EFFECTS OF THE GLOBAL FINANCIAL CRISIS IN THE BANKING INDUSTRY IN KENYA

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DECLARATION

This project is my original work and has not been submitted for examination in any other University.

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This project has been submitted for examination with my approval as University supervisor.

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DEDICATION

This project is dedicated to my mother Cecilia Wambui and my sisters Elizabeth Wangui,Rozaria Wanja and Magdaline Wambui for the prayers and encouragement. also my daughter Salome Wacera for being an inspiration to me.

May the Lord, God Almighty bless you abundantly

ABSTRACT

The objective of this study was to determine the effect of the global financial crisis on commercial banks in Kenya. The current study expected to establish how Kenyan banks prepared, dealt and saw themselves through the crisis which climaxed in 2008/09 financial year. This study therefore adds to new knowledge on how commercial banks in emerging economies of Africa such as Kenya dealt with the crisis.

The study employed a cross sectional survey design. The target population of this study was all the 43 commercial banks in Kenya which included both locally owned and those that are subsidiaries of foreign multinationals (CBK, 2011). Due to the size of population, the researcher carried out a census hence each bank had a subject who was the source of information required. In this study a semi-structured questionnaire and an interview were used to gather primary data from senior managers of the targeted commercial banks responsible for risk management. Data collected was both qualitative and quantitative in nature. Qualitative data was collected through semi structured interviews with the selected respondents. This data was manipulated through thematic summary analysis that depicted what the main theme and direction of responses was. Quantitative data was collected through questionnaires. This data was manipulated through descriptive statistics such as means, percentages and frequencies. This data was presented in tables and graphs.

Findings indicate that although the crisis started out in 2008, Kenya experienced a lagged effect and started to face significant consequences later on. The measures deployed to withstand the crisis were oriented towards a combined strategy of increasing liquidity and investing in stocks and fixed income securities. Interestingly, even during the crisis, Kenyan banks diversified both their product offering and regional reach in terms of branch network. Further, the banks seemed not to have been affected by the crunch in their operations since

their recruitment, expansion and profitability improved. Results further indicate that the Kenyan commercial banking sector resisted quite successfully to the effects of the Global Financial crisis. While Kenya's banking system withstood the crisis, the Nairobi Stock Exchange was adversely affected and foreign direct investment and remittances seemed to have slumped.

The following recommendations are made. In order to cushion financial systems from crisis, it is important to ensure that financial sectors of Africa are regulated effectively to spurt their growth and prevent them from collapse instigated by phenomena such as the global financial crisis. The Kenyan sector was spared the negative effects of the global financial crisis due to the recent deep reforms that have been implemented in the sector. In order to strengthen the financial sector regulation, governments should establish financial sector reforms that enhance competition, while enforcing mechanisms that minimize exposures to risky foreign currency borrowing. Capital requirements for banks should also be revamped, since the size of a bank was seen as factor to minimize risk of being affected by offshore forces. Banks also should ensure that they practice good corporate governance and follow sound prudential guidelines to ensure longevity of operations and safeguard of shareholder resources. Customer satisfaction and confidence is also an important factor in stability and growth of a financial system. Ensuring that customers have faith in a financial institution gives the institution a lifeline even in terms of chaos. Lastly, financial systems in emerging economies should learn a lesson against over-reliance on investments and capital from developed economies. This over-reliance makes these institutions over dependent and can be the death knell in times of crisis.

TABLE OF CONTENTS

CHAPTER ONE: INTRODUCTION

1.1 Background of the Study

As the drivers of globalization remove barriers that traditionally segmented the competitive environments of small and large firms, firms of all sizes are beginning to share the same competitive space (Scholes and Johnson, 2008). Given these dynamics, organizations must obtain a solid understanding of the forces that are shaping their respective industries today, locally and abroad. They must then formulate and implement strategic/business plans that will enable them to respond to these forces in a way that will allow them to not only survive, but to thrive in the global economy.

The proliferation of the new MNEs has taken observers, policymakers, and scholars by surprise. Many of these firms were marginal competitors just a decade ago; today they are challenging some of the worlds most accomplished and established multinationals in a wide variety of industries and markets. Multinational firms exist because certain economic conditions and proprietary advantages make it advisable and possible for them to profitably undertake production of a good or service in a foreign location. The proliferation of the multinational corporation has complicated the global economic perspective. International business environment is influenced by activities of other organizations internationally. Kenyan banks are not an exception. Internationalization has brought about economic interdependence among countries. The theory of environment dependence depict that international banks are influenced by activities of other financial institutions in the global marketplace.

1.1.1 Environment Dependence

Organizations are depicted as environment serving and at the same time environment dependent (Hamel and Prahalad, 1994). Environment influences the way companies work. Organizations that trade internationally therefore are influenced by what is happening either locally or in international business. An organization working or having operations touching other countries is affected by the environmental factors in the global arena. The recent global financial crisis affected organizations dealing in international businesses directly and those dealing locally indirectly. The modern multinational enterprise (MNE) as we know it today has its origins in the second industrial revolution of the late 19th century. British, North American, and continental European firms expanded around the world on the basis of intangible assets such as technology, brands, and managerial expertise. The climax of their worldwide expansion was reached during the 1950s and '60s, as trade and investment barriers gradually fell around the world (Chandler, 1990). This relatively straightforward state of affairs is changing rapidly. Since the 1990s, the global competitive landscape is becoming increasingly populated by MNEs originating in countries that are not among the most advanced in the world.

Strategic choice theorists have long suggested that firms actively manage and control their plans such that they can adapt to environmental forces and remain competitive in the market (Child 1972; Miller and Friesen 1983). This stream of research places emphasis on a firm's ability to cope with the direct challenges of competitive forces (Porter 1991). In particular, the literature suggests that market and technological environments are two profound forces influencing MNCs (Lee et al. 2008). Market turbulence refers to the rate of change in customer preferences and competitive actions in a host country (Cui et al. 2006; Lee et al. 2008). Similar to market turbulence, technological turbulence may call for equal attention to

MNCs (Lee et al. 2008). Technological turbulence refers to the rate of change in new products and processes as a result of proliferating technology in a given host country market (Jaworski and Kohli 1993: Tushman and Anderson. 1986). The world has been turned into a global village and some companies are virtually everywhere. This has also made it easier for advantages and crisis to spread fast throughout the world.

1.1.2 Concept of International Business

Daniels and Radebaugh (2001) define international business (IB) as all commercial transactions, private and governmental, between two or more countries. Griffin and Pustay (2005) similarly define IB as consisting of business transactions between parties from more than one country. Cullen and Parboteeah (2010) provide a definition in terms of activity: IB activities are those a company engages in when it conducts any business functions beyond its domestic borders. Others define IB in terms of the entity that conducts it, as any firm that engages in international trade or investment (Hill 2007). Czinkota. Ronkainen. and Moffett (2003) provide a more detailed definition of IB as consisting of interrelated transactions that are devised and carried out across national borders to satisfy the objectives of individuals, companies, and organizations. From these definitions, it is evident that international business environment is a combination of many local environments into one big arena. These definitions therefore see IB environment as first of all concerned with firm-level business activity that crosses national boundaries or is conducted in a location other than the firm's home country. Second, IB is construed as dealing in some way with the interrelationships between the operations of the business firm and international or foreign environments in which the firm operates (Wright and Ricks 1994).

1.1.3 Global Financial Crisis

The most current global financial is a perfect example. This economic and financial crunch started in the United States of America (USA) around 2007 but its effects were evidently felt from around September 2008. The global financial crisis was generally manifested through the credit crunch that brought inadequate liquidity in the financial markets. The financial crunch eventually spiraled to the real sectors of the economy thereby affecting economies the world over and bringing an economic crisis (Biekpe, 2009). This affected the economies world over but the developed and well integrated economies of the west were mostly affected. As a result of the crisis, a recession overtook the globe in form of a general, rapid and high decline in economic activities of production, distribution and consumption of goods and services.

The crisis over 2008, 2009 and 2010 increasingly resulted to mini-crises around the globe with countries that have well integrated financial and economic systems among the first culprits and worst hit. The crisis spread later to African countries and its effect was rather mild compared to the financial disruptions the crisis had brought in developed economies and financial systems of European, American and major Asian countries (Akbar, 2008). Some financial analysts had predicted the collapse of some financial systems and wreckage of some economic systems if the crisis continued unabated for long (Biekpe, 2009). There was therefore need for governments, financial market players and international organizations to chip in with policy measures and bail out economies that had troubled financial and economic systems.

Most African countries were affected by the aftershocks in the second wave which was mainly brought by the effects the financial crisis had on the global economic systems

(Kilonzo, 2008). These indirect effects mainly affected African countries in areas such as reduced exports, decreased financial remittances from their nationals abroad and lessened financial assistance and grant worth from development partners. Other causes of financial disruption in African economies came in form of foreign control in foreign owned commercial banks (Chan-Lau, 2010). This is because Africa is laden with subsidiaries of foreign banks and in times of crisis. many head offices of such subsidiaries would have taken more from the subsidiaries to cover their exposures elsewhere. When Africa was affected, the crisis was severe in some countries due to the way most African financial markets are weakly regulated and how financially dependent they are on other foreign markets.

The financial crisis has caused the world to experience a deep recession and some countries are still reeling in the crisis such as Greece and UK. This financial crisis that originated from the US spread throughout the world with dire consequences for economies and financial markets. Many countries in Africa and other in the developing economies of Asia, Caribbean and Southern America were spared the shocks of the first wave of the crisis. This is because such countries have little integration with the global financial systems and hence what affected big financial power houses barely touched countries in Sub Saharan Africa. However, according to IMF (2009), Africa was expected to be affected by the aftershocks of the crisis.

Though Africa seemed well insulated against the crisis, it could not survive unscathed since its organizations have international operations, relies upon the global financial system for aid, foreign direct investment, trade and fuel mostly crude oil. Africa also holds money denominated in foreign currency. This therefore indicated that the indirect impact had to hit Africa and the effect was projected to be more due to the poor preparedness, poor corporate governance and poor risk management practices of African institutions. Governments in

Africa also did not have the capacity and skills to deal with crisis of a global nature. It was therefore expected that the crisis would neutralize the gains Africa had made on economic growth and reforms. The purpose of this study was to examine the effects of the global financial crisis and the possible financial impact on the Kenyan banking system. The study sought to examine the impact of the global financial crisis on indigenous Kenyan banks with the scope being three publicly quoted indigenous banks of Kenya which include Equity Bank Ltd, Kenya Commercial Bank Ltd and Cooperative Bank of Kenya Ltd. There is a relatively large amount of literature on the global financial crisis but most of the studies have been concentrated in developed countries with few in the developing and emerging markets (e.g. Kilonzo, 2008). This study will seek to contribute to the literature on the effect of the global financial crisis on the economics of the least developed countries such as Kenya.

1.1.4 Kenyan Banking Industry

Banking can be traced back to the year 1694 with the establishment of the bank of England. The bank was started by a few individuals who were actually money lenders with an aim of lending money at interest. Banking in Kenya started in 1896 with the National Bank of India opening its first branch. Standard Chartered Bank opened its first branches in Mombasa and Nairobi in January 1911.The Kenya Commercial Bank was established in 1958 with Grindlays Bank of Britain merging with the National Bank of India. The Cooperative Bank of Kenya was established in 1965 for the express purpose of providing financial services to Co-operative societies. Three years later, National Bank of Kenya (NBK) was incorporated (Ojung'a 2005). There is about one Automated Teller Machine (ATM) for every 100.000 people in Kenya according to a paper presented at a South African university by Central Bank of Kenya (CBK) official. Currently, there are 43 commercial banks for 33million Kenyans (www.sun.ac.za).

The Banking sector in Kenya is governed by multiple rules such as the Companies Act, the Banking Act, the Central Bank of Kenya Act and various prudential guidelines and policies issued by the Central Bank of Kenya (CBK) (CBK, 2009). Reforms in the banking sector started in 1994 with failure of several banks in Kenya. The financial sector in Kenya was finally liberalized in 1995 where exchange controls and other control regimes were lifted.

As at 31st December 2010, the banking sector comprised of the Central Bank of Kenya, as the regulatory authority, 44 banking institutions (43 commercial banks and 1 mortgage finance company), 2 representative offices of foreign banks, 5 Deposit-Taking Microfinance Institutions (DTMs) and 126 Foreign exchange Bureaus. Thirty one of the banking institutions are locally owned while 13 are foreign owned. The locally owned financial institutions comprise of 3 banks with public shareholding, 27 privately owned commercial banks, 1 mortgage finance company (MFC) while 5 Deposit taking Microfinance Institutions and 126 foreign exchange bureaus are privately owned.

The banking sector has reported massive growth and development in recent years (Kibaara, 2008). This is attributable to the effective regulation and reforms effected by the central bank after many banks went into bankruptcy in the 1990s. Much of the growth in the banking sector has been witnessed in branch network expansion, growth in capitalization and asset base and the expansion of some of the banks regionally. The banks have also been in the frontline of automating their functions to give their customers good service. Kenyan banks have engaged in product innovation where internet banking and mobile banking have taken root in various local banks. As the Kenyan financial market is expanding, banks have realized that they are facing more and more competition from others thus forcing them to increase their marketing spend, lower charges such as lending rates and increase their presence.

While Kenya's banking sector looks set to enjoy swift growth over the coming years, it will first of all need to weather a stormy period. A key problem at present is low liquidity amid capital shortages and increased reluctance to lend, in the aftermath of the global financial crisis. Risks in the sector have increased somewhat of late, with non-performing loans as a proportion of gross loans and advances having risen to 13.3% in March 2011 from 7.1% in December 2010. Meanwhile, total asset growth has slowed to 20.9% in March 2011(taking total assets to KES1, 202bn), from 24.4% in December 2010, albeit remaining strong. Despite these trends, the banking sector remains in good shape, with the loans to- deposit ratio estimated to be 91.0%. The Kenyan authorities have been making moves to ease the liquidity shortage and thereby encourage economic growth.

In 2010, the Central Bank of Kenya (CBK) cut interest rates by 25 basis points to 8.00%, despite headline inflation remaining high at 26.1% by April that year. The bank has since revealed that the move was made primarily to reinvigorate bank lending. Again in 2010, the CBK introduced a horizontal repo transaction' (HRT), allowing inter-bank lending to take place using government securities as collateral (www.cbk.or.ke) Given the amount of money locked in government securities, it was hoped that the HRT would provide a boost to inter-bank lending – although take up has been disappointingly slow. Earlier, the bank had reduced the cash ratio requirement for banks to 5.0% from 6.0% in December 2008, freeing up cash in the banking system.

Since the year 2000, technology has increasingly been employed in the delivery of services in the Kenya banking industry. The adoption of technology into service industries, more so in banking is becoming a strong trend as service providers are now being urged by industry bodies to invest in technology. The small business segment (retail and corporate services) has not been an easy one for the main banks to target and a number of studies have highlighted imperfection in service provision and problems regarding service quality. Particular problematic areas include knowledge and understanding, providing explanations for decisions, queuing, charges, collateral requirements, network failure and insecurity. Due to this, customer satisfaction levels are at all time low, dragging the bank's image, credibility and staff morale down (Kiptoo, 2009).

1.2 Research Problem

Akbar (2008) indicated that the global financial crisis affected economies and financial markets the world over and this needed effective containment strategies from authorities and financial institutions. This is because economies and organizations depend on the environment and what happens in the environment affects the organization. Based on the literature review and previous research work, there has not been any known empirical research that have been designed to establish how the African financial markets and institutions have dealt with the crisis. The area of study is important due to the nature of emerging markets in terms of coping with risks and corporate governance in times of turmoil (Kibaara, 2008).

The financial crisis affected the developed nations first and was also most severe in these countries (Kiptoo, 2009). The developing countries were only affected by aftershocks and were not materially affected in their financial sectors. However, there were serious effects in some sectors that depend on export and international trade. This is because there were some trade deficits that were reported during the crisis. There was no good projection on how the crisis was forecasted to affect the world economies and institutions. The effects of the crisis however unfolded as the crisis manifested.

Depending on various analyses by IMF (2009) and various governments, the actual extent and impact of the financial crisis was dependent on various interrelated issues. These issues included but were not limited to the degree to which a particular country is integrated into the dynamics of global investment flows, expanded trade, information technology and vibrant financial security arrangement. Ikome (2008) further argued that the effect of the crisis on an economy was also dependent on the extent to which a country was marginalized from the dynamic processes mentioned above. The kinds of corporate governance and regulation on or before the crisis also mattered in determining the effect on a country. Policies that were put in place by individual governments in collaboration and independently and with the global community to mitigate and solve the impacts of the downturn determined among others, the severity and length of the crisis.

The global financial crisis was a test for economies and financial markets all-over the world. Other studies related to this work include Kamau (2009), Kibaara (2008), Kilonzo (2008) and Krugman (2008). However, all these studies were done in the height of the crisis and the effects of the crisis may not have fully manifested itself in Africa and hence the studies cannot be said to be conclusive. The current study expects to establish how Kenyan banks prepared, dealt and saw themselves through the crisis which is currently cooling down with only a few shockwaves in countries like Greece. This study therefore seeks to determine the effect of the global financial crisis on Kenyan commercial banks. To attain this objective, the study seeks to answer the following research question. How has the global financial crisis affected commercial banks in Kenya?

1.3 Research Objectives

The objective of this study was to determine the effect of the global financial crisis on commercial banks in Kenya.

1.4 Value of the study

The current study is related to a table survey by Central Bank of Kenya (2009) which reviewed bank performance in Kenya in 2009 at the height of the crisis. This study indicated that performance had declined marginally. This study is also related to a paper by Harsch (2009) which was speculative on how Africa would be affected by the global financial crisis. However, this was a theoretical paper which was not based on empirical research as is the case with this study. Other studies related to this work include Kamau (2009), Kibaara (2008), Kilonzo (2008) and Krugman (2008). However, all these studies were done in the height of the crisis and the effects of the crisis may not have fully manifested itself in Africa and hence the studies cannot be said to be conclusive.

The current study expects to establish how Kenyan banks prepared, dealt and saw themselves through the crisis which is currently cooling down with only a few shockwaves in countries like Greece and UK. This study therefore adds to new knowledge on how commercial banks in emerging economies of Africa such as Kenya are prepared to deal with economic, financial and other types of risks. The study also sheds light on the preparedness of such financial institutions against the global shocks. This paper can be useful both in informing policy and in practice since it gives empirical findings of coping mechanisms of African banks.

The study also provides additional literature on the subject of global financial crisis and hence can be used by scholars, students and any other academicians as a reference article or as a basis for further research.

CHAPTER TWO: LITERATURE REVIEW

2.1 Introduction

In this chapter, the researcher provides a review of literature that is relevant to this study. The researcher also discusses the gaps realized and how this study expected to fill those gaps. Reviewed literature consists of earlier studies, books on international business and journal articles touching on the subject. The researcher also provides the relation between this study and earlier studies.

2.2 Concept of International Business

International business is a term used to collectively describe all commercial transactions whether they are private and governmental. sales. investments, logistics and transportation that take place between two or more regions, countries and nations beyond their geographic boundary. Usually, private companies undertake such transactions for profit: governments undertake them for profit and for political reasons (Cullen and Parboteeah, 2010). International business hence refers to all those business activities which involves cross border transactions of goods, services and resources between two or more nations. Transaction of economic resources include capital, skills, people and other resources for international production of physical goods and services such as finance, banking, insurance, construction and other services.

A multinational enterprise (MNE) is a company that has a worldwide approach to markets and production or one with operations in more than a country. An MNE is often called multinational corporation (MNC) or transnational company (TNC). Most of the largest corporations operate in multiple national markets. Even in Kenya, there are emerging companies which are expanding to neighboring countries. As these companies engage in international business, they face different environmental forces than the ones they face at home in the host countries (Czinkota, Ronkainen, and Moffett, 2003). They meet different legal systems, political systems, economic policy, language, accounting standards, labor standards, living standards, environmental standards, local culture, corporate culture, foreign exchange market, tariffs, import and export regulations, trade agreements, climate, education and many more different variables. Each of these factors requires significant changes in how individual organizations operate from one country to the next.

The conduct of international operations depends on companies' objectives and the means with which they carry them out. The operations affect and are affected by the physical and societal factors and the competitive environment. There has been growth in globalization and international interdependence in recent decades due to various factors. These factors include among others expansion of technology especially in transportation and communications, governments removing international business restrictions and institutions providing services to ease the conduct of international business. Other factors which have accelerated international trade include consumers knowing about and wanting foreign goods and services, competition becoming more global, and political relationships improving among some major economic powers (Wright and Ricks 1994). Further, there have been increased volumes of international trade due to countries cooperating more on transnational issues and cross-national cooperation and agreements becoming order of the day.

Organizations must continually monitor the environment since what happens in the environment affects their operations. This is because organizations are open systems which are environment serving and environment dependent. Monitoring international business environment is important since most companies are either international or are competing with international companies. The topic of firms' competitiveness in international business environment is greatly debated today among managers, politicians as well as academics. Globalization and changes in the world economy over the last years have raised new challenges for firms, industries and countries. Forces outside the firm's traditional boundaries are increasingly important in determining the firm's success (Griffin and Pustay, 2005). These forces in "the environment of business" differ among nations and over time, continually confronting the firm with new issues that require modifications in strategies and management practices. Managing in the context of turbulence has become an ongoing reality.

2.3 Global Financial Crisis

In recent history, three economic crises have occurred in the United States of America. The first two were, however, restricted due to limited communication and globalization (Aluko, 2009). The most recent one, which has spread to other parts of the world, started in 2007 in United States of America due to unrestricted lending to sub prime mortgages (Soludo, 2009). The easy spread of this crisis was due largely to improvements in technology, globalization and the removal of various trading barriers. This accounted for the quick and deep impact that the crisis had on other economies around the world.

The current financial crisis is more global and has wider impacts than any other period of financial crisis or economic downturn in the past 70 years or so. Its effects are more encompassing due the nature of globalization and financial integration in these markets in the 21st century (IMF, 2009). There have been other crisis like the great depression of the 1930s which left economies devastated. However, the current global financial crisis was expected to have more and far reaching effects than the great depression and more so to those economies that were more integrated in the global scene. The crisis manifested itself in form of severe currency, credit and finance crisis which spread to developed nations in 2008 but which lagged in their spread in emerging economies and least developed countries. As earlier discussed in this paper, the global financial crisis resulted from the sub-prime mortgage crisis of the US which was first evident in 2008. There are however some background financial market events dating back to July 2007 that point out some poor lending, corporate governance and reporting standards in the US home market. The basis of the crisis is however put by some writers to 2000 where some economic problems may have set the way for the current crisis (Ngowi, 2009a).

Akbar (2008) correctly argues that the crisis is an ongoing major financial crisis which needs effective containment strategies from authorities and financial institutions the world over. The crisis became clearly visisble to authorities and financial players in September 2008 with the merger, failure and in some instances, or conservatorship tendencies of several large United States-based financial firms. The firms that were first affected and which started reactionary plans included Citigroup, Goldman Sachs, Bank of America, Morgan Stanley, Merrill Lynch, J.P. Morgan, Wells Fargo, Bank of New York and Mellon and State Street. These firms were dealt a big blow and some of them just survived due to the bailout policy by the US Federal Reserve. The underlying causes that led to the crisis had been reported many months prior to the real entry of the crisis in September 2008. Most of the major U.S. and European investment banks, mortgage banks and insurance companies were succumbing to the sub-prime mortgage crisis and their stability and future was seen to be severely dented. The collapse of large financial institutions in the United States like the Lehman Brothers rapidly deteriorated into a global crisis resulting in a number of bank failures in Europe and major Asian markets and the dip of various major stock indexes. There were large decreases in general stock prices of various companies in stock markets which eroded investor confidence and future projections. Eventually this trickled to the commodity markets and the emerging markets of Asia (Mtango, 2008). The collapse of Lehman Brothers in September 2008 when it filed for bankruptcy was a clarion call of the global financial crisis. Broadly, it is seen that lack of adequate regulation (laisser-faire) of the financial markets by the appropriate authorities in the US is the major explanation behind this crisis.

2.4 General Impacts of the crisis

The global financial crisis have had many and far-reaching direct and indirect and short-term and long-term consequences across the globe. However, given the source and nature of crisis, the developed nations were the ones who were affected first and more severely according to a study by Kiptoo (2009). The developing countries were only affected by aftershocks and were not materially affected in their financial sectors. However, there were serious effects in some sectors that depend on export and international trade. This is because there were some trade deficits that were reported during the crisis. However, the impacts of the crisis continuously unfolded as the crisis manifested.

Depending on various analyses by IMF (2009) and various governments, the actual extent and impact of the financial crisis was dependent on various interrelated issues. These issues included but were not limited to the degree to which a particular country is integrated into the dynamics of global investment flows, expanded trade, information technology and vibrant financial security arrangement. Ikome (2008) further argued that the effect of the crisis on an economy was also dependent on the extent to which a country was marginalized from the dynamic processes mentioned above. The kinds of corporate governance and regulation on or before the crisis also mattered in determining the effect on a country. Policies that were put in place by individual governments in collaboration and independently and with the global community to mitigate and solve the impacts of the downturn determined among others, the severity and length of the crisis.

Generally, the crisis to a large extent led to a liquidity problem and the de-leveraging of financial institutions especially in the United States and Europe. which further accelerated the liquidity crisis. It caused fears and declining consumers and investors sentiments in the market. It went and continued to change and evolve at the close of October 2008 into a currency crisis with investors transferring vast capital resources into stronger currencies such as the yen, the dollar and the Swiss franc. This in turn led many emergent economies to seek aid from the International Monetary Fund. (Landler, 2008 and Fackler, 2008. quoted on Ngowi, 2009a).

Other general impacts of the crisis included reduced aggregate demand of goods and services across the globe. This was due to limited liquidity and related problems such as all-times low consumer sentiments that were emanating from the crisis. The reduced aggregate demand in turn led to reduced production of goods and services with the necessary result of reducing demand for and employment of factors of production including labour. The implications of reduced employment of factor inputs included reduced incomes to the factors and their owners in general and reduced standard of living and possibility of vulnerability to poverty for labour in particular. In some countries, migrant workers, (foreign labour) suffered more by being the first to be laid-off (Kilonzo, 2008). This had many and far-reaching implications on the countries and individuals dependent on transfers from migrant workers in form of remittances. The crisis culminated into a worrisome meltdown in the economies of most developed countries.

2.5 Impacts of the Crisis on Africa

While the developed world was panicking over the crisis, most African countries were like ostriches - burying their heads in the sand - and acting as if the crisis would not reach them, since it was not of their own making" (AAPAM, 2009). Similar to the observation made by AAPAM, Ngowi (2009) reports that it has been wrongly argued and expected that Africa's generally weak integration with the rest of the global economy meant that many of its countries would not be affected by the crisis, at least not initially. The situation in Africa showed that the continent was affected by the crisis and proves the schools of thought excluding Africa from suffering from the crisis wrong.

A number of publications exist on the impacts of the crisis in Africa. These include but are not limited to Biekpe (2009) on the impact of credit crunch on foreign aid in Africa: Myburgh (2009) on correlations between Sub Saharan Africa (SSA) currencies during the 2008 financial crisis; Kiptoo (2009) on the potential impacts of the global financial crisis on African economies and International Monetary Fund – IMF – (2009) on the impacts of the global financial crisis on Africa. Many other works exist on country-specific issues on the crisis. The works include but are not limited to Ngowi (2009).

2.6 Impacts of the Crisis on African Financial Markets

It is argued that African banking sectors are insulated from foreign finance. The sectors rely on domestic deposits and lending and do not have derivatives or asset-based securities among their portfolios. According to Shanta Devarajan, Chief Economist of the Africa Region at the World Bank, 'African banks retain loans they originate on their balance sheets, the inter-bank market is small, and the market for securitized or derivative instruments is either small or nonexistent'. 2 Even though some banks have significant foreign ownership, parent banks are typically not in the US and the foreign ownership share is less than 5%, compared with an average of 40% in other developing countries. However. Financial sectors in sub-Saharan Africa are also vulnerable to several risks that could still unfold from the crisis. Unlike in developed economies, there has been no systemic banking crisis in sub- Saharan Africa. Commercial banks and other financial institutions in this part of the world so far remained largely sound. IMF (2009) correctly points out that cross-border banking system linkage is minimal; there is less exposure to complex financial products and financial systems are not well integrated with other global financial markets.

However, as the crisis continued, risks grew because a protracted economic slowdown elevated credit risk (Massa, 2009). Financial sector is vulnerable to a substantial weakening in client incomes and debt servicing capabilities. Banks could also incur losses on other financial assets, such as deposits with troubled correspondent banks. Due to declines in the prices of most commodities, major industries, such as tourism and agriculture are hard hit. Problems in these sectors could quickly affect the banking sector due to interconnectedness and multiplier effect. Due to the crisis, parent banks investing in Africa could withdraw funds from subsidiaries and local banks and negatively affect the sector in Africa.

Besides the possible withdrawal, there can be stopping of investing local profits in local subsidiaries. This calls for among other things, monitoring of the sector vigilantly in order to minimize vulnerabilities and mitigate risks (Mwega, 2009). Many countries in sub-Saharan Africa enjoyed robust economic growth in recent years that strengthened their balance sheets. Sound economic policies were an important factor, as was the favorable external environment and increased external support in the form of debt relief and higher inflows. But the food and fuel price shocks of 2007–08 that preceded the global financial crisis weakened the external position of net importers of food and fuel, caused inflation to accelerate, and dampened growth prospects. The global financial crisis greatly compounds the policy challenge confronting the region as it strives to consolidate its economic gains and meet the Millennium Development Goals (MDGs). The global financial crisis initially affected advanced economics, emerging markets, and low-income countries in very different ways.

Advanced economics were first hit mainly by the systemic banking crisis in the United States and Europe (Ramlall, 2009). Emerging markets with well-developed financial systems were initially mostly affected by cross-border financial linkages through capital flows, stock market investors, and exchange rates. In financially less-developed countries the growth and trade effects dominated, with lags. Now, however, growth and trade effects are crucial for all countries. In Africa, frontier and emerging markets were hit first; by now indirect channels are fully at work in all countries, and risks are mounting that other channels may gain in importance, especially in the financial sector.

In Africa, frontier and emerging markets were hit first. By 2009, indirect channels were fully at work in all countries, and risks were mounting that other channels may have gained in importance, especially in the financial sector (Osakwe, 2008). Through their financial links with other regions in the world, South Africa, Nigeria, Ghana, and Kenya were hit first, suffering falling equity markets, capital flow reversals, and pressures on exchange rates. Ghana and Kenya had to postpone planned borrowing, and in South Africa and Nigeria external financing for corporations and banks was becoming scarce.

Financial sectors in sub-Saharan Africa were also vulnerable to several risks that could still unfold. Unlike in developed economies, there had been no systemic banking crisis in sub-

Saharan Africa. Commercial banks and other financial institutions there so far remained largely sound. Cross-border banking system linkages were minimal; there is less exposure to complex financial products like derivatives, and financial systems are not well integrated with other global financial markets. However, as the crisis continued through 2009, risks grew because a protracted economic slowdown elevates credit risk (Ngowi, 2009b). For instance, the domestic financial sector is vulnerable to a substantial weakening in client incomes and debt servicing capabilities, particularly where credit growth has been rapid in recent years as is the case in Kenya. Banks could also incur losses on other financial assets, such as deposits with troubled correspondent banks. Concentrated bank portfolios have become a source of vulnerability in several African countries. With global demand significantly lower and hefty declines in the prices of most commodities, major industries, such as tourism, lumbering and horticulture are hard hit. Problems in these sectors could quickly affect the banking sector. In some countries banking systems may be increasingly exposed to market volatility. Countries where high equity returns had led to borrowing for investment in the stock market (e.g., Kenya, Nigeria, and Uganda) were at greatest risk.

Other indirect factors which could have affected African banks include parent banks withdrawing funds from subsidiaries and local banks (Yilmaz, 2008). Risks of contagion from distressed foreign parent banks to local subsidiaries within sub-Saharan Africa could be associated with parent banks either withdrawing capital from African subsidiaries, calling in loans to their African subsidiaries, no longer investing local profits in local subsidiaries or a combination of these factors (Ngowi, 2009a).

Thus, the financial sector, especially banks, must be monitored vigilantly in order to minimize vulnerabilities and mitigate risks. This paper aimed at filling a gap in financial risk management literature particularly in the less efficient and illiquid emerging economies of Africa. The study in particular focused on analyzing the effect of the global financial crisis in Kenya and to find out what measures indigenous banks took to cope with the crisis. A study done by IMF (2009) indicated that the impact of the crisis on Africa came from both direct and indirect channels. The direct effects were felt mostly through the financial sector which is dominated by banks in emerging economies. The same IMF (2009) study indicated that volatility in African stock markets had increased since the onset of the global financial crunch and erosion of wealth was evident. The adverse effects in stock markets of Africa were seen to have negative effects on mostly the financial sector and the economy in general. This study is also related to earlier papers such as the one done by Bredencamp (2008) in LICs. However this study was done when the crisis was manifesting worldwide and its findings may be premature.

2.7 Relation to Earlier Studies and Research Gap

The current study is also related to a table survey by Central Bank of Kenya (2009) which reviewed bank performance in Kenya in 2009 at the height of the crisis. This study indicated that performance had declined marginally. This study is also related to a paper by Harsch (2009) which was speculative on how Africa would be affected by the global financial crisis. However, this was a theoretical paper which was not based on empirical research as is the case with this study. Other studies related to this work include Kamau (2009), Kibaara (2008), Kilonzo (2008) and Krugman (2008). However, all these studies were done in the height of the crisis and the effects of the crisis may not have fully manifested itself in Africa and hence the studies cannot be said to be conclusive. The current study expects to establish how Kenyan banks prepared, dealt and saw themselves through the crisis which is currently cooling down with only a few shockwaves in countries like Greece. This study therefore adds to new knowledge on how commercial banks in emerging economies of Africa such as Kenya dealt with the crisis. The study also will shed light on the preparedness of such financial institutions against the global shocks. This paper can be useful both in informing policy and in practice since it gives empirical findings of coping mechanisms of African banks.

CHAPTER THREE: RESEARCH METHODOLOGY

3.1 Research Design

The study employed a cross sectional survey design whereby access to the widest possible amount of data from the targeted banks was sought. Nachmias and Nachmias (2007) pointed that a researcher can employ survey design to measure variables or test hypothesis using many data collection instruments to get a feel of a population or industry.

The methodology applied provided an added benefit of overcoming the deficiencies that could have resulted from employing constricted design like case study which has generalization challenges. This design was adopted since the study required data from different commercial banks to have a more encompassing feel of how the sector was affected by the global financial crisis and how they dealt with the challenges that emanated from the crisis. This method had been applied before e.g. by Bartram et al (2003) and Freeman, Cox and Wright (2006). The adopted research design further utilized multiple statistical research techniques.

3.2 Target Population

The target population of this study was all the 43 commercial banks in Kenya which included both locally owned and those that are subsidiaries of foreign multinationals (CBK, 2011). These commercial banks were selected due to the nature of the institutions in the financial markets of developing economies.

Commercial banks dominate financial markets in emerging markets and hence their health critically affects the economic well being of these economies. Data which was collected from the subjects included effects of the crisis on the said commercial banks, how the commercial banks dealt with challenges emanating from this crisis and lessons that were learnt by these commercial banks in dealing with the global financial crisis.

3.3 Sample Design

Due to the size of population, the researcher carried out a census hence each bank had a subject who was the source of information required. This process was guided by Nachmias and Nachmias (2007) on the need for sampling who indicated that when population is small, error of sampling increases and it's advisable to study the whole population.

3.4 Data Collection

In this study a semi-structured questionnaire and interview was used to gather primary data from senior managers of the targeted commercial banks responsible for risk management. This included treasury and risk directors of the targeted banks. Secondary sources of data such as bank's financial statements, ratios and comparisons with industry were also considered as data for the purpose of this study. Kumar (2005) indicates that this approach has the effect of allowing patterns of comparison to develop to enable collaboration of the overall interpretation of results. This procedure improved both internal and external validity and the context realism thereby reducing the risk of false conclusions. Interviews were also conducted on the questionnaire respondents to get a deeper feel of the subject.

Some practical difficulties can be encountered in access to reliable and valid information which was used in the study such that accurate conclusions are arrived at. Banks are known to observe utmost confidentiality in their information and since this study was utilizing not only public but private information. access to such information was somehow difficult. The researcher mitigated this challenge by negotiating with senior employees in the banks and explaining the importance of the study to theory and practice. Another challenge which the researcher faced is non-response in some queries during interviews and a possibility of biased responses. The researcher, prior to distributing the questionnaires requested the respondents to fill in as truthfully and as completely as possible. Lastly, the researcher ensured confidentiality of all information gathered and assured respondents that information gathered was only applicable for the purposes of the study.

3.5 Data Analysis

Data collected was both qualitative and quantitative in nature. Qualitative data was collected through semi structured interviews with the selected respondents. This data was manipulated through thematic summary analysis that depicted what the main theme and direction of responses was. The information provided through interviews was presented through prose and provided a critical analysis of the responses. This information was compared with secondary data collected to depict validity of responses. Quantitative data was collected through questionnaires. This data was manipulated through descriptive statistics such as means, percentages and frequencies. This data was presented in tables and graphs.

CHAPTER FOUR: DATA ANALYSIS AND PRESENTATION OF FINDINGS

4.1 Introduction

In this chapter, the researcher presents the analysis, results and discussion of the study findings. The findings are presented according to the described methodology. The findings are presented according to the study objectives such that the research questions are answered. The results in this section are from analysis of the data collected from questionnaire and interview survey. There were forty three questionnaires distributed to forty three senior executives of commercial banks in Kenya. The target respondents to the questionnaires were the senior executives of the banks due to their presumed involvement in any strategic risk management to deal with the global financial crisis.

4.2 Response Return Rate

Out of the distributed 43 questionnaires to the senior executives in the banks, sent to the sampled subjects, 34 were filled by respondents and later collected by researcher. This translated to 79% response rate. This response rate was considered appropriate to enable conclusions and recommendations on the subject under study.

4.3 Effect of Global Crisis on Economy

The researcher sought to investigate the effects of the global financial crisis on the Kenyan economy in general. The respondents were asked to state what they thought was the effect of the crisis on the different sectors of the economy and which sectors were mostly affected. The analysis of data from this query is presented in figure 4.1. As per figure 4.1, 15 (44%) of the respondent banks indicated that tourism and financial services sectors were the most affected by the crisis as these two sectors come out among the most affected ones with number one being synonymous with the highest effect felt. Eleven of the banks (32%) indicated that the financial services sector was the most affected by the crisis while 5 (15%) felt that the agricultural sector was the most affected. The results bode well with the fact that the crisis has strained hard on the exporting arm of Kenya with the financial services and tourism sectors being the most badly hit ones. Besides the dwindling demand for our tourism services by foreigners, a depreciating shilling vis-a-vis the euro and dollar had further squeezed on the profit margins of the exporters. Intriguingly, in the case of some banks, it transpires that financial services sector has been the most affected one followed by the IT sector. The financial services sector suffered from reduced remittances from the Diaspora, capital drain from subsidiaries of multinational banks and reduction in foreign investments in local capital markets.

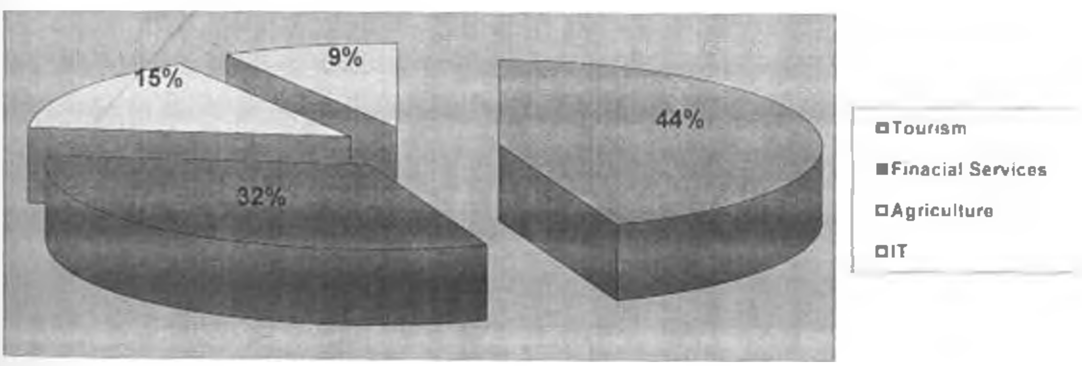

Figure 4.1: Impact of Financial Crisis on different sectors in Kenya

On how the sectors were affected by the crisis, the respondents reported that Kenya's exposure to the crisis was driven by the following key factors. First was that demand for Kenyan exports declined. The recession in North America and Europe triggered by the credit crunch reduce demand for Kenyan exports goods. Secondly, respondents indicated that Kenyan commercial banks had deposits and placements in foreign institutions. Kenyan institutions also had credit lines with foreign banking institutions. Collapse of any of these institutions or a credit crunch hurt the economy. However, these effects were minimally witnessed towards the end of the crisis. Thidr respondents indicated Kenyans living abroad remitted money home to support consumption, and for investment purposes. Early indications showed that Remittances declined as disposable incomes declined in the countries experiencing the global recession. Further effect of the crisis was reported on the tourism sector. Tourism was affected directly as tourists postponed or cancelled visits abroad on account of difficult economic conditions and uncertain duration of the economic recession. Further respondents indicated that Kenyan exporters and importers use letters of credit issued by financial institutions abroad to facilitate trade between Kenya and the rest of the world. Since confidence in such institutions was high and global interbank lending resumed, this effect was minimal.

The effect of the crisis was reported to emanate from the shilling depreciating to the US dollar between September 1 and November 30, 2008 following pressure from the global financial crisis as foreign investors "fled to safety" while consolidating their finances to meet their obligations abroad. The stock markets, and respective investors, recorded a sharp fall in the value of their investments and general financial net worth following the global financial meltdown. Stock markets fell 27 percent in Kenya between September 1 and November 30 in 2008 when the crisis hit Kenya. Kenya was also reported to be affected due to the aid it receives from abroad. Kenya receives foreign assistance from overseas for official use to finance development projects (e.g. roads, energy etc), and through NGOs to finance poverty reduction activities. This assistance declined considerably due to the crisis.

4.3.1 Financial Sector mostly affected

When questioned about the impact of the crisis on the banking, offshore and insurance sectors was raised, most participants responded that the offshore sector has been the most directly hit as depicted in figure 4.2, followed by the banking sector and the insurance sector. Those who indicated that the offshore banking was the most financial sector affected were 19 (56%) while 11 (32) indicated that domestic banking was the most affected. Four (12%) indicated that the insurance sector was the most affected. Most of the banks indicated that the domestic banking sector has been the second most badly hit followed by the insurance sector. Nonetheless, it is evident that the offshore sector has indeed borne the direct brunt of the crisis relative to the domestic or insurance sectors.

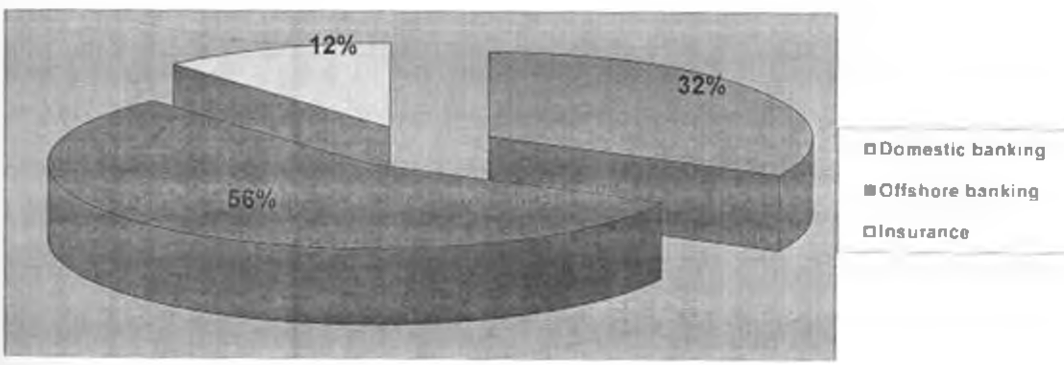

Figure 4.2: Effect of the Crisis on Different Financial Sectors

4.3.2 Effect of Global Financial Crisis on Banks

When asked whether the global financial crisis affected their banks, all the respondent managers indicated that the financial crisis affected their institutions directly in some ways but in many instances, they were affected indirectly. The respondents indicated that their banks started feeling the effects of the crisis towards 2009. This finding concurs with earlier observations (e.g. Bredencamp, 2008 and Kiptoo, 2009) that Africa did not feel the effects of the crisis at first but the effect was felt later after the crisis had manifested in the developed economics.

4.3.3 Effect of Crisis on banks Key performance ratios

The respondents were queried on the effects of the crisis on their bank's key performance ratios. Respondents were required to indicate the trend in the past about movement of the stated financial ratios over the last 5 years for their banks. Findings are as presented in table 4.1

Table 4.1: Effect of Global Financial Crisis on Banks' Key ratios

Ratio	Increased considerably	Increased A little	Did not change	Decreased a little	Decreased considerably
Interest income over total assets	58%	24%	12%	6%	0%
Profit from forex transactions	48%	26%	15%	11%	0
Operating profit (EBIT)	58%	15%	15%	5%	7%
Return on Equity	58%	24%	12%	6%	0
Liquidity ratio	13%	48%	24%	15%	0
Tier 1 capital	58%	24%	12%	6%	0
Tier 2 capital	58%	15%	15%	5%	7%
Debt/Equity ratio	0	15%	24%	48%	13%

Results presented in table 4.1 clearly indicate that the Kenya banking sector was minimally affected by the global financial crisis. The Kenyan banking system has indeed come out unscathed by the crisis as most of the respondents identified themselves in the first column whether the values rose considerably. Such a finding signifies that most of the activities are internally based so that the risk is lower relative to the case where the activities are more dependent on foreign sources of activities. Indeed, probing deeper, it emerged that, only two international banks were present. The findings in table 4.1 indicate that generally Kenyan banks reported increased interest income over the period (82%). Further, profit from foreign exchange transactions also improved (74%) and operating profit from the banks increased

(73%). The surveyed banks also reported that their return on equity improved (82%). Lastly the liquidity rations and tier 1 and 2 capitals also improved during the crisis period.

4.3.4 Effect of Crisis on Loan Portfolio of banks

The study had a specific objective of establishing the effect of the crisis on banks. Loan portfolio is one major area that determines banks profitability and performance. Table 4.2 presents results from that question.

Table 4.2: Effect of Global Financial Crisis on Banks' Loan Portfolio

Loan Type	Increased considerably	Increased A little	Did not change	Decreased a little	Decreased considerably
Personal loans	38%	36%	25%	1%	0
Corporate loans	68%	5%	5%	25%	7%
Home loans	49%	35%	13%	5%	0
Credit Cards	23%	58%	14%	5%	0
Debit Cards	49%	35%	12%	6%	0

Results in table 4.2 substantiate the earlier findings of table 4.1 that the crisis did not affect the Kenyan banking sector much. This is because as per the findings, the bank's loan portfolios of personal loans, home loans, credit cards and even corporate loans had improved during the crisis.

However, due to reforms the respondents credited to the central bank of Kenya, commercial banks were able to monitor and control risks in a timely manner, while also strengthening corporate governance in banking institutions. The key highlights of the banking sector by end of November 2008 were as follows as indicated from the interviews. Deposits increased by 25% from Kenya shillings 730 billion at November 2007 to Kenya shillings 911bn in 2008 as the sector continued to expand its outreach and aggressively market for new deposits. The asset base of the sector also increased by 33% to stand at Kenya shillings 1.2 trillion. The asset growth was largely fuelled by an increase in loans and advances. Further respondents reported that the total capital to total risk weighted assets ratio of the sector increased from 16.7% in November 2007 to 18.1% in November 2008. This ratio is an indicator of the capital adequacy of the sector. The minimum statutory ratio is 12% and at slightly over 18%, the sector has some cushioning to absorb losses. Respondents further indicated that The average liquidity of the sector which is the ratio of liquid assets to deposits and other short term liabilities stood at 37.3%. This was above the statutory minimum of 20%. The stock of non performing loans to gross loans decreased from 11.4% as at the end of November 2007 to 8.4% at the end of November 2008. The reduction was largely attributable to enhanced risk management practices by banks and non-performing loans recoveries. Further to indicate that the global financial crisis had little effect on Kenya's commercial banking sector, respondents indicated that the sector's profit before tax stood at Kenya shillings 40.2 billion for the eleven months ending November 2008. This was a 21% increase from the Kenya shillings 33.2 billion registered over a similar period in 2007. The enhanced profitability was driven by interest income on loans and advances and foreign exchange dealing income. These indicators further strengthened the indication that the global financial crisis affected Kenya's commercial banks but at a very low extent.

4.4 Strategies Employed to counter threats from Global Crisis

When questioned about the major strategies their banks deployed to mitigate the risk in their investment portfolios. The banks indicated that they took a proactive strategy rather than just waiting.

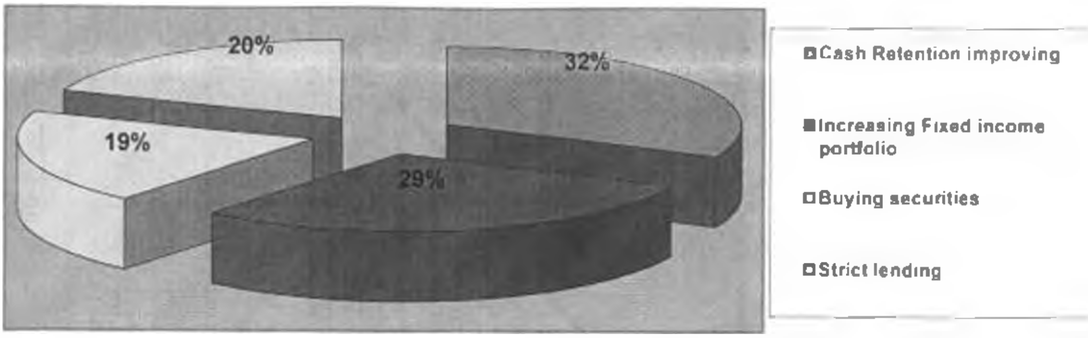

Figure 4.3: Strategies Employed to counter threats from Global Crisis

Those who applied increasing to cash retention were 31% while those who resorted to strict lending were 20%. Those who increased their investment in fixed income portfolios were 29% and those who employed the strategy of buying marketable securities in the stock exchange in their dip were 20%. Most respondents pointed out that their banks went for more cash retention during the crisis while other respondents indicated the bank resorted to balancing their portfolio towards assets perceived to have fewer risks and those not affected by offshore issues. However, responses indicated that most banks continued with their expansion and diversification strategies amid the crisis. This was in terms of regional reach and asset types. Other strategies which were mentioned by the respondents included moving towards more liquidity which was in turn invested in high return short term fixed income securities which were mainly leasing deposits. Other strategies included buying back of market securities such as stocks on the market as soon as they hit a dip. Since the all the Kenyan commercial banks were included in the survey, it can be deduced that larger banks are in a better position to withstand the financial crisis by adopting prudent portfolio management. No respondent however, indicated that his/her bank reduced lending as a measure to cope with the crisis.

4.4.1 Products as a way to mitigate Risks

All the respondents indicated that their banks frequently introduced new products to the market. This was termed as a way of providing customers with what they required and diversifying product offering. This finding concurs with CBK (2009) survey that the banking sector in Kenya continued providing new and innovative products. On whether the banks specifically introduced some products to cope with the crisis, all indicated that no new product was introduced specifically to cope with the effects of the crisis. However, all of them indicated that they realigned their investment portfolios to be in line with CBK regulations (2009) that were aimed at maintaining any risks that could have emanated from the crisis. All the banks indicated to have put much of their resources towards fixed income investment products. From the findings, the banks seem to have been satisfied with their lending and investment practices. The banks that introduced new products usually did that on a quarterly basis and also based on the demand side of the market. However, all banks responded to the crisis by introducing new products in terms of proper diversification, exposure to markets and currency-wise diversification.

4.4.2 Effect of Crisis on Operational Climate

In general, the recruitment level has been on a slight ascendancy for the surveyed banks for the years 2005, 2006, 2007, 2008 and 2009 as indicated in table 4.3. The average number of branches, employees recruited and layoffs was computed for the three banks.

Table 4.3: Effect of Crisis on Operational Climate

Year	New Branches	Recruitment	Lay offs
2005	10	257	-
2006	21	367	-
2007	17	248	-
2008	12	267	-
2009	16	263	-

The findings indicate that there were no layoffs for the same time period under review. On interviews, the respondent indicated that there had been an increase in the number of new customers during the financial crisis. Some banks even issued issued new share capital during the crisis which was a success. From these findings, it can be deduced that on a great extent, Operations of the Kenyan banking sector were not materially affected by the crisis.

Table 4.4: Growth and Structure of the Banking Sector, 2002 to 2009

Average indicator	2002	2003	2004	2005	2006	2007	2008	2009
Return on assets	5.7%	5.2%	6.5%	6.5%	8.3%	8.2%	7.7%	6.9%
Growth in EPS	5.8%	6.3%	8.3%	7.7%	9.2%	8.7%	7.2%	7.7%

Sources: CBK Banking Survey (2009)

Table 4.5: Financial Soundness indicators (%)

	2001	2002	2003	2004	2005	2006	2007	2008	2009
Regulatory capital to risk weighted assets	17.5	17.1	17.4	17.2	16.6	16.4	16.5	18.0	18.4
Regulatory Tier 1 capital to risk weighted assets	14.2	14.5	14.1	14.7	16.3	16.0	16.4	16.8	16.2
Non-performing loans to gross loans	37.2	39.4	39.6	34.9	29.3	25.6	21.3	10.9	8.4
Non-performing loans net of provisions to total capital	78.7	78.8	77.8	60.7	52.7	40.1	28.6	15.1	10.8
Return on Assets	0.5	1.6	1	2.3	2.1	2.4	2.8	3.0	2.9
Return on equity	4.9	15.7	10.9	23.2	22.0	25.0	28.6	27.5	28.6
Net interest income to gross income	42.1	43.6	43.8	50.5	50.7	50.2	50.2	50.1	48.3
Non-interest expenses to gross income	65.4	58.6	66.9	62.9	63.9	55.7	52.8	50.8	48.7
Liquid assets to total assets	29.5	34.4	33.7	33.2	32.4	33.1	30.5	35.1	34.6

Source: Central Bank of Kenya banking Survey (2009)

The analyzed primary data was compared to the collected secondary data in the triangulation approach. This was to ensure that data collected from various sources tallied which ensured validity and reliability of the primary data collected from questionnaire and interviews. This comparison was conducted and the assessment brought a clear resemblance of the three sets of data. As indicated in tables 4.4 and 4.5, the banking sector in Kenya suffered minimal consequences from the global financial crisis.

4.4.3 Change in Strategic Focus

Banks indicated that they had adopted a more customer centric focus during the crisis. They also indicated that they specifically focused more on their corporate governance and reporting to ensure that they adhered to all set and requisite standards. Other strategies mentioned by the respondents included increasing focus on customer service, more segmented offering, channel-specific pricing and scaling up exposure to loans and advances which are more resilient in difficult times. This clearly shows that when the crisis begins to impact on the local economy, new strategies are vital to ensure that profit margins are at least maintained at current levels. Besides, the fact that more attention is given to customer service plainly shows that maintaining of enhancing the service quality dispensed to customers is of paramount significance. Moreover, based on the discriminatory pricing mechanism, this ensures that different customers are charged different rates as per their capacity to pay. Such a strategy is highly beneficial as it ensures that there is no loss of customers on one side while securing profit margins on the other side.

4.5 Lessons learnt by banks in Kenya

When asked to rank on a scale ranging from one point to five points (the highest) to depict the extent to which the banks have been proactive during the crisis, all the respondents selected above four points meaning that they had been reasonably proactive in taking measures to mitigate the effects of the crisis on their organization. The respondents indicated that their banks already had a prudent approach with policies being reviewed in light of changes in the environment. However, all indicated that more measures needed to be taken to cushion their customers from the effects of the crisis.

However, the effect of the global financial crisis on Kenya commercial banks notwithstanding, respondents indicated that it is important to observe that the financial sector could be vulnerable to effects of the global financial crisis and economic recession, as individuals and firms are likely to struggle to repay debts, thereby resulting in a deterioration of the quality of loan portfolio, and profitability in the financial system. In particular, the respondents indicated that Central Bank was cognizant that there could have been a lag and perhaps second round effects of the crisis on the Kenyan economy. Central bank therefore actively engaged banks to ensure that they had adequate capital buffers to withstand the turbulences then. Respondents indicated that to cushion themselves from future crisis, they should focus on liquidity management strategies to ensure that they can meet their obligations as and when they fall due.

The respondents pointed out three main areas of focus for Kenyan monetary authorities and commercial banks to respond to in dealing with corporate governance in banks and to cushion from future crisis of global nature. First, they indicated the need to continuously strengthen the regulation of the financial sector. Secondly, they recommended a reappraisal of the role and activities in the capital markets and thirdly the importance of strengthening coordination of regulatory authorities in Kenya. In this regard, the following policy measures and actions are recommended to safeguard the confidence of credit markets and stability of the financial system in Kenya. The respondents further indicated that for the Kenyan context, a highly enhanced regulatory and supervisory oversight of the commercial banking system remains the key plank to addressing the kind of crisis experienced in 2008/09. Further, respondents indicated that there should be enhanced capital requirements for banks, thereby reducing their vulnerability to sudden asset-price movements and ensure they have the resources to support any off-balance sheet exposures. The central bank of Kenya should also enhance and constantly monitor commercial banks' liquidity positions, thereby reducing the chances of institutions being threatened by a reduction in financial market liquidity. This should be made possible through improving the bank's risk management capabilities, through better stress-testing of their market positions against possible adverse price movements. Also the respondents recommended a review of the role of credit-rating agencies in the financial system.

Respondents also pointed out that the recent passage of the Finance Act, 2008 had increased the minimum core capital for banks to Kenya shillings one billion by the end of 2012. This measure the respondents believed will strengthen the banking sector further and enable it withstand periodic local and global turbulences. The respondents further indicated that to be ready for major risks and crisis, there is need to undertake reforms in the capital markets to restore investor trust and confidence. Respondents indicated that the reforms should also cover a reappraisal of the role and activities of investment banks which remain the weakest link in the financial sector and their regulatory structure in order to stem any downside risk to the banking system. Respondents indicated that the reforms should entail developing a comprehensive and enforceable regulatory framework and streamline the corporate governance in line with the international best practices and a thorough fit and proper vetting of directors and owners of these institutions. It should also include re-assessing the use of the word bank by investment banks in Kenya where there is potential to confuse the commercial banks with investment banks. Further, respondents pointed out that there should be an increase in capitalization requirements. Capital adequacy, and Institute risk management practices as well as improved disclosure requirements should be enhanced so that financial market participants have better information.

Lastly, the Kenyan financial sector is regulated by various institutions, namely, the Central Bank of Kenya, the Capital Markets Authority, the Insurance Regulatory Authority, and the Retirement Benefits Authority. Given the inter-dependence of financial markets, and contagion effects of risks emanating from any sector, the respondents indicated that there is need to begin thinking towards a Financial Services Authority (FSA), which will coordinate financial sector-wide stability surveillance at the technical level. In addition, regional cooperation is critical in addressing financial risks arising from events outside our borders, and within the Eastern Africa region.

4.6 Discussion

The purpose of this study was to establish the effect of the global financial crisis on commercial banks in Kenya. The financial crisis revealed the power of globalization and how the world economy is interlinked. The threads of globalization can take a problem from one corner of the globe to multiple destinations, Kenya included. Fortunately this study indicates that financial indicators for the Kenya indicate that the commercial banking sector managed to weather the storm relatively well. Lending to the private sector, for example, grew by 26.6% during the year to September 2009. Other key indicators for the financial sector show that the average capital adequacy ratio was 19.3 percent against the benchmark of 10 percent. Further, all commercial banks had adequate liquidity; whereby their liquidity ratio was 48.5 percent as compared to the flow of 20 percent. The Gross non-performing loans ratio was equivalent to 6.8 percent compared to the international lower standard of 10 percent. The interbank payments and settlements system continued to be liquid and efficient; and the interbank cash market continued to be liquid and characterized by stable interest rates. These findings agree with the findings by IMF (2009) which indicated that African banking sectors are insulated from foreign finance. The sectors rely on domestic deposits and lending and do not have derivatives or asset-based securities among their portfolios. The study indicated that

African financial markets would be affected minimally since African banks retain loans they originate on their balance sheets, the inter-bank market is small, and the market for securitized or derivative instruments is either small or nonexistent. The above findings from this study further agree with findings from a study by Massa (2009) on African financial markets and how they were affected by the global financial crisis. This study by Massa (2009) found that even though some banks have significant foreign ownership, parent banks are typically not in the US and the foreign ownership share is less than 5%, compared with an average of 40% in other developing countries. This makes financial markets in sub-Saharan Africa less vulnerable.

Despite the encouraging financial indicators established in this study, some commercial banks during the period experienced an increase in their non-performing loans leading to a decline in their profitability. However, the effects were felt much later after the crisis had taken its toll on western economics. Ngowi (2009) had similar findings in a study of the effects of the crisis on the retirement benefits industry in Kenya. Ngowi's (2009) findings indicated that at the beginning of the global financial crisis and throughout the entire first wave and much of the second wave, African countries including Kenya appeared to be insulated from the crisis due to their limited integration in the global economy. Ngowi (2009) indicated that African capital markets are the smallest in the world accounting for 2.1% of the global stock market capitalization, 0.4% of debt securities and 0.9% of bank asset8. Most of the financial institutions and economies in Africa are also marginal recipients of portfolio flows. It was therefore widely held that Kenya would not be much affected by the situation occurring in the developed world and other emerging markets. It, however, turned out that the financial sector in Kenya was indeed adversely affected and this in turn transmitted major shocks to the retirement benefits industry.

CHAPTER FIVE: SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

5.1 Summary of findings

This study was aimed at establishing the effects of the global financial crisis that started in 2008. The study established that that tourism and financial services sectors were the most affected by the crisis as these two sectors come out among the most affected ones with number one being synonymous with the highest effect felt. Besides the dwindling demand for our tourism services by foreigners, a depreciating shilling vis-a-vis the euro and dollar had further squeezed on the profit margins of the exporters. On the effect to financial sectors, offshore banking was the most financial sector affected with 19 (56%) indicating this while 11 (32) indicated that domestic banking was the most affected. The study established that the financial crisis affected the banks directly in some ways but in many instances, they were affected indirectly. Most of the respondents indicated that their banks started feeling the effects of the crisis towards 2009. This finding indicates that Africa did not feel the effects of the crisis at first but the effect was felt later after the crisis had manifested in the developed economies.

On the effects of the crisis on banks performance indicators, the study established that Kenyan banks reported increased interest income over the period (82%). Further, profit from foreign exchange transactions also improved (74%) and operating profit from the banks increased (73%). The surveyed banks also reported that their return on equity improved (82%). Lastly the liquidity rations and tier 1 and 2 capitals also improved during the crisis period. On the effect of the crisis on the banks' loan portfolios, Results in table 4.2 substantiate the earlier findings of table 4.1 that the crisis did not affect the Kenyan banking sector much. This is because as per the findings, the bank's loan portfolios of personal loans

(74%), home loans (84%), credit cards (81%) and even corporate loans (73%) had improved during the crisis.

On the strategies employed by these banks to counter the threats of the crisis, the study established that many strategies were employed by the banks. Those who applied increasing to cash retention were 31% while those who resorted to strict lending were 20%. Those who increased their investment in fixed income portfolios were 29% and those who employed the strategy of buying marketable securities in the stock exchange in their dip were 20%. Most respondents pointed out that their banks went for more cash retention during the crisis while other respondents indicated the bank resorted to balancing their portfolio towards assets perceived to have fewer risks and those not affected by offshore issues. However, responses indicated that most banks continued with their expansion and diversification strategies amid the crisis. This was in terms of regional reach and asset types. Other strategies which were mentioned by the respondents included moving towards more liquidity which was in turn invested in high return short term fixed income securities which were mainly leasing deposits. Other strategies included buying back of market securities such as stocks on the market as soon as they hit a dip.

Further the study established that the commercial banks introduced new products and diversified their portfolios to cope with the crisis. Improvement of customer service was another strategy which was mentioned by the respondents. All the respondents indicated that their banks frequently introduced new products to the market. This was termed as a way of providing customers with what they required and diversifying product offering. All the banks indicated to have put much of their resources towards fixed income investment products. The banks that introduced new products usually did that on a quarterly basis and also based on the demand side of the market.

Results also indicate that there had been an increase in the number of new customers during the financial crisis. Some banks even issued new share capital during the crisis which was a success. From these findings, it can be deduced that on a great extent, Operations of the Kenyan banking sector were not materially affected by the crisis. The analyzed primary data was compared to the collected secondary data in the triangulation approach. This comparison indicated that the banking sector in Kenya suffered minimal consequences from the global financial crisis.

Surveyed commercial banks indicated that they had adopted a more customer centric focus during the crisis. They also indicated that they specifically focused more on their corporate governance and reporting to ensure that they adhered to all set and requisite standards. Other strategies mentioned by the respondents included increasing focus on customer service, more segmented offering, channel-specific pricing and scaling up exposure to loans and advances which are more resilient in difficult times. This clearly shows that when the crisis begins to impact on the local economy, new strategies are vital to ensure that profit margins are at least maintained at current levels. Besides, the fact that more attention is given to customer service plainly shows that maintaining of enhancing the service quality dispensed to customers is of paramount significance. Moreover, based on the discriminatory pricing mechanism, this ensures that different customers are charged different rates as per their capacity to pay. Such a strategy is highly beneficial as it ensures that there is no loss of customers on one side while securing profit margins on the other side.

5.2 Conclusions

This study was triggered by the global financial crunch that affected financial institutions the world over in from 2007 which raised various concerns about the prudence of financial institutions in managing business risk in general and financial risks in particular. The financial crisis made governments to step in and bail out financial institutions to prevent collapse of the financial sector. The study was also triggered by the researcher's experiences in this area. By providing answers to the research questions, the study has contributed largely to theory and practice. This was through analyzing how the crunch affected the developing world financial systems and how this was mitigated by the concerned entities and governments to mitigate risks from crystallizing.

The paper investigated the extent to which global financial crisis had been affecting the Kenyan commercial banking. Although the crisis started out in 2008. Kenya experienced a lagged effect and started to face significant consequences. The measures deployed to withstand the crisis were oriented towards a combined strategy of increasing liquidity and investing in stocks and fixed income securities. Interestingly, even during the crisis. Kenyan banks diversified both their product offering and regional reach in terms of branch network. Further, the banks seemed not to have been affected by the crunch in their operations since their recruitment, expansion and profitability improved. However, Kenyan banking sector comprises of 53 institutions including microfinance institutions, foreign owned banks and smaller local banks. These results therefore cannot be generalized on the whole sector. However, the study gives important findings that economies that are not well integrated with the global economy only get affected by global phenomena through indirect means which is usually minimal and with less impact.

Finally, what can be concluded is that the Kenyan Banking sector resisted quite successfully to the effects of the Global Financial crisis. This may be partly due to the fact that Kenyan banking sector is not contaminated by toxic assets and partly due to the fact that the lagged effect of the crisis has curbed its impact and has allowed the banks to be more proactive and take appropriate measures. The expectations of the future are very optimistic in the sense that the banks are expecting the world to slide out of the crisis completely to continue with the gains the sector has had before.

While Kenya's banking system withstood the crisis, the Nairobi Stock Exchange was adversely affected and foreign direct investment and remittances seemed to have slumped. Tourism has suffered a blow though its recovering and export prices have declined. The crisis has aggravated the current account deficit, depreciating the national currency, and also the budget deficit. However, the future is bright for the Kenyan financial sector. Despite, the apparent negative shocks on overall financial intermediation output, interest rates remained stable during the period. There was however a sharp spike in the overall inflation rate during the crisis period but much of this can be attributed to unique domestic factors including drought and the post 2008 elections crisis in the country but not directly on the global financial crisis.

5.3 Recommendations for Further Research

The study was aimed at establishing the relationship between strategic positioning and performance of commercial banks in Kenya. This scope excluded other financial institutions in the banking industry such as investments banks and micro finance institutions. For further research on the effects of strategic positioning on performance of organizations, the researcher recommends another study that will include the other financial institutions such as

MFIs and Saccos to establish what performance benefits they derive from strategic positioning. This is because these institutions are depicted as important for economic advancement and poverty reduction in the country.

5.4 Recommendations for Policy and Practice

In order to cushion financial systems from crisis, it is important to ensure that financial sectors of Africa are regulated effectively to spurt their growth and prevent them from collapse instigated by phenomena such as the global financial crisis. The Kenyan sector was spared the negative effects of the global financial crisis due to the recent deep reforms that have been implemented in the sector. In order to strengthen the financial sector regulation, governments should establish financial sector reforms that enhance competition, while enforcing mechanisms that minimize exposures to risky foreign currency borrowing. Capital requirements for banks should also be revamped, since the size of a bank was seen as factor to minimize risk of being affected by offshore forces. Banks also should ensure that they practice good corporate governance and follow sound prudential guidelines to ensure longevity of operations and safeguard of shareholder resources.

Customer satisfaction and confidence is also an important factor in stability and growth of a financial system. Ensuring that customers have faith in a financial institution gives the institution a lifeline even in terms of chaos. Lastly, financial systems in emerging economies should learn a lesson against over-reliance on investments and capital from developed economies. This over-reliance makes these institutions over dependent and that can be the death knell in times of crisis. Financial markets should learn to be independent but at the same time forging important integration and cooperation arrangements with other markets globally.

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APPENDICES

Appendix I: Questionnaire to senior bank employees

Effect of the global financial crisis on commercial banks in Kenya

Accompanying note:

I am currently doing a research study on 'the impact of the global financial crisis on Kenyan commercial banks' for presentation in the University of Nairobi, School of International Business. The objective is to get a first hand insight of the financial and economic crisis and to investigate whether Kenya commercial banks have been resilient or proactive in view of curbing the adverse effects of the global financial crisis. I would therefore be grateful if you could spare some of your valuable time to fill in the attached questionnaire, without which my research work cannot progress. In case you are not able to do so, I would be grateful if you could send it to the most appropriate person(s) in your bank. On collection of the questionnaire, I will request an interview lasting not more than 25 minutes with you.

I wish to assure you that all information you would provide will be treated with strict confidentiality and will be used solely for academic purposes. Kindly note that for your convenience, the questionnaire is requested back after a period of 5 working days.

I remain at your disposal for any information or clarification. I thank you in advance for your cooperation and participation.

Yours,

Susan Gicheru

SECTION A: Financial Crisis and the Kenyan Economy

1. In your opinion, how has the following sectors of our economy been affected by the Global financial crisis? *Rate them on importance on a scale of 1-4, 4 being the sector which has been mostly affected while 1 the least affected.*

    [ ] Tourism

    [ ] Financial services

    [ ] Agriculture

    [ ] Information and Communication Technology

2. In the financial sector which sub-sector do you think has been more affected by the crisis? Rate the following according to their importance from 1-4, 4 being the sector which has mostly been affected and 1 the least affected.

    [ ] Domestic Banking

    [ ] Offshore Banking

    [ ] Insurance sector

3. (a) In your view and experience, do you think that your bank was affected by the financial crisis?

    [ ] Yes

    [ ] No

    (b) If Yes, in (a) above, when did your bank start feeling the effects?

    [ ] From the beginning of the financial crisis that is 2007/2008

    [ ] The effect was felt later in .... (Please specify)

4. What has been the trend in the past about movement of the following financial ratios over the last 5 years for your company? *Tick as appropriate.*

Ratio	Increased considerably	Increased A little	Did not change	Decreased a little	Decreased considerably
Interest income over total assets					
Profit from forex transactions					
Operating profit (EBIT)					
Return on Equity					
Liquidity ratio					
Tier 1 capital					
Tier 2 capital					
Debt/Equity ratio					

5. As far as demand for loans for your bank is concerned, what has been the trend during the last five years?

Loan Type	Increased considerably	Increased A little	Did not change	Decreased a little	Decreased considerably
Personal loans					
Corporate loans					
Home loans					
Credit Cards					
Debit Cards					

SECTION B: STRATEGIES EMPLOYED TO COPE WITH THE CRISIS

1. What was the major strategy deployed by the bank management to reduce risk emanating from the global crisis?

   [ ] Improve their cash retention ratio

   [ ] Increase in fixed income portfolios

   [ ] Lower their lending

   [ ] Any other please specify ....

2. (a) Does your bank constantly introduce new investment products?

   [ ] Yes

   [ ] No

   (b) If yes, how often? ....

   (c) Did your bank introduce new products in 2009 and 2010 mainly to alleviate the negative effects of the crisis?

[ ] Yes

[ ] No

(d) If Yes, Please state the products and explain briefly to what extent these new products were effective in achieving the objective.

....

....

....

3. (a) Do you perceive the bank as having the correct preparedness for dealing with crisis of the global magnitude?

[ ] Yes

[ ] No

(b) If No, how has your bank responded to ensure that in future it is prepared?

....

....

....

....

4. What were the figures for your institution for the following?

Year	New Branches	Recruitment	Lay offs
2005			
2006			
2007			
2008			
2009			

5. During the financial crisis period, was there an increase in the number of new customers?

[ ] Yes

[ ] No

6 (a) Did your company adopt new marketing strategies during the crisis?

[ ] Yes

[ ] No

(b)If yes, state the strategies deployed.

....

....

....

7. To what extent do you view that your bank has been proactive during the crisis? Rate on a scale from 1-5, 1 being the least and 5 the highest.

[ ] 1 [ ] 2 [ ] 3 [ ] 4 [ ] 5

8. From your experience, do you agree that your institution has to be more prepared in future to deal with such crisis?

[ ] Strongly agree

[ ] Somewhat agree

[ ] Neutral

[ ] Somewhat disagree

[ ] Strongly disagree

Please briefly explain your answer

....

....

....

....

9. Concerning the global financial crisis, what is your on future prospect of the local financial system?

....

....

....

....

Appendix II: Interview Guide

1. How was;

   i) The economy,

   ii) Financial sector,

   iii) Banking sector,

   iv) Your bank,

Affected by the global financial crisis?

2. Was your bank prepared with structures to deal with such occurrences as serious as the global financial crunch?

3. In what specific ways was your bank prepared.

4. What specific strategies did the bank employ in dealing with the direct or indirect negative effects of the global financial crunch?

5. What lessons did the bank learn from the effects of the global financial crisis?