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THE PERFORMANCE EFFICIENCY OF COMMERCIAL BANKS IN KENYA

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ABSTRACT

The commercial banks deals with most liquid asset (cash), of people and helps them for stability and growth of a country's economy. Kenya is one of the East African Countries. It has a population of 40 million people. The policy frame work of Kenya combines socialistic and capitalistic features with a heavy bias towards private sector investment. However, the last couple of decades in Kenya have witnessed continuous change in regulation, technology and competition in all sectors including financial services industry. The rising cost-income ratios and declining profitability reflect increased competitive pressure. To assess the stability of the banking system, it is therefore crucial to benchmark the performance of banks operating in Kenya. An efficient banking system contributes in an extensive way to higher economic growth in Kenya. This paper investigates the performance analysis of Kenyan Commercial banks. It is found that private banks performed well relatively compared to public banks sector and foreign sector banks in Kenya.

Keywords: Performance, Efficiency, Commercial Banks of Kenya, Descriptive Statistics

1. INTRODUCTION

There is a great belief that the competition in business is a driving force behind numerous important policy changes. The competition exerts downward pressure on costs, reduces slacks, provides incentives for the efficient organization of production, and even drives innovation forward in the balancing operation across the country. However, the evidence in its favor is mix. The effects to promote productivity performance put to manage competition. The productivity performance of banks is measured through efficiency and scale economies, as these two are perceived as the two most important key issues in the banking sector.

The Central Bank of Kenya (CBK) issued guidelines with respect to establishment of new banks in the private sector. Apart from taking high measures and risks to enhance competition in the banking sector, Central Bank of Kenya as a sector regulator is also entrusted to ensure stability in the financial sector so as to achieve greater objective of economic growth and stability. CBK guarantees the stability of banking operation by instructing banks to follow certain norms so as to avoid risks. In this respect, the CBK used Basel II norms in Kenya for making Kenyan banks as internationally active. Under the revised regime of Basel II, most of the Kenyan commercial banks had been maintaining a Capital Adequacy Return (CAR) of 6% even prior to 22-03-2011(**Central Bank of Kenya 2009 publications**).

Efficiency of Banks

This is the cost of inputs for each unit of output produced. For example, the assembly department spent 2,320 hours of direct labour to produce 2,000 actual units of out output, while the budget allows only 2,000 direct labour-hours for that level of output. Then the department was clearly inefficient in the use of labor since it spent 320 hours more than allowed. Likewise the efficiency of the banks in this study will be tested. The input and the output of the banks used to find the efficiencies in this study are given in table 1 and the formulae for its calculations given below.

$$\text{Efficiency} = \frac{\text{Weighted sum of inputs}}{\text{Weighted sum of outputs}}$$

Efficiency of Commercial Banks in Kenya shown in Table-1; From Table 1, it clearly indicates that in the year 2007, Kenya commercial banks like Barclays bank of Kenya, Cooperative bank of Kenya, Consolidated bank of Kenya, Dubai bank and Development bank of Kenya played a commendable role in achieving the economic growth of Kenya, they have an efficiency of 0.712, 0.629, 0.559, 0.541, and 0.539 respectively.

In the year 2008, Barclays bank of Kenya showed a decrease of 0.006 from the previous year but still remains with the best performance of 0.702. Development bank of Kenya also showed a decrease of 0.054 from the previous year. Banks like consolidated bank of Kenya, cooperative bank of Kenya and Dubai bank showed a positive trend compared to the previous year. Diamond Trust bank of Kenya, Habib bank, Equatorial bank and National bank of Kenya showed a positive trend but still underperformed.

In the year 2009, consolidated bank of Kenya showed a poor performance of 0.215. Cooperative bank of Kenya and Barclay's bank of Kenya showed a decreasing effect but having an efficiency of more than half. Development bank of Kenya and Dubai bank showed an increased performance from the previous year. National bank of Kenya, Equatorial bank of Kenya, Diamond Trust bank of Kenya and Habib Bank showed an increase in their performance but still having an efficiency that is less than half.

1. REVIEW OF LITERATURE

The existing studies conducted in respect of performance of commercial banks in India and other countries are reviewed below.

Agarwall (1979) assessed the performance of nationalized banks in discharging the various social obligations. There is absolute line of measurement in this regard; an effort has been made to evaluate the performance of the nationalized banks and discharging the various social obligations on the basis of comparison with performance of other bank groups. For the assessment of their individual performance, the line of assessment adopted was the average performance of the entire nationalized in total. **Hempel G. Coleman,** (1986). Found that there is a generally accepted relationship between risk and return, that is, the higher the risk the higher the expected return. **English M.** and **Warng,**(1992). Much of the current bank performance literature describes the objective of financial organizations as that of earning acceptable returns and minimizing the risks taken to earn this return. **Sathye** (2001) studied the relative efficiency of Indian banks in the late 1990's and compared the efficiency of Indian banks with that of the banks in other countries. This study found that the public sector banks have a higher mean efficiency score as compared to the private sector banks in India, but found mixed results when comparing public sector banks and foreign commercial banks in India. **Kumbhakar** and **Sarkar** (2003) found that while private sector banks have improved their performance mainly due to the freedom to expand the output, public sector banks have not responded well to the deregulation measures. **Mazhar M. Islam,** (2003) discussed the development and performance of domestic and foreign banks in Arab gulf countries, and showed that local and foreign banks in these countries have performed well over the past several years. Efficiency is treated as a relative measure which reflects the deviations from maximum attainable output for a given level of input. **Rammohan** and **Ray** (2004) compared the revenue maximizing efficiency of public, private and foreign banks in India, using physical quantities of inputs and outputs, using deposits and operating costs as inputs, and loans, investments and other income as outputs. They found that public sector banks were significantly better than private sector banks on revenue maximization efficiency, but between public sector banks and foreign banks the difference in efficiency was not significant **Arzu Tektas, and Gunay,** (2005) discussed the asset and liability management maximizing bank's profit as well as controlling and lowering various risks. . **Arabind Saha** (2008) pointed out that the commercial banks like NCBs, PCBs, SCBs and FCBs have been playing a commendable role in achieving the economic growth of Bangladesh. The study focuses the performance indicators of banking activities of Bangladesh through highlighting their productivity. The introduction of modern technology in banking sector is the need of the hour. **Prasad V.**

Josh and **Bhalerao J. V.** (2011) found the performance of the banking sector ranges above 80%, which indicates an appropriate conversion of inputs into outputs.

The above literature provides an overview of different models used to study the performance of commercial banks. But, there is no comprehensive study focusing the performance of Commercial banks from East African countries. Thus, an attempt has been made in this study to evaluate the performance of commercial banks in Kenya.

2 STATEMENT OF THE PROBLEM

It is reposted that private banking sector in Kenya has produced commendable results in achieving the social-economic objectives entrusted to them. Against the achievement in a few areas of business, the overall business performance as well as financial performance of the banks was not encouraging. It has brought to light the alarmingly low capital base, high and growing non-performing assets relatively low profitability position of banks. Like profitability and productivity of the banks too shows deceleration. To obtain a clear picture, it is worthwhile to have a close look at the performance effectiveness of Kenyan banks which will further reflect the state of affairs in the rest of the entire sectors of banks in the country. In this situation it's observed well by central bank of Kenya on a monthly economic review April 2010 journal that Kenyan banking sector is not improving by any margin. Hence, an attempt is made in this study to study the overall performance of banks in Kenya.

3 OBJECTIVE OF THE STUDY

The objective of the present study is to examine and compare the performance of Public, private and foreign banks in Kenya during post global crisis period.

4 HYPOTHESIS OF THE STUDY

The following are the hypothesis of the study:

Ø NH1: There is no significant difference in the performance of the public sector banks during the study period.

Ø NH2: There is no significant difference in the performance of Private sector banks during the study period.

Ø NH3: There is no significant difference in the performance of foreign sector banks in Kenya.

5 METHODOLOGY OF THE STUDY

a. Sample selection

There are 5 public sectors, 28 private sector and 12 foreign banks in Kenya as on 2009. For the purpose of this study, 9 banks (3 public, 3 private and 3 foreign) based on their top profitability of banks. The names of the sample banks chosen for this study are given in table 2.

b. Sources of Data

The study entirely depends on secondary data collected from Central Bank of Kenya Bank Association Journals and respective websites of the sample banks. The data were collected from CBK website. The other required data were collected from reputed journals, books etc.

c. Period of the Study

The comparative study of the Kenyan Commercial banks covers a period of three years from January 2007 to December 2009.

d. Tools Used For Analysis

The following are the tools used for this study.

$$\bar{x} = \frac{1}{n} \cdot \sum_{i=1}^{n} x_i$$

I. Descriptive statistics

Mean

A mean refers to the arithmetic mean, which is simply the sum of given values divided by the numbers of such values (that were included in the summation).

A median is a value in the middle of the distribution, dividing the distribution in such a way that there is an equal numbers of values above and below the median. Median is non-algebraic, as its calculation requires that the values be ordered, which requires comparison of logical nature.

Standard Deviation

The standard deviation is the most common measure of statistical dispersion, measuring how widely the value in a data set is spread. If many data points are close to the mean, then the standard deviation is large. If all the data values are equal, then the standard deviation is zero.

$$\sigma = \sqrt{\frac{\sum (x - \bar{x})^2}{N}}$$

Where Ó=Sum of

X= Individual score

N= Sample size (Number of scores)

$\bar{x}$ = Mean

Skewness is a measure of the degree of asymmetry of a distribution. If the left tail (tail at small end of the distribution) is more pronounced than the right tail (tail is the large end of distribution), the function is said to have negative skewness. If the reverse is true, it has positive skewness. If the two are equal, it has zero skewness. The skewness of a distribution is define to be

$$S = \frac{\overline{u^3}}{\left(\overline{u^2}\right)^{\frac{3}{2}}},$$

1. Limitations of the study

- This research study is based on secondary data only and all limitations applicable to secondary data are applicable to this study.
- This study covers only 9 sample banks out of 45 banks in the country, based high profitability.
- There are no references to this study basically from Kenya so the study from India and other countries were taken as references.
- The period of this study covers only 3years.

2. Analysis of Descriptive Statistics of Sample Commercial Banks in Kenya

For the purpose of this study, the Analysis is classified into the following sub sections:

a. Descriptive Statistics for Efficiency of Public sector Banks in Kenya

b. Descriptive Statistics for Efficiency of Private sector Banks in Kenya and

c. Descriptive Statistics for Efficiency of Foreign Banks in Kenya

A. Descriptive Statistics for Efficiency of Public sector Banks in Kenya

TABLE-3 shows descriptive statistics for efficiency of Public sector banks in Kenya. It is important to refer that the Public sector banks are the ones in which the Government has a major holding. According to the result the efficiency value of sample banks during 2007 to 2009 varied from year to year. During the study period, the efficiency scores of the public sector varied from0.301 to 0.526. It shows its underperformance through its efficiencies values. The range of the National bank of Kenya, Development bank of Kenya and Consolidated bank of Kenya is 0.1, 0.069, and 0.486. The Std. Deviation of Consolidated bank of 0.249899 showed the high risk with good performance, followed by Development bank of Kenya with 0.03629 and lastly by National bank of Kenya with 0.047571 with the lowest risk showing the list performance. The skewness of the public sector banks shows that there is the normality of the banks. The normality of the banks is best seen within the ranges of -3 to +3. For that case all the public sector banks all shows the normality of the banks for they all range between -1.1244 to 0.2826. This shows the performance of the bank is not 100% good. From the analysis the negative NH1 tested was rejected as there was underperformance of the public sector banks in Kenya uring the study period.

B. Descriptive Statistics for Efficiency of Private sector Banks in Kenya

The descriptive statistics for efficiency of Private sector banks in Kenya are given in table 4: The private sector banks came into existence to supplement the performance of Public sector banks and serve the needs of the economy better. As the public sector banks were merely in the hands of the Government, the banks had no incentive to make profits and improve the performance. The Main difference is that Public sector banks follow the Central Bank of Kenya Interest rules strictly but private banks could have some changes but after the approval from the Central Bank of Kenya. The private sector banks in Kenya are the banks controlled by the private lenders with the approval from the CBK. The interest rates are high as compared to Public sector banks. The range of the private sector banks between the maximum and the minimum are as follows for Cooperative bank of Kenya, Barclays bank of Kenya and Dubai bank are 0.062, 0.032 and 0.035 respectively. The best mean was measured with Barclays bank of Kenya with 0.6993. The normality (skewness) of the banks is best seen within the ranges of -3 to +3. For that case all the private sector banks all shows the normality of the banks for they all range between -0.0832 to 1.4927. The Std.Deviation was highly measured with Cooperative bank of Kenya with 0.0360. Based on the performance, the second hypothesis was accepted. Thus, there is a positive relationship among the inputs and the bank size.

C. Descriptive Statistics for Efficiency of Foreign Banks in Kenya

TABLE-5 Shows descriptive statistics for efficiency of Foreign Sector banks in Kenya: The result shows the mean efficiency value of the foreign sector banks during this period of study shows the underperformance, comparing the performance of the three bank sectors, foreign sector shows the mean best performance of 0.443, which is not more than half. The average efficiency score of the public, private, and foreign banks shows, even the private banks are the most efficient and the foreign banks are becoming almost equally less efficient. The range between Equatorial bank, Diamond Trust bank of Kenya and Habib bank as foreign sector banks are represented as 0.055, 0.055, and 0.047 respectively. Std. Deviation here is used to measure high risks of the bank, for this case the higher risks is measured with 0.02816. The skewnes is used in this case to measure the normality of the bank which lies between -3 to +3, the values are -0.3780, -1.0494 and -1.0030 respectively showing the normality of the banks. Based on the performance of the hypothesis was rejected, hence there is a negative relationship of the inputs and the size of the bank.

CONCLUSION

The study attempts to explore the performance of banking sector of Kenya. The study finds that, there have been significant changes in the performance of the banking sector in Kenya. The relative importance of the public sector banks has been declining with the emergence of the domestic private banks and more foreign banks. The asset, deposit and the credit share shows the share of public sector has been declining and the share of the private banks is increasing, which implies declining concentration and increasing competition. The foreign banks are found to be the less profitable in comparison to the domestic private and the public sector banks. However, the efficiency results of the study are quite contrary to the international evidence. The public sector banks are found to be the less efficient banks outweighed by the domestic private sector which has best efficient and lastly foreign banks with the least efficient. It is evident from the efficiency scores of the domestic private banks. Since early 2000's, the domestic private banks are becoming relatively increasing in their efficiency.

Scope for future Research

A close look at the performance effectiveness of some selected kenyan banks has been undertaken through for a comparative analysis of public sector banks, private sector banks and foreign sector banks. The study is undertaken by reviewing and analyzing the performance effectiveness of the banking sector in Kenya.