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PERFORMANCE INDICATORS OF KENYAN COMMERCIAL BANKS

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ABSTRACT

Commercial banks deals with most liquid asset (cash) of people and helps them for the stability and growth of economy. Kenya is one of the important 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 ratio and declining profitability are mainly due to increased competitive pressure from global players. To assess the stability of the banking system, it is therefore crucial to benchmark the performance efficiency 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 relatively well compared to public banks sector and foreign sector banks in Kenya.

Keywords: Performance, Kenyan Commercial Banks, Descriptive Statistics

INTRODUCTION

Competition in business is a driving force behind 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. Banks play an important role in Kenyan financial system. When we look at the composition of balance sheet of the Financial Sector we can see that a huge part (85%) belongs to banks. In this context the health of banks has a crucial importance for Kenyan economy. By September 2009, of the 45 banks in the Kenyan banking sector banks, 28 are private sector banks, 12 are foreign sector banks and 5 are Public sector banks. This is pointing to the preference of private banking in the Kenyan banking sector **(Financial Stability Report, 2009).**

However, the evidence in its favor is mix. The efforts to promote the performance of the unit are put to manage the increased competition. The performance of banks can be measured through efficiency scale. The Central Bank of Kenya (CBK) issued guidelines with respect to establishment of new banks in the private sector and foreign 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. CBK guarantees the stability of banking operation in by instructing banks to follow certain norms so as to avoid risks.

There is need to make the financial institutions in Kenya more competent and more efficient. The banking sector plays an important role as a resource mobiliser. It remains the principal source of resources for many households, small and medium enterprises and also caters the large industries. It also provides many other financial services. The present study intends to determine the efficiency of the banks operating in Kenya.

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. An effort has been made to evaluate the performance of the nationalized banks that discharge the various social obligations. **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),described 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. The study found that the public sector banks have a higher mean efficiency score as compared to the private sector 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. The study showed that local and foreign banks have performed well over the past several years. **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. The study found that public sector banks were significantly better than private sector banks on revenue maximization efficiency. **Arzu Tektas, and Gunay,** (2005) discussed the asset and liability management maximizing bank's profit as well as controlling and lowering various risks. . **Arabinda 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 focused the performance indicators of banking activities of Bangladesh through highlighting their productivity. **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.

STATEMENT OF THE PROBLEM

It is reposted that private banks in Kenya produced commendable results in achieving the social-economic objectives entrusted to them. Except 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 that there was alarmingly low capital base, high and growing non-performing assets and low profitability position of banks. Besides, like the profitability, it is noted that the productivity of the banks too shows deceleration. It was urged to have a close look at the performance of Kenyan banks. (**Monthly economic review April 2010 Journal**). It is also reported that the Kenyan banking sector has not improved any margin even after liberalization. Hence, an attempt is made in this study to assess the overall performance of banks and offer suggestions for the improvements of the banking system in Kenya.

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.

HYPOTHESIS OF THE STUDY

The following are null hypothesis are tested in this study.

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

METHODOLOGY OF THE STUDY

Efficiency

The efficiency of the sample banks is tested in this study. The four inputs and the four outputs of the banks are used to find the efficiencies of sample banks. The formula used to know the efficiency is as follows.

$$\text{Efficiency} = \frac{\text{Weighted sum of Outputs}}{\text{Weighted sum of Inputs}}$$

Where

Weighted sum of outputs = Advances + Investments + Interest Income + Non-Interest Income

and

Weighted sum of Inputs= Deposits + Interest expenses + Operating expenses + Assets.

a. Sample selection

There are 5 public sector banks, 28 private sector banks and 12 foreign sector banks in Kenya as on July 2009. For the purpose of this study, totally 9 banks (3 public sector banks, 3 private sector banks and 3 foreign sector banks) based on their top profitability were chosen as sample size. 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 books and records of Central Bank of Kenya and Bank Association Journals and respective websites of the sample banks. The other required data were collected from reputed journals, books etc.

c. Period of the Study

The study on 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.

I. Descriptive statistics

a) 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).

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

b) Median

A median is a value in the middle of the distribution, dividing the distribution in such a way that there are 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.

c) 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 Σ=Sum of

X= Individual score

N= Sample size (Number of scores)

$\overline{X}$ = Mean

d) Skewness

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

Present study suffers with the following limitations.

1. The period of the study is limited to two years.
2. The study examines only the technical efficiency of Kenyan commercial banks, not the absolute efficiency and
3. The study depends only on secondary data and limited to 10 sample banks only.

2. Analysis of Efficiency of Sample Commercial Banks in Kenya

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

a. Efficiency of Commercial Banks
b. Descriptive Statistics of Public sector Banks in Kenya
c. Descriptive Statistics of Private sector Banks in Kenya and
d. Descriptive Statistics of Foreign Banks in Kenya

A. Efficiency of Commercial Banks

Table-1 shows efficiency of commercial banks in Kenya. From the above Table, it is clearly understood that in the year 2007, Kenya commercial banks namely Barclays bank of Kenya, Cooperative bank of Kenya, Consolidated bank of Kenya, Dubai bank and Development bank of Kenya played a commendable role in providing better banking service and improving the economic growth of Kenya since they have earned an efficiency score of 0.712, 0.629, 0.559, 0.541, and 0.539 respectively which are considered to be good scores and these banks can called as efficient. It is to be noted that in the year 2008, Barclays bank of Kenya showed a negative figure with the score range of 0.006 from the previous year but still remains with the best efficiency score of 0.702. The Development bank of Kenya also showed a negative score of 0.054 from the previous year. The other sample banks like Consolidated Bank of Kenya, Cooperative Bank of Kenya and Dubai Bank showed a positive trend compared to the previous year. It is to be noted that Diamond Trust Bank of Kenya, Habib Bank, Equatorial Bank and National Bank of Kenya showed a positive trend but still showed a low efficiency. The above Table also reveals the fact that in the year 2009, the Consolidated Bank of Kenya showed a poor efficiency of banking service with 0.215. The banks like Cooperative bank of Kenya and Barclay's bank of Kenya showed a decreasing effect (scores) but having an efficiency of more than half ranging from 0.681 to 0.592. The Development bank of Kenya and Dubai bank showed an increase of efficiency from the previous year (2008). The National bank of Kenya, Equatorial bank of Kenya, Diamond Trust bank of Kenya and Habib Bank showed an increase in their efficiency score facing a turmoil situation as the scores depict about being in-efficient.

From **Graph-I**, the overall performance of commercial banks in Kenya can be easily understood with the help of the averages efficiency scores for 2007 (0.4931), 2008 (0.5243), and 2009 (0.4808).There was no significant difference between the public sector banks and foreign sector banks with their inputs (deposits, interest expense operating expenses and assets) as can be seen in private sector banks which is the most banking sector of the Country having higher concentration of inputs and outputs. It is to be noted that the banks with high deposits, savings and loan recovery have got good efficiency performance.

B. Descriptive Statistics of Public Sector Banks in Kenya

Table-2 shows the result of Descriptive statistics for public sector banks in Kenya from January 2007 to December 2009. The analysis reveals the fact that public sector banks in Kenya (National bank of Kenya, development bank of Kenya and Consolidated Bank of Kenya) earned positive returns while the mean returns 0.526, 0.4916 and 0.301 was earned which gave positive returns respectively. The value of the standard deviation of consolidated bank of Kenya (0.249899) indicates the highest risk among the three other banks. It indicates that there was linearity between the return and risk. Therefore, it is suggested that the investors should invest in low standard deviation with banks i.e. National bank of Kenya and Development bank of Kenya with (0.047571 and 0.03629) respectively. The return distribution was positively skewed in National Bank of Kenya (0.2826) and negatively skewed with devèlopment bank of Kenya (-0.1.4051) and Consolidated Bank of Kenya (-0.1.1244). This indicates that the Banks registered more negative efficiency score than positive ones.

C. Descriptive Statistics of Private Sector Banks in Kenya

The result of Descriptive statistics of private sector banks in Kenya from January 2007 to December 2009 is given in **Table 3**. The analysis reveals that there was a positive return for all the private sector banks (co-operative bank of Kenya, Barclays bank of Kenya and Dubai Bank of Kenya). The positive mean returns of 0.712, 0.664 and 0.576 was earned by Barclays bank of Kenya, Cooperative bank of Kenya and Dubai bank of Kenya and Dubai bank of Kenya respectively. The value of the standard deviation of the cooperative bank of Kenya (0.036005) indicates the highest fluctuation in return among the three other banks. It is reposted that there was linearity between the return and the risk.

D. Descriptive Statistics for Efficiency of Foreign Banks in Kenya

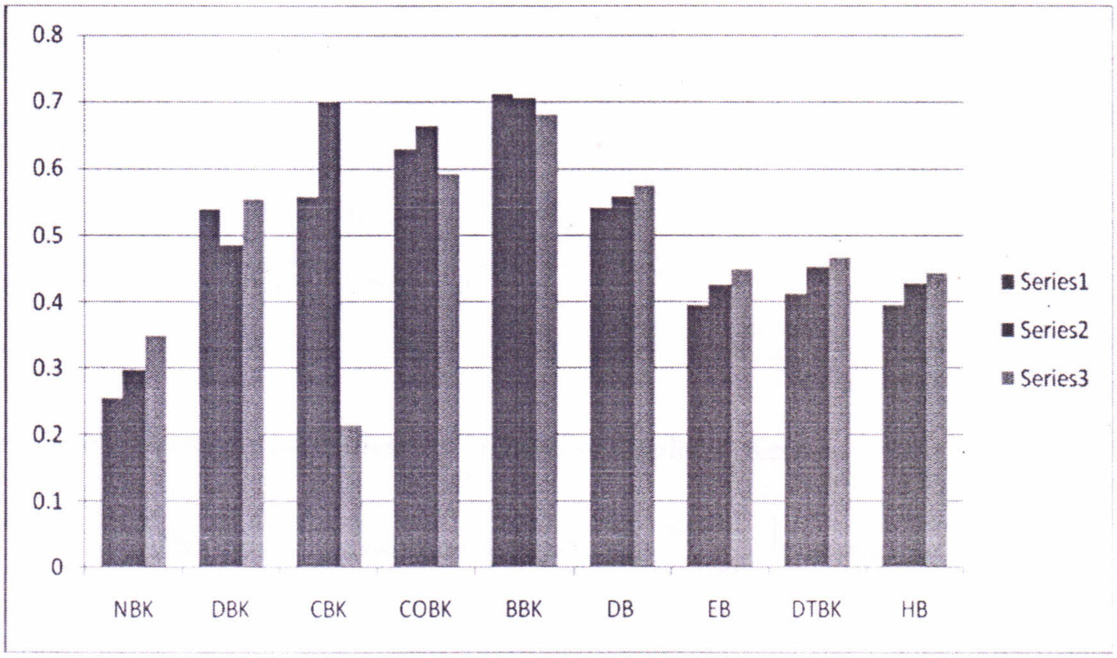
TABLE-4 Reveals the result of Descriptive statistics for foreign sector banks in Kenya from January 2007 to December 2009. The analysis f the above Table shows the fact that there was a positive return for all the foreign sector banks (Diamond Trust bank of Kenya, Equatorial bank of Kenya and Habib Bank of Kenya) with the positive mean returns of 0.443, 0.4236 and 0.4223 respectively. Diamond Trust bank of Kenya gives the higher value of the standard deviation of 0.02816. It is suggested that there was linearity between the return and the risk.

Table-1: Efficiency of Commercial Banks in Kenya

Serial Number	Name of the Bank	Efficiency 2007	Efficiency 2008	Efficiency 2009
1.	National Bank of Kenya	0.255	0.298	0.350
2.	Development bank of Kenya	0.539	0.485	0.554
3.	Consolidated Bank of Kenya	0.559	0.701	0.215
4.	Cooperative Bank of Kenya	0.629	0.664	0.592
5.	Barclays Bank of Kenya	0.712	0.706	0.681
6.	Dubai Bank	0.541	0.558	0576
7.	Equatorial Bank	0.395	0.426	0.449
8.	Diamond Trust Bank	0.412	0.453	0.467
9.	Habib Bank	0.396	0.428	0.443

Source: computed from respective bank websites of 2007, 2008, 2009.

Graph-1 Efficiency Trend during 2007 to 2009



Note: Series1-2007, Series2-2008, Series3-2009.

Table-2: Descriptive Statistics of Public Sector Banks in Kenya

Name of the Public sector Banks	N	Minimum	Maximum	Mean	Std. Deviation	Skewness
National Bank of Kenya	3	0.255	0.35	0.301	0.047571	0.2826
Development Bank of Kenya	3	0.485	0.554	0.526	0.03629	-1.4051
Consolidated Bank of Kenya	3	0.215	0.701	0.4916	0.249899	-1.1244

Sources: Computed from secondary data using SPSS 11.0

Table-3: Descriptive Statistics for Efficiency of Private Sector Banks in Kenya

Name of the Domestic Private sector Banks	N	Minimum	Maximum	Mean	Std. Deviation	Skewness
Cooperative Bank of Kenya	3	0.592	0.664	0.6283	0.036005	-0.0832
Barclays Bank of Kenya	3	0.68	0.712	0.6993	0.01701	1.4927
Dubai bank	3	0.541	0.576	0.5583	0.017502	0.0856

Sources: Computed from secondary data using SPSS 11.0

Table-4: Descriptive Statistics for Efficiency of Foreign Banks in Kenya

Name of the Foreign sector Banks	N	Minimum	Maximum	Mean	Std. Deviation	Skewness
Equatorial Bank	3	0.395	0.45	0.4236	0.027574	-0.3780
Diamond Trust Bank of Kenya	3	0.412	0.467	0.443	0.02816	-1.0494
Habib Bank	3	0.396	0.443	0.4223	0.024007	-1.0030

Sources: Computed from secondary data using SPSS 11.0

CONCLUSION

The study explored the performance of banking sector in Kenya. The study found that, there have been significant changes in the performance of the banking sector in Kenya. It is found that the relative importance of the public sector banks has been declining with the emergence of the domestic private banks and more foreign banks. The analysis of asset, deposit and the credit share shows that the share of public sector has been declining while the share of the private banks is increasing. The public sector banks are found to be the less efficient than that of private and foreign banks in Kenya during the starting period

Scope for future Research

The performance effectiveness of all Kenyan banks can be undertaken.

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