base, the Society's Advocate was invited to join as a director, and is currently the Society's Chairman. In later years, as the Society's position grew from strength to strength, a doctor was invited to join as a director, a position he still maintains.

1963-1964 operations

28. The basic policy of running the Society was established. Advertising still continued, agencies were doing regular business and mobile service was playing its part. The year 1963, marked Kenya's independence and confidence in the country's economy was revived slowly but steadily. The standard of living and wages of workers were up and in view of the Society's past efforts to reach to the common man, the Society was able to create more confidence among them. By the end of 1964, the Society's membership and assets went up considerably. By this time, the Society paid off all its other debts, and had no other liability except to its shareholders and depositors.

Economy drive

29. Whilst the Society's capital and assets were up it still was not making enough profits to cover the payment of dividends and management expenses. The directors of the Society were still made personally liable for shortfall in the payment of dividend and, therefore, it was essential to economize on the Society's expenses and yet maintain its rapid progress. More expansion was necessary at minimum expense, a difficult task, difficult but not impossible. An economy-drive was carried out in 1965, cutting down some of the expenses on agencies, mobile van service and staff. Personal efforts and advertising still continued and a land-mark was reached at the end of 1965, when for the first year and time, the Society met all payments, including that of management as well as dividend, from its current revenue, and still made a small profit.

30. In the same year, the Kenya Government introduced exchange control to prevent funds leaving the country, and the Society took the maximum

benefit of this restriction. It stepped up its publicity and offered attractive and high rates of interest to its members. In fact we were able to raise our deposit rate to $6\frac{1}{2}$ per cent (on 12 months' notice) and slightly lower on demand deposits. As funds came into the Society, it was able to offer loans to its members either to buy or build houses. There was a growing demand for loans. A boom in building industry had begun and the Society fully participated in it. It afforded major financing in building projects in such predominantly Kenyan-occupied areas as Ofafa, Jericho, Jerusalem, Mbotela for which it earned congratulations of the Mayor of Nairobi. The advancement of loans created more confidence among the investors and by the end of 1965, the Society's assets reached K.Shs.3 million, and membership was 7,353.

31. Almost 100 per cent growth in assets was achieved during the year 1966, and the assets were then near K.Shs. 6 million.

1967-1969 operations

32. In 1967, the lease of the premises occupied by the Society expired and in view of excessive increase of rent by the Landlords, the Society bought its own premises, not far away from these offices. The Society's own premises created confidence among the general public and the Society's assets rose to a record figure of K.Shs.13 million, by the end of the year 1968. The Society by now had cleared all its past losses, the directors were relieved of their liabilities and had built up a respectable amount in general reserve. The Society was on sound footing, profitable and popular, after a decade. The difficulties were over and the Society was ready to go ahead with an expansion programme.

Expansion

33. It was necessary to expand the Society's services in other towns of the country. In 1969, the Society bought its own premises in a central situation in Mombasa, and turned an agency office into a branch office. The branch office expanded its services satisfactorily and offered loans to buy or build houses in Mombasa to Society members.

34. The Society felt that it should not deviate from its original view of having centrally situated offices in Nairobi, and although the present offices were doing excellent business, yet decision was taken to open another branch office in a prominent location of Nairobi. This was done and the Society commenced business in its new offices in March, 1970.

35. With the above expansion and continuing its contact with small investors, the Society's assets by the end of 1969 reached a record figure of K.Shs. 22 million, and by January this year near 25 million. It showed a rise of - 70 per cent in its assets, and 375 per cent in its general reserve, over the year 1968. The Society hopes to reach its target figure of K.Shs.40 million by the end of 1970. It is an ambitious target, but

in view of the recent progress, the Society is reasonably confident of achieving this milestone.

Future

36. The Government has a separate Ministry to deal with housing. According to the new Development Plan for Kenya (1970-74) the shortage of housing is acute and is likely to remain so for many years. It is estimated to be at least 10,000 housing units per year in the urban areas alone. The Government plans to spend £33 million during the five-year development period, with another £20 million to be forthcoming from the private sector. The last point is by its very nature unsure, as there is no direct control by the Government over the private financial sources. The East African Building Society is, however, committed to Kenya and its people, as they form the major part of our members. As we have learned by hard-won experience the confidence in the country is the major factor in creating stability and progress. By showing this confidence we hope that we shall be able to inspire a similar confidence in our depositors and borrowers. If we are successful in this, we shall have a significant part to play in Kenya's economic development.

Recommendations

37. As can be observed from this paper, the Building Societies Act in this country needs to be amended, if we are to see the establishment of new building societies.

38. In my view, therefore, Section 30 which forbids payment of any dividend until a society makes a profit should be done away with due to the complex nature of the shares of a building society. In the true sense of the word, a building society share is in the form of depsit and, therefore, Section 22 of the Act should be rigidly applied. Alternatively the Registrar of Building Societies should be given discretionary powers to allow a building society to pay out dividends, without it making a profit, but depending upon the capital structure and feasibility of profitability.

39. Secondly, under the present legislation Section 6 (1) says that,

> "Any ten or more persons may form a building society by subscribing their names and addresses to rules agreed by them for the Government of such society and by obtaining registration under this Act."

40. In my opinion, before a building society can be registered, the names of the first ten founder members should be approved by the Registrar of Building Societies, after carefully considering their standing in society. This I believe to be very important especially in a developing country, where we cannot afford to lose the confidence of the people in building societies, and where so many would like to lure people to part with their money under a false pretext.

41. An initial fixed capital should be subscribed by these members and they should be prevented from withdrawing this capital for at least a period of three years. Section 77(6) of the Act could also be made applicable, because it states that,

(a) "fix the maximum rate of interest which may be paid or charged by building societies in respect of the borrowing or advancing of money."

(b) "require building societies to hold such amount in cash or on deposit or in investments in accordance with Section 25 of this Ordinance as may be specified in such order as security for the prompt repayment of shares, deposits, loans and over drafts and for the payment of interest accrued thereon."

Conclusion

42. I hope this report will serve as an eye-opener to anyone considering setting up a building society. They should not attempt this unless they have access to large capital resources and the trained staff who can administer it. The experiment of setting up the East African Building Society was in some ways unique, but although it succeeded it was only because of personal commitment and months and years of hard work by directors and staff, - often with little pay. Had we failed it would have been detrimental not only to its directors, who were involved with everything they had, but it was an unbearable thought that the small depositor who had trusted us with his money should be let down. Having succeeded, it is not only a good feeling of achievement, which everyone in the Society has, but it is even more a pride in being able to increase our support to more and more members, who have long been hoping for a loan to realize their dream of a new home.

ANNEX I

SPECIAL ASSISTANCE TO HOUSE MORTGAGE INSTITUTIONS[1/]

First Permanent

	BANK	C.S.F.C.	KENYA GOVERNMENT	TANGANYIKA GOVERNMENT	N.RHODESIA GOVERNMENT	CDC	TOTAL	AID AS PER CENT MORTGAGE LOANS OUTSTANDING
1961	238,700	420,000	270,000	-	-	860,000	1,788,700	58
1962	27,462	-	250,000	150,000	980,635	1,240,300	2,648,397	46.6
1963	72,000	-	250,000	150,000	952,817	728,633	2,081,451	40.5

Kenya Building Society

	BANK	NORWICH UNION	CDC	TOTAL	AID AS PER CENT MORTGAGE LOANS OUTSTANDING
1961	330,000	3,000	620,000	953,000	48
1962	326,000	109,000	650,000	1,085,000	60
1963	350,000	230,650	832,124	1,412,664	90

Savings and Loan Society Ltd.

	CDC	PEARL ASSURANCE	TOTAL	AS PER CENT MORTGAGE LOANS
1961	201,666	427,883	629,549	14.8
1962	585,000	620,000	1,205,000	30.6
1963	500,000	620,000	1,120,000	30.8
1964	200,000	250,000	450,000	13.7

1/ Source: Housing Research and Development Unit University College, Nairobi, Kenya.