If

FACTORS THAT CONTRIBUTE TO THE FAILURE OF ADMINISTRATIVE RECEIVERSHIP; THE CASE OF COMMERCIAL BANKS AND NON-BANKING FINANCIAL INSTITUTIONS IN KENYA "

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A MANAGEMENT RESEARCH SUBMITTED IN PARTIAL FULFILLMENT OF THE REQUIREMENTS OF THE DEGREE OF MASTERS IN BUSINESS ADMINISTRATION (MBA), THE SCHOOL OF BUSINESS, UNIVERSITY OF NAIROBI

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DEDICATION

To my husband,

Joseph Obwogi

For tirelessly supporting my education.

DECLARA1 iON:

This project is my original work arid has not been submitted to any other institution for a degree.

Signed: — Date: ....^J.ii]__Q_h

Tabitha Nasieku M.

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

Signed: ------------------------------date or? [^ovf wol

Mrs. Winnie Nyamute

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ABSTRACT

The purpose of this study was to determine the role of administrative receivership in the recovery process of a firm and determine the factors that have attributed to the failure of administrative receivership as a company's rescue mechanism in Kenya. The study focused on all the commercial banks and non banking financial institutions (NBFIs) registered and licensed under the Banking Act that were placed under central bank of Kenya (CBK) statutory management between 1993 and 2004.

The researcher used both primary and secondary data to attain these research objectives. Primary data was collected using questionnaire method while secondary data was collected from the documents available at the CBK. The administrative measures put in place by the receiver manager and why those measures could not help turn-around failed financial institution are also discussed in the paper. Further issues, relating to the general causes of bank failure in Kenya were looked into. This was done in an attempt to help reduce the possible causes of administrative receivership failure. Since most of the data collected was basically qualitative, the researcher used content analysis to analyze the findings of the study.

From the study, the main administrative measures that were put in place by the receiver managers in their effort to turn around failing financial institution included the following; the scheme of arrangement, cost management, and human resource management. Howeveij these measures are always frustrated due to lack of company stakeholder's support. Receivers are also not so pillared in Kenya and the process of administrative receivership is perceived to be an expensive event that destroys a business. Likewise, some company failure causes such as political interference, are beyond the powers and capabilities of the receiver managers. These findings are consistent with the literature. Thus administrative receivership may not be an appropriate remedy to company failure.

CHAPTER ONE

1.0 INTRODUCTION

1.1 Background

Administrative receivership is a process under which the charge holder, holding security by way of a floating charge, appoints an insolvency practitioner (IP) known as an administrative receiver to manage the assets, which are subject to a floating charge. An administrative receiver is defined by Insolvency Act 1985, S45 (2) as; a receiver or manager of the whole (or substantially the whole) of a company's property appointed by or on behalf of the holders of any of the company secured by a charge which, as created was a floating charge, or by such a charge has one or more other securities (Binnie, 1960). At the end of the receivership the company can be returned to the directors and shareholders (successful receivership), it can be wound up (failed receivership) or the company can go into corporate voluntary arrangement.

1.1.1 Insolvency and Administrative Receivership

In an insolvent company the debtor may have an administrative receiver appointed under a floating charge to reorganize the business and turn it back to profitably. The receiver manager takes over the day-to-day business operations with the hope of trying to preserve at least part of the business as a going concern and avoid its liquidation. Insolvency law (chiefly the insolvency Act 1989) governs how companies go out of business or recover from crippling debt (Argenti, 1976).

For the last twenty-five years or so, the focus of insolvency law reform in the United Kingdom has increasingly been on the promotion of a rescue culture for companies, and an attempt to remove the stigma associated with personal bankruptcy. A trend which started with the work of the Cork committee chaired by Sir Kenneth Cork in June 1982.

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The legal changes introduced by the Insolvency Act 1985, a piece of legislation that was immediately replaced by a combination of the Insolvency Act 1986 and the Company Directors Disqualification Act 1986, was by far the most significant since the inception of corporate insolvency law in the mid 19th century. Those reforms were essentially based on the findings of the Cork committee (Milman, 2002).

The Cork committee (2002) appointed by the UK government to report on their current insolvency laws reported that it believed the power to appoint a receiver and manager on the whole property and undertaking of a company has been of outstanding benefit to all. In some cases they have been able to restore an ailing enterprise to profitability and return it to its former owners. In others, they have been able to dispose of the whole or part of the business as a going concern. The preservation of the profitable parts of the business has been to the advantage of the employees, the commercial community and the general public.

The cork report (2002) recommended encouraging the continuation and disposal of a debtor's business as a going concern wherever possible. Receivership can thus be said to be effective if the solvent company is rescued as a going concern. To facilitate those objectives the UK government responded by introducing new mechanisms on administrative receivership and corporate voluntary arrangements (CVA) procedures in the Insolvency Act 1986. Companies can be placed either into administrative receivership or re-organized under CVA (Lingard, 1986). However, the take-up of those procedures since 1986, whilst on an increasing trend has been seen by many as disappointingly low. There was also widespread concern that the large number of administrative receivership appointments in the early 1990's has been presenting precipitate behaviour on the part of lenders, causing companies to fail unnecessary. On 14th September 2003 potentially major changes to insolvency procedures in the UK came into being. The government hopes that those changes will help keep more businesses alive and out of the hands of liquidators.

Those measures helped to facilitate the government's aim to move away from administrative receivership (where the receiver takes control of a company on behalf of a floating charge holder and where the main aim is to secure payment for that one creditor) towards more collective methods where the aim is to realize money for all creditors (Davies, 2004).

In regard to all this changes to enhance the success of administrative receivership the reality is, receivers have been regarded as distressed company undertakers rather than rescuers. This is so because receivers are not very popular in Kenya. This country has had very few success stories with administrative receivers indeed; our experience has taught us that once a company is put under receivership, it never returns to profitability. The best examples in this regard are the commercial banks, which were placed under statutory management. Not one of them came back to life. This research seeks to establish the factors that have attributed to the failure of this company rescue mechanism in Kenya. This is important because the Central Bank of Kenya (CBK) places financial institutions experiencing solvency and liquidity problems under statutory management in the hope to restore them back to profitability. The receivers are typically asked to give their approval to rescue scheme. Where they always come up with short-term solutions and one "scheme of arrangement after another". But they don't have a truck record of reviving companies (Kisero, 2005).

Different policies, strategies and tools of reform have been used in an attempt to foster liquidity, solvency and proper functioning of a sound stable financial system particularly due to the dynamic environment under which it operates. Due to the central role of a developed banking system in our economy, it is necessary to identify a re-organization technique that can be used to forestall bank failures. Thus it is necessary and in order to identify whether placing under performing financial institutions under statutory management has any practical value to those concern and the society as a whole. Further the need to strengthen the financial system has been emphasized by the recent bank crisis. But can this be achieved through administrative receivership or is there need for a more practical solution?

The structure of any country's financial system is of great importance to the impact of its economic activities (Chesang, 2002). Indeed, no government will in this sense permit wide spread bank failure; hence the focus on failed bank rescue attempts that are productive is of great necessity as significant amount of time, effort and expense could be saved. Companies, for example, which might have otherwise been subject of unsuccessful rescue attempt could be more readily identified and placed into immediate liquidation. Conversely, companies, which might have been placed directly into liquidation, could be similarly identified as having a good chance of survival under an appropriate rescue package (Hamiliton, 2002).

Preventing the occurrence of the systematic banking sector problems is undoubtedly a major concern of policy makers and understanding the mechanisms that are behind the surge of banking crises has been a major issue throughout the world (Chesang, 2002). This is also the case considering the colossal cost of bank failures (Meroka, 2003). Bank regulators are faced with the challenge of strengthening the financial system by all means. However, little or no study has been done in Kenya to identify why administrative receivers have failed to turn around financially distressed companies to profitability, whilst the wide spread of placing under performing companies into receivership.

Outstanding benefits of receivership to the general public and to the society as a whole are also yet to be established. As recent episodes have shown financial institutions placed under statutory management are always later liquidated, does this suggest that statutory management is not an appropriate rescue mechanism to forestall Bank failures? This study will empirically investigate why most of the insolvency practitioners' turn to be liquidates instead of "doctors" to these ailing cases.

Studies have been written on the prediction of corporate failure in Kenya (Kiege, 1991 and Kogi, 2003). The studies recommended that it is possible to identify and notice the symptoms of downturn in a company early enough to take the correct action and avert the situation. Varies attempts have also been made to explain the causes of corporate failure in Kenya and other countries (Kamau, 1985, Mbuvi, 1983 and Argenti, 1976).

The main conclusion of those studies is that there is a wide variety of failure causes, and that failure is preventable. This has been done with the understanding that identifying the causes of failure early enough a way could be found to prevent the collapse or to reverse the situation. However companies continue to fail despite rescue mechanisms being put in place. Thus this study is primarily concerned with identifying why administrative receivership has failed as a company rescue mechanism in Kenya's financial sector, in contrast to previous studies where the emphasis is on causes of corporate failure. The aim is to ascertain if receivership is the appropriate remedy to rescue an ailing company.

1.2 Statement of the Problem

Kenya has experienced banking problems since 1986 culminating in major bank failures despite rescue mechanism being put in place. Administrative receiverships have been prevalent in Kenya as a strategic tool for financially distressed companies. Ailing financial institutions are placed under CBK statutory management in the hope to restore them back to profitability and facilitate total debt recovery. However this has not happened and almost all those cases result into liquidation. In a banking crisis, depositors, lenders to the bank, and owners of bank capital all lose confidence and seek to simultaneously salvage their resources by withdrawing them (Chesang, 2002). Proper re-organization of insolvent banks is therefore a must for the regulatory framework and supervisory system to be respected as a source of discipline and sound banking.

Literature suggests that, all the symptoms of failure are often observable for some years before the failure actually occurs. According to Argenti (1976), top management should see symptoms of failure fast. If they do not, then this suggests they are not competent and it is reasonable to guess that matters will deteriorate until others start to see the signs. A study conducted by Kamau (1985) on the magnitude and causes of corporate failure in Kenya ranked management incompetence and inexperience as the major cause of corporate failure. Part XIII of the Insolvency Act 1986 prescribes that an administrative receiver should be a qualified professional, with the competence and experience to prevent avoidable corporate failure (Lingard, 1986).

However, companies continue to collapse, even after the failure symptoms have been identified and a receiver manager is appointed to help reverse the situation. The researcher is not aware of any study that has been documented to explain why administrative receivers have failed to rescue the distressed companies and turn them around to profitability. Therefore this study intends to answer the questions: What administrative measures have been put in place in management of receivership? Are those measures responsible for the failure of the recovery process?

1.3 Objectives

1. Determine the role of administrative receivership in the recovery process of a firm.
2. Determine the reasons that can be attributed to the failure of administrative receivership in Kenya's financial sector.

1.4 Importance of the Study.

In Kenya the banking sector continues to grapple with the problem of non-performing loans, which now account for 29% of the total deposit fund protection loan portfolio (Wetzel 2003). Therefore a study set up to determine why Commercial Banks placed under statutory management always results into liquidation will help to document important information that can be used by all concern with the company rescue. While this study may be of value to any person interested in corporate rescue mechanisms in Kenya, it is expected to be of particular benefit to the following;

- *The central bank of Kenya:* there have been calls for more productive approaches to forestalling bank failures. As the country's banking sector regulator and supervisor, the central bank will be challenged to critically assess any rescue method before embanking on it.

- *Practicing accountants, auditors, official receivers and liquidators.* It is hoped that the finding of this study will increase their understanding and knowledge of the subject enabling them to give better advice to both the going concerns and the failing cases. Such advice may be in the form of identifying the appropriate rescue remedy to improve profitability of operation instead of winding up.

- To the *managers, directors, owners, creditors and investors* in general may find the study enlightening on when to appoint a receiver during periods of financial distress and what their expectations could be without incurring liability for wrongful trading. The success of any rescue mechanism largely depends on the support of all the stakeholders.

- To *academicians* the study will encourage more research into various aspects of corporate rescue mechanisms in Kenya and elsewhere. Such further research will be a step in the right direction of identifying the effectiveness of company rescue mechanisms.

CHAPTER TWO

2.0 LITERATURE REVIEW

2.1 Financial Distress and Administrative Receivership

Financial distress is an emerging field stepped in confusion and complexity. Some of the confusion can be resolved by understanding the diverse nature of distress and appreciating that it is not synonymous with corporate death (Kogi, 2003). Firms in distress face a variety of situations having very different effect on their values and claim holders. This diversity in conjunction with conflicts of interest among claim holders has an information problem that makes rescue of a financially distressed firm very difficult.

Financial distress is often described as one of the circumstances; as a condition of negative net worth; the inability to pay debts as they come due (insolvency) and, as a legal definition under which a firm continues to operate or liquidates under court protection (legal bankruptcy). The most definite word to use for corporate failure is insolvent, liquidation, receivership and bankrupt (Argenti, 1976).

Insolvency is a much more definitive word than failure; it means you cannot pay your bills when they fall due. This can be a purely temporary situation known as technical insolvency. Kamau (1985) in his study on the magnitude of causes of corporate failure in Kenya articulated that simple management mistakes in decision-making could easily lead to technical insolvency, which is among the cases in which the court may wind up a company.

However its important to know that technical insolvency is not in itself a ground for winding-up. But 'insolvency in a bankruptcy sense' is much more serious. It implies that the firm's liabilities exceed a fair valuation of its assets; the company has negative net worth. Oddly enough, as Argenti (1976) remarks, you know when you are technically insolvent because of the unmistakable fact that you have no cash with which to pay your

bills, but you may not know that you have hit the far more serious version of insolvency because it is so difficult to value assets unless they are actually sold off and a true market value thus placed upon them.

Legal Bankruptcy is often used synonymously with insolvency meaning there is a negative net worth. In another sense it refer to the actual declaration of bankruptcy together with a petition by a company to a court to liquidate its assets or to attempt a recovery programme of some sort and it is then called a bankruptcy-reorganization or receivership. This reorganization is designed to keep at least part of the firm going if it is thought to be worth more to its creditors as a going concern than as dead one. The primary role of the bankruptcy court in reorganization is to determine the fairness and the feasibility of any purposed plans of reorganization (Brigham and Gospenski, 1997). Even if some creditors or stakeholders dissent and do to accept the reorganization plan, the court may still approve the plan if it is deemed to be fair and equitable to all.

If a company is 'to far gone' to be reorganized, then it must be liquidated. Liquidation should occur when the business is worth more dead than alive, or when the possibility of restoring it to financial health is so remote that the creditors run a high risk of greater loss if operations are continued. In liquidation all the company's assets are sold off and all its creditors paid in a strictly laid down sequence; it is rare in an involuntary liquidation (one requested by creditors) for all creditors to be paid in full. In a voluntary liquidation (normally called for by the share holders) payment in full is usual.

It is an offence to continue to trade while insolvent and directors and others who do so are liable to severe penalties. Instead the debenture holder usually calls in a 'Receiver' who takes over the management of the company. The administrative receiver does two things; one continues to trade in the hope of bringing the company, or part of it around to profitability again, or he puts it into 'liquidation', which means the company stops trading and all the assets are sold for the benefit of the creditors.

Liquidation is the end point in the process of failure, referred to as corporate collapse (Argenti, 1976). However, corporate collapse has always brought fearful mental pain to proprietors, entrepreneurs, and managers and to their families. It ruins lives, destroys the health of its victims, it pushes them to the edge of suicide and beyond. This is so in our modern society after each individual is becoming so much dependent upon companies and other organizations, that the misery of failure is spread far and wide. People will not accept failure; they will go to any length to avoid it. The pain of experiencing a loss by admitting failure is approximately twice as intense as the pleasure derived from a gain (Ward and Foster, 1997).

Therefore the only alternative left to a company whose performance is too poor is call in a "receiver and manager" in the hope he will turn the company to profitability again rather than liquidation. But the power to appoint a receiver under a company debenture has attracted continuous attention on the ability of an administrative receiver being a 'doctor' of an ailing company. Thus by successfully being able to analyze if administrative receivership is a viable company rescue mechanism before embanking onto it, companies can make optimal exit decisions and save a lot of unnecessary pain, costs and time wasted on unproductive rescue procedures.

2.2 Costs of Financial Distress

The possibility of bankruptcy has a negative effect on the value of the firm (Meroka, 2003). However, Ross, et al (1990) articulates, that it is not the risk of bankruptcy itself that lowers value. Rather it is the cost associated with bankruptcy that lower value. Those costs include:

Direct costs of financial distress

Legal and administrative costs of liquidation or re-organization: Lawyers are involved throughout all the stages before and during bankruptcy with fees often in the hundred of dollars an hour, those cost can add up quickly. In addition, administrative and accounting fees can substantially add to the bill.

If a trial takes place, we must not forget expert witnesses to testify about the fairness of the prepaid settlement. For example, in the case of banks that fell, 1 guess the receivers are still earning fees even as they drive the company's to their final resting place.

Indirect costs of financial distress

Impaired ability to conduct business: bankruptcy hampers conduct with customers and suppliers. Sales are frequently lost because of both unfair and impaired service and loss of trust; For instance, many customers swift from companies managed by receivers or declared insolvent. Ross et al (1990) remarks that, the taint of impeding bankruptcy is enough to drive customers away. For example, gamblers avoided Atlantis Casino in Atlantic City after it become technically insolvent. Many questioned, "If the casino itself cannot make money how can 1 expect to make money there". Another particularly outrageous story concerns two unrelated stores both named Mitchells in New York City. When one Mitchells declared bankruptcy, customers stayed away from both stores. In time the second store was forced to declare bankruptcy as well. Though those costs clearly exists, it is quite difficulty to estimate them. Perhaps Altman as Ross et al (1990) quotes made the best attempt, estimating both direct and indirect costs when he stated that indirect costs are frequently greater than 20% of firms' value.

2.3 Background of Kenya's Banking System

An overview of the banking sector in Kenya and the role of the Central Bank of Kenya (CBK) and Deposit Protection Fund Board (DPFB) in encouraging the rescue and liquidation of failed financial institutions are discussed. Banks in Kenya are established under the Banking Act cap 488 and regulated under the provision of the Central Bank of Kenya Act Cap 491 of the law of Kenya. The banking Act part 11 sec 4(1)&(2) gives the Minister of finance power to license any institution intending to carry out banking business in Kenya on recommendation from Central Bank of Kenya. Part IV sec. 32 of the act gives Central Bank of Kenya exclusive inspection power of any licensed banking institution to ensure that they conform to the law and the prudential guidelines issued by the Central Bank of Kenya from time to time (CBK, 1998).

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This is in line with one of the principal objectives of the bank as outlined in the central bank of Kenya Act of 1996 part 11 Sec. 4 (2) which states, "The bank shall foster liquidity, solvency and proper functioning of a stable market based financial system". Kenya has experienced three financial crises since 1980s; 1989 1993, and 1998. These lend to tightening of the regulatory framework by introducing changes in the Banking Act aimed at enhancing efficient operations of the industry (CBK Act, 1999).

In late 2000, parliament passed the Central Bank of Kenya (amendment) Act, which contained provision regulating interest rates. Though the new law was given presidential assent on August 6, 2001, the law was contested in courts and was not implemented. In the June 2003, budget statement the government announced its intention to enact provisions similar to the Central Bank of Kenya (amendment) Act, but did not impose interest rates controls.

In 2002, the CBK set requirements for all banking institutions and building societies to publish their quarterly un-audited financial results in the print media. The objective of the disclosures is to enable bank customers to make informed decisions about the general soundness of banks, particularly when placing large deposits (Kenya Economic Review, April 2005) The Central Bank of Kenya also issued guidelines requiring banks to report on a daily basis their financial status.

2.4 The Structure of Kenya's Financial Sector

The Kenya's financial system has grown in size and structure since independence due to polices pursued by the authorities. The legal framework: Central Bank Act and Banking Act have also been amended to reflect the policies and growth of the industry. This was particularly so following liberalization period 1992-1994. The objective was to create a conducive environment for banks to operate and protect stakeholders (Kenya Economic Review, 2005).

The financial sector is well diversified. As at the end of April 2005, the banking system consisted of 43 commercial banks, 2 investment banks, 1 operating non-bank financial institution (NBFIs), 2 mortgage finance companies, 4 building societies and 48 foreign exchange bureaus. Two multinational banks (Barclays and Standard Chartered) and two Parastatal banks (Kenya Commercial Bank and National Bank of Kenya) dominate the banking sector. Other U.S. banks have correspondence relationships with Kenyan banks. Other financial institutions include 10 development finance companies, 5 representatives offices several pension funds (including the large state owned national Social Security - NSSF), 5 representative offices of foreign banks, a Capital Market Authority (CMA), one securities exchange based in Nairobi, several pensions funds, a post office saving bank, 40 licensed insurance companies, 2 re-insurance companies, 2 claims agents, 22 insurance surveyors, 7 risk managers, over 184 insurance brokers, 19 loss adjustors, 1,061 insurance agents and over 3,000 poorly structured cooperative savings and credit unions (Wetzel, 2003).

2.5 Bank Restructuring Approaches

For one reason or another banks fail, they fail because of, liquidity, insolvency, mismanagement or sudden shocks to the economic system; such as violent fluctuations in interest or exchange rates or outright frauds. Depending on the severity of the problems of the falling banks, the remedial measures open to central bank vary (Chesang, 2003). Further, as Chesang remarks the method used depends on a country's specific situations and the strength of the financial system.

In Kenya a large number of financially distressed financial institutions have been merged or placed under statutory management with the aim to rescue them and boost economic growth and stability. As CBK records have shown most if not all of these institutions placed under statutory management have resulted into liquidation with very minimal debt recovery. For instance, as at 30th June, 1999 the total cumulative debt recovered was Kshs 3,202 M representing 20% of the initial debt of Kshs 15,978 M for the financial institutions which were liquidated within the period (Cheserem, 1999).

However, little has been documented to clearly assess the success of administrative receivership rescue mechanism or its failure. Although the Kenya government have been implementing economic reforms in almost all sectors including the banking sector for almost a decade some problems persists. For instance the banking sector continue to grapple with the problem of non-performing loans, which now account for about 29% of the total loan portfolio (Wetzel, 2003).

Chesang (2003) notes that even when rescue operations are carefully designed they still have several drawbacks which includes; High budgetary costs, Possibility of inefficient banks remaining in business creating expectations of future bailouts thereby reducing incentives for adequate crisis management, weakening managerial incentives as are often the case in most developing nations, thus forcing healthy banks to bear the losses of ailing institutions, Inflammatory loose monetary policy to prevent banking sector losses and; in countries with an exchange rate commitment, possibility to trigger of a speculative attack against the currency.

2.6 Reforms of the Insolvency Laws and Success of Receivership

Prior to the insolvency act 1985, Receivership was the most attractive insolvency procedure for a failed management because it avoided a creditors meeting and provided the best prospect of preserving the viable parts of the business for the management to buy back. Such buy backs left trade creditors and shareholders with no dividend and contributed to the pressure for reform leading to the Insolvency Act 1985 (Lingard, 1986)

Originally, the duty of the receiver was to secure the property in dispute *pendent lite,* while the case was tried. He was then required to facilitate, by equitable execution, the satisfaction of creditors' claims out of assets over which the common law did not afford rights of enforcement. If a business can no longer repay its debts, the debenture holder, usually a bank, will seek to satisfy its claims out of the security given by the debtor (Lange and Hartwig, 1989).

However, under law the creditor has four remedies which includes; the right to take possession of the secured property and enjoy the benefit of its use; further right, after a prescribed period, to foreclose, that is, to exclude the debtor from all rights of ownership; or to sell the secured property; and Finally, the right to have a receiver appointed by the court, or to appoint one privately, to realize the benefit of the asset. The rules of law governing taking possession, foreclosure and sale are unsatisfactory for the debenture holder. The very admissibility of a particular remedy may depend on whether the security is legal or equitable; the remedies usually require observance of strict procedures; and the debenture holder may risk claims in damages, arising from his possession, management or sale of the property. In addition, a foreclosure can be retrospectively rescinded (Lange and Hartwig, 1989). A creditor also has particular interest in saving the business if this improves his chances of full recovery of the loan, or if he has an interest in maintaining his trading relationships with the affected debtor. The creditor may also wish to avoid breaking up the enterprise for other business, political, social and moral reasons.

These functions developed into the wide-ranging duties of today's receiver, satisfying the claims of the debenture holder out of the security given by the debtor company and concurrently trying to preserve at least part of the business as a going concern. The task of satisfying the claims of the debenture holder out of the security given by the debtor company and concurrently trying to preserve at least part of the business as a going concern imposes a considerable responsibility on the modern receiver. To meet this responsibility the receiver seeks to satisfy all creditors by re-organizing the company.

Saving the company has become the priority not the ability of the administrative receiver to control the business and to realize whatever assets are available in order to pay the charge holder usually the bank that appoints him (Davies, 2004). The crucial decision in any receivership is whether to continue the business with a view to selling it as a going concern or whether to stem trading losses by closing it down and disposing of the assets. Sale as a going concern is always better; it is disastrous for a receiver to continue to trade at a loss for a prolonged period only to find that the business is not saleable (Argenti, 1976).

A receiver and manager appointed after March. 1, 1986 is designated an administrative receiver by the Act. These management powers in many cases gave the receiver the chance to satisfy creditors by saving the profitable parts of a business. The receiver appointed under a floating charge could by the nature of the charge, be given the contractual right to take over the management of the company and to satisfy the claims of the creditors by carrying on the business.

Some aspects of the receivership procedure were, however, subject to serious criticism before the reform of the insolvency laws. Complains included insufficient statutory provision to ensure prompt commencement of the procedures, lack of professional standards for receivers, and lack of statutory definition of a receiver's powers. Particular criticisms attached to the ignoring of the interests of unsecured creditors and the general vagueness surrounding the legal concept of a floating charge. Over the years many small firms have criticized bitterly lenders' decisions to send receivers arguing that a less self-centered approach to short-term financial problems could have saved the business concerned and the jobs of those who worked for them (Davies, 2004).

To deal with the criticisms attached to, the ignoring of the interest of unsecured creditors and the general vagueness surrounding the legal concept of a floating charge. The UK Parliament took up many of the suggestions in the Cork Report. Which recommended encouraging the disposal of a debtors business as a going concern, and the discussions that followed its publication. The effectiveness of receivership was enhanced, and many of the criticisms dealt with, in the Companies Act 1985 and the Insolvency Act 1985. The relevant sections of the two Acts of 1985 were largely replaced by the Insolvency Act 1986, which now includes a fairly comprehensive code covering the rescue of companies. For instance, Insolvency Act 1986 (section 46, 48 and 49) did introduce requirements on administrative receivers to notify and report to creditors and provide for the possibility of a committee of creditors being established. The aim is to guarantee unsecured creditors a greater say in the process of rescue and its outcome. But in practice, very few such committees are appointed (Lange and Hertwig, 1989).

On 15th September 2003 potentially major changes to the insolvency procedures in the UK came into being. The government hopes that these changes will help keep more businesses alive and out of the hands of liquidators. At the same time, it hopes to ensure that ordinary trade creditors get a fairer deal when a company collapses.

The changes brought in under the Enterprise Act 2002 affect firstly receivership and secondly, the respective rights of different classes of creditors in formal insolvencies. The changes mean that banks loose the right to appoint an administrative receiver under any floating change, which will take over business assets. These changes to insolvency procedures were designed to keep small businesses afloat, though a more constructive approach to short term problems. However, the prohibition on the appointment of administrative receiver only applies to new loan agreements entered into after 15th September 2003. Pre-existing agreements are not affected, so receivers may still be appointed in these cases (Davies, 2004).

2.7 Failure of Receivership

Administrative Receivership has bore the brunt of criticisms as a rescue mechanism of companies in financial distress. Law Africa's Kanjama (2002) looks at a recent decision by Justice Ringera in **Showind Industries and Guardian Bank** (2002) and its impact on the law relating to receiverships. The Showind case has attracted attention back to the contentious issues surrounding exercise of the power to appoint a receiver under a company debenture.

The debenture and subsequent appointment of a receiver was subjected to gimlet-eyed scrutiny. On an interlocutory application to restrain the receivers, it was alleged that the debenture was invalid because it was not endorsed with the firm's name contrary to the Advocates Act. Further, the company argued that the deed of appointment of the receivers was incomplete for lack of attestation, that there were illegal debts and penalty charges and that the demand was invalid.

The court concurred with the company, and also found that the solvency report upon which basis the bank decided to appoint receivers was unreliable because it was equivocal and had material disclaimers. Justice Ringera held that, under the authority of **Obura** v **Koome,** the company had established a prima facie case with probability of success. He took judicial notice of the fact that most receivership tended to cause irreparable injury to companies and decided the balance of convenience in favour of the status quo ante.

In the light of the above judicial proceedings, the decision in **Showind Industries Ltd** v **Guardian Bank** (2002) has not just unseated the company director from the pedestal of judicial admiration; it has toppled the pedestal's pillar and reworked the base as well. For while all previous interlocutory applications have assumed that a restraining injunction will be granted if the applicant establishes a prima facie case, Showind has held that a receiver will only be unseated by a mandatory injunction based on a strong and straight-forward case.

As Kanjama (2002) remarks receivers have been termed to be the villains of company law just as criminal law has always had its heroes; company law has always had its villains. Ironically so, because the company has been the vehicle for commercial development while the criminal has been the source of retrogression in society. Kenyan company law has for long cast about for its own villain, before settling on the receiver, the doctor-turned-undertaker of companies. Justice Tunoi also took a swipe at the company receiver, In **Fina Bank** v **Spares & Industries** (2000), when he remarked;

> *"The issue ofreceivership is an emotive one and 1 understand why the respondent had to resort to litigation. It destroys the business. It is expensive".*

Lingard (1986) noted that in receivership, the viable portions of a business are hived down, made viable and then sold. However, only exceptionally hive down companies trade at a profit whilst controlled by a receiver, it being for a purchaser to make something of them. Banks will continue to appoint receivers and the appointment will often be followed by the liquidation of the companies so that the validity of the

debentures and the liability of the directors for wrongful trading can be examined.
The receiver has not always been so pilloried, nor the debenture under which he is appointed subjected to such scorching scrutiny. In the last two years, the initial doubts of the late 1980s have sprouted a judicial attitude hardening ever more against the company receiver. **Fina Bank** v **Spares & Industries** (2000) more than any other decision shows up the judicial angst that has attended this transformation.

The company filed suit seeking a declaration that the receivers' appointment was null and void, on the grounds that the property under fixed charge was sufficient to satisfy the debt, that the interest charged was unconscionable and that the bank's action was oppressive.

The courts must resolve the doubt that now surrounds an already appointed receiver. As the relevant principles are resolved, perhaps the courts should also examine the practice of both directors and receivers bringing proceedings in the company's name after the appointment of receiver managers has taken effect. As Kisero (2005) remarks, Minister Kirwa's battle with the receivers at Muhoroni and Miwani sugar factories raises several questions. First who has the powers to terminate the services of a receiver? If the receivers are not performing to the satisfaction of the person who appointed them, can he/she throw them out?

These issues will need to be ventilated as the number of receivers appointed under debentures continues to rise concurrently with growing interest rates. Will the courts rehabilitate the 'villains' of company law? Only time will tell. Receivership is the only hope for a failed company before liquidation. But has it achieved its main objective of company rescue by reversing the situation of a failed business back to profitability.

2.8 Review of Empirical Findings

Most of the relevant studies have focused on the factors associated with the relative 'success' or 'failure' of companies. There has been a tendency to associate business closure with business failure or to assume that the majority of closures represent unsuccessful business ventures, a large number of studies have attempted to build or test models for the identification of business failure, its prevention and cure. Again, this has been driven by an agenda, which seems to imply that business closure is negative rather that part of dynamic economy (Stakes & Blackburn, 2002).

Throughout the past decades, the accepted management literature has been upon the achievement of success, but little has been written about corporate rescues and how to identify that critical point when directors and bankers should seek the assistance of an insolvency practitioner. Indeed, you will not find the words insolvency or receiver or liquidation in the index of even such publications as guide to accounting and finance for managers. However the avoidance of failure is as much a part of a manager's job as the achievement of success (Argenti, 1976).

The fashion in management literature for the past two decades has been to concentrate on go-go performance and how to achieve it. While it was right that this should be so, and it still is, it is nevertheless extraordinary that so little should be have been written about an already failed company and how it can go back to its profitability. Kamau (1985) noted that, many studies on testing and development of models that can help in predicting and classifying business failure has been done but none has been done to help a business that has failed go back to its shoes. These studies have been based on various financial variables and both multivariate and univariate models have been developed and tested. Probable the most significant work was by Altman, who was the first to apply the technique known as discriminate analysis to the failure classification problem (Ward and Foster, 1997). The analysis is multivariate in that a number of variables are combined simultaneously to analyze a firm for its failure chances or potential (Altman, 1969).

Signs of potential financial distress are generally evident in a ratio analysis before the firm actually fails. Brigham and Gopenski (1997) remarks, even if the manager do recognize, this symptoms of failure, they do not take emergency action, do not call in experts, do not cut back, because they hope the cloud, will roll away. This is a great pity because large parts of the firm could be saved if they called in a receiver or a consultant earlier But even after failure something can usually be saved, Indeed, it is the receiver's job to find a profitable Kernel and work on it (Argenti, 1976). However, in reality considering that all the financial institutions placed under statutory management in Kenya have been liquidated (see appendix 1), it poses doubts on the ability of an administrative receiver to save an ailing company.

Argenti (1976) briefly reviews previous works on the causes of failure he identified what causes perfectly healthy companies to collapse. He thought in understanding this we could then find some ways of preventing their collapse or elevating it or may be even reversing it. The main conclusion of these studies is that there is a wide variety of failure causes. He says that most of these studies conclude that failure is preventable, but Altman (1968) as Argenti quotes, believes that mere causal analysis cannot provide a sound basis for prevention. He believes that prevention can best come by detecting the impending crisis far enough ahead to do something. Altman wished to examine this association more closely and to learn what other factors outside the firm itself mainly affect failures. He developed a number of equations in order to examine the influence on failures rates, investor expectations and so on. His skepticism as to the value of merely enumerating possible causes is underlined by the fact that you get completely different explanations of failure depending upon whom you ask the managers or the creditors.

Much also has been done in Kenya on identification of failure and prediction of failure methods have been developed over the last few decades. For instance; Wetzel (2003) looked at the following factors as the main course of financial distress in Kenya's financial sector and other firms. Poor financial management, distortions in price structure, inefficient infrastructure and services and the high cost of doing business in Kenya associated with high power tariffs, bureaucracy in obtaining licenses and corruption.

According to him the negative impact on physical infrastructure coupled with poor management of public expenditure and corruption adversely affect productivity in all sectors of the economy resulting to a number of firm failures.

Likewise, Cheserem (1999) attributed the causes of bank failures in Kenya mainly to the country's poor infrastructure, inadequate provision of public services and insecurity. According to him those factors worked to, among others, erode investor confidence and lower efficacy in production and distribution, thus adversely affecting economic growth. Those factors led to low performance in the banking sector in 1990s with most institutions reporting low profits while others were placed under statutory management

In a study done by Kamau (1985) whose main objectives were to identify and describe the reported causes of corporate failure in Kenya between 1970-1984, Kamau identified the following as the main causes of failures in their order of importance.

Cause of failure as reported by accountants' and liquidators	% order of importance
Management incompetence and inexperience	26.9
Undercapitalized	18.4
Over borrowing	13.2
Poor financial management	10.6
Poor Investment decisions	7.9
Excessive competition	5.3
Fraud	5.3
Lack of professional management	2.6

Cause of failure as found in failed companies files	% order of importance
Management incompetence	21
Fraud	19
Irresponsible management	17
Slowdown in sales	8

From the above, it is evident that management incompetence and inexperience were the most reported as the cause of corporate failure. Further, case studies have also shown that financial difficulties are usually the result of a series of errors, misjudgment and interrelated weaknesses that can be attributed directly or indirectly to management.

The management has the direction of the business and is responsible for selecting the venture, which it undertakes. According to Argenti (1976) any management failure will weaken a company in three prime areas; those are production marketing and financial control to ensure the outcome is profitable. Failure in any of these three areas will in the end destroy the company. While all literature agree that 'bad management' is the prime causes of failure no one agrees what bad management means nor how it can be recognized except after the company has collapsed, then everyone agrees how badly managed it was.

However Lingard (1986) noted that, although most causes of failure are attributed to weak management this may not be invariably so. For instance the business may fail for reasons connected to the economy as a whole. The government may without warning impose exchange controls, hire-purchase controls, materially change tax policies. For example, in Kenya during the 1990s the manufacturing and the agriculture sector registered declining growth. Firms in the first phase of an import substitution industrialization strategy could not compete in the face of liberalization and had to close down (Wetzel, 2003). In such cases all the management can do is to adopt as quickly as possible to the new situation. Thus Lingard further articulates that the rescue of a financially distressed company might be possible if management changes are made.

The importance of different factors varies over time, depending on such things as the state of the economy and the level of interest rates, also, most business failures occur because of a number of factors combined to make the business unsustainable (Brigham and Gopenski, 1997). However, it is one thing to discuss causes and prevention of failure and another to show if an already failed company has any survival potential through the hands of an administrative receiver.

This is because companies continue to fail despite rescue mechanism being put in place. As Hamilton (2002) quotes, Gilbert et al (1990) argued that ex-poste discrimination between risky companies, which have failed, and non-risky companies, which have not, has limited practical value. Gilbert et al's study focused on whether financial ratios can be used to discriminate between weak companies that are destined to go to liquidation and weak companies that will avoid liquidation.

2.9 Failure Prediction Models

The prediction of failure has interested both academic researchers and business managers for a long time. Various methods of prediction have been developed over the last few decades. Corporate failure literature contains a number of methodologies used to discriminate between failed and non-failed firm. These methods can broadly be classified as ratio based and non-ratio based methods.

2.9.1 Ratio Based Models

Business failure is costly to society and its prediction in ratios as opposed to absolute values, is a mathematical one and is basically in order to facilitate comparison. However, this assumes that ratios possess the appropriate statistical properties for handling and summarily data (Ogeto, 1994). The interrelationship that exists among the different items appearing in the financial structure is revealed by financial ratios. Financial ratios are used for all kinds of purposes including the assessing the ability of the firm to pay its debts, the evaluation of business management success and even the statutory regulation of a firm's performance (Kogi, 2003). Ratios are the best tools for measuring management efficiency, profitability, solvency and liquidation. It helps analyze the probable causal relationship among different items after analyzing and scrutinizing the past results. Secondly, it helps to take dimensions into account or by tending analysis such as whether the firm is improving or deteriorating over a number of years (Ogetol994). In general ratios measuring profitability, solvency and liquidity prevailed as the most significant indicators of corporate failure.

In studies done in Kenyan companies to predict business failure, Kiege (1991) found out that it is possible to predict business failure using financial ratios two years before it occurs. Kogi (2003) likewise developed a discriminant model incorporating financial ratio stability that can be used to predict corporate failure. By incorporation a measure of stability of financial ratio in discriminant analysis model Kogi concluded that it's even possible to predict failure 5 years in advance. Brigham and Gopenski (1997) suggested that Multiple Discriminant Analysis technique was developed to improve the use of ratios in determining the probability of company failure.

The use of ratios is based on the realization that failing firms' ratios are significantly different from non-failing firms ratios. Kiege (1991) noted that the type of ratio that could best discriminate between failed companies and successful ones differ from place to place. This can be justified by Hamilton (2002) who used financial ratios in an attempt to predict the survival potential of companies placed under administrative receivership Hamilton revealed rather interesting results in the ratio interpretation difference between health companies and those already under administrative receivership as he computed the *debt turnover ratio, gearing ratio,* and *current ratio.*

The analysis revealed that, when debtor turnover (DT) fell between 64 days (which was the average collecting period in the sample) and 140 days, companies had a very good chance of being rescued over 80 percent of companies within this range were rescued. However, when debtor turnover was less than 64 days the chances of the companies being rescued were much lower at 52.4 percent. This result was totally unexpected because a low debtor's turnover figure is usually associated with efficient credit control and good management practice.

The findings with regard to gearing ratio were also interesting. It is generally accepted that lending banks do not normally lend more than the "net-worth" of the Company, with net worth typically including equity plus retained profit and capital regulation less intangible assets such as goodwill, patents, and extra.

The analysis revealed that Companies with low gearing ratio have a good chance of being rescued. Companies with a high gearing ratio that is those, which are fairly "normal", have a much greater chance of not being rescued. As with current ratio it is generally accepted, however, that banks will not lend on a current ratio of less than unity and a current ratio of 2:1 is generally regarded as providing additional comfort.

However the study revealed that the majority of sample companies had current ratio of less than 1.10 just slightly greater than unity. This was not unexpected as all of the Companies were weak and had been placed into administrative receivership. But, rather interestingly, the current ratio did not reveal any significant difference between the rescued and failed companies. This could seem to suggest that although the current ratio might be useful as an early warning signal. It is essentially concerned with short -term liquidity rather than insolvency and long term survival of a Company. Hamilton's study concluded that failing firms exhibit significant different ratio measurement than continuing entities.

In view of the above literature, the symptoms and signs of failure are so evident and easily predictable using financial ratios. Then, why has it become so hard to avoid or prevent this failure even after placing the distressed companies under the competent management of insolvency practitioners? Likewise as various authorities (such as Cheseng 2003, Kanjama 2002, and Lingard 1986) have cited different causes of company failure none has mentioned if those series of errors, misjudgment and interrelated weakness can be attributed directly or indirectly to the failure of administrative receivers rescuer efforts despite the vast trend of placing under performing companies under receivership.

2.9.2 Limitations of Ratio based Models

Ratio based models are subject to some of the limitations of financial ratios, the main being that they use accounting data. Accounting data is subject to different interpretations and even manipulation for example, using of different accounting methods as in inventory valuation and depreciation. Comparison between two variables proves healthy provided their basis of evaluation is identical, in reality however this is not possible.

Moreover, ratios depend on figures appearing in the financial statement. But in most cases, the figures are window dressed especially when a corporation is in financial distress. As a result, the correct picture cannot be drawn up by the ratios. Lastly, ratios are computed on past results and corporate failure is futuristic. It therefore does not help to properly predict the future and significantly it is difficult to ascertain old ratio in order to make proper comparison because it differs from firm to firm and industry to industry. Thus there is considerable debate in financial literature as to which ratios are most useful and in particular for assessing the likelihood of failure (Keige, 1991).

CHAPTER THREE

3.0 RESEARCH METHODOLOGY

3.1 Research Design

This research was conducted through a survey of all the commercial banks and NBFIs that were placed under statutory management between 1993-2004. This method was chosen because of the availability of reliable and accurate data on the financial institutions that were placed under CBK statutory management and later liquidated. The researcher also took into account that the financial sector contributes greatly to the economic growth of the country. A census of all the cases within the time span enabled the researcher to probe and obtain an in-depth understanding of the appropriateness of administrative receivership in Kenya and why it has not helped to restore the failed financial institutions back to profitability.

3.2 Population and Sampling Design

The population of interest consisted of all those commercial banks and NBFIs registered and licensed under the Banking Act and were placed under CBK statutory management between 1993-2004. A census of all the 27 institutions as available in the CBK records was taken thus no sampling was required (see appendix 1).

3.3 Data Collection

Both primary and secondary data was collected. Primary data was collected using two questionnaires; one questionnaire was directed to the CBK as the population of interest was under its statutory management. The other to the bank-liquidating agents as named by the CBK records in the year 2004.

The questionnaires main objective was to gather information that could help the researcher determine the factors that have attributed to the failure of statutory management as a company rescue mechanism in Kenya. Thus the liquidators and the bank supervision officers provided information about the administrative measures put in place by the receiver managers and why those measures really succeeds, resulting to liquidation of those institutions.

Secondary data was collected from various documents available at the Central Bank of Kenya. Such documents include; Bank supervision annual report and accounts, Monthly Economic Reviews of central bank of Kenya, and the statistical bulletins from Central Bank of Kenya. The Bank supervision annual report provided information on the central bank functions in liquidating insolvent institutions, paying depositors and amount of outstanding debts as at the date the institutions were placed under receivership and the total debt recovery as at the date of liquidation.

The Economic Reviews gave insights as to the factors that attributed to the failure of those financial institutions, which the researcher used to deduce the possible causes of failure in their rescue mission. The information available in the Statistical bulletins from the CBK enabled the researcher in making conclusion about the effectiveness of the CBK responsibly in the inspection of the distressed institutions. The documents also provided the researcher with information on how the CBK intends to deal with the challenges facing the banking sector such as, failing institutions and debt collection mechanism

3.4 Data Analysis

This research was to determine the factors that have attributed to the failure of administrative receivership as a company rescue mechanism in Kenya. The questionnaires were analyzed to identify the underlying failure of statutory management in Kenya's financial sector. As most of the data used in the study was qualitative the researcher used content analysis to describe the administrative measures, which were put in place by the administrative receivers, and why they did not work.

CHAPTER FOUR

4.0 DATA ANALYSIS AND RESEARCH FINDINGS

4.1 Introduction

The purpose of this study was to determine the role of administrative receivership in the recovery process of a firm and factors that have attributed to the failure of administrative receivership as a company's rescue mechanism in Kenya. A case study of commercial banks and non-banking financial institutions (NBFIS) was taken. This chapter summarizes the data collected and discusses the findings of the study. It is organized into 4 parts: The role of administrative receivership in the recovery process of a firm; General information on the effectiveness of the insolvency practitioners; Effectiveness of the Central Bank as the regulator and supervisor of Kenya's financial sector and General causes of bank failures in Kenya.

Out of the 8 liquidating agents (named in appendix 1) only three were available for interviewing. However three more liquidating agents as were available at the Central Bank deposit protections funds boards (DPFB) readily accepted the questionnaires and responded. The banks supervision officers answered the questionnaires directed to the Central Bank. In total, 6 liquidating officers and 2 banks supervision officers responded to the questionnaires. The director of banks supervision Mr. Pere advised the researcher to refer to the bank supervision report (BSR 2002) available on the Internet for more information. Other secondary data such as the Central Bank Statistical Bulletins and Economic Review were readily available at the two departments visited, that is supervision and DPFB department.

4.2 The role of Administrative Receivership in the Recovery Process of a Firm

Both the primary and the secondary data collected indicated that when the receiver manager takes over a business, his/her primary role is to save the business if this improves the creditors' chances of full recovery. The receiver manager brings in new administrative measures in his effort to achieve this objective. Those measures includes, scheme of arrangement, cost management, and human resource management.

However these administrative measures as are implemented by the receiver manager rarely succeed as is shown by table 1 below. The table summarizes the liquidators' responses in question 6, 7, 8 and 11.

Table 1: Analysis on the effectiveness of administrative receivership

Factor that elaborate the effectiveness of administrative receivership	**Effective YES**	**Not effective NO**
Can receivership help avert company failure?		**NO**
Should the CBK place under performing financial institutions under statutory management?		**NO**
Should under-performing financial institutions be Liquidated Immediately the downturn is noticed?	**YES**	
Do you think placing under performing financial Institution under CBK statutory management could reverse there status?		**NO**
Are the statutory manager well Vested to	**YES**	

company problems?		

The findings in the table 1 above indicate that, the statutory manager knows well the company problems and they feel that those problems could not be solved through administrative receivership. Since all the respondents stated that central bank should not place under performing financial institutions under statutory management as this could not help reverse there status.

The failure of those administrative measures as implemented by the receiver manager was attributed to lack of management and company stakeholders' support. In the banking sector the bank major depositors are also the bank owners thus whenever the bank fails the owners' fear to loose their deposits. Therefore the main task of a receiver manager who takes over an ailing entity is to see how the depositors will be paid in full and put the entity back to business. This is done through a scheme of arrangement.

A scheme of arrangement is an arrangement with the depositors and the receiver manager on how the depositors will be paid as the bank is revived and returned back to the owners. Here the owners are expected to inject in new capital to boost the failed bank but this rarely happens. If a bank goes through a successful receivership, the entity in not returned back to the old management but it's taken over by the bank major depositors. This is done because it is believed that being the bank owners they will be more devoted to the success of the entity than any other persons.

However this is not always the case, as there is of conflict of interest. Since the owners of the banks are the major depositors their interests at such times are on how they can recover their money not to add more to a failing bank. Thus they will not be interested on the banks survival but on how fast they can get back their deposits in full. Trust bank is a good case example here, the bank went through a successful receivership and it was put back to profitability only to be liquidated later after 2 years in 2002. Those who took over the bank (the big Depositors) had no loyalty to the bank success and in the end they stripped off the bank.

Cost management is another major administrative strategy taken by the receiver manager in his/her effort to revive the entity. Common sense suggests that if a bank is under performing the best thing to do is to withdraw ones money and leave it. Thus immediately a depositor notices the symptoms of bank failure his/her first instincts are to withdraw all his money before he/she looses it. In order to prevent the bank from collapsing the first task a receiver manager does is to stop further withdrawal. This further frustrates the bank customers who wait for any opportunity to get back their deposits. Therefore by the time the receiver is taking over the banks image has already deteriorated making recovery very difficult.

These findings are further supported by the answers in question 12 directed to liquidators and 2 directed to central bank whose findings are summarized in table 2 below.

Table 2: Summary on the most effective remedy to avert bank failures

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Remedy	Frequency	Percentage %
Receivership	0	0
Merger	"1	13
Change of management	1	13
Closing them	6	74
Total	8	100

As shown in table 2 above, all the respondents felt that administrative receivership is not a remedy to bank failure. 13% felt that merger and change of management is a better solution than receivership. However 74% of the respondents felt that the best remedy to company that is under performing is to close them. In summary, the respondents own opinion was that banks should be liquidated immediately a downturn is spotted rather than placing them under statutory management.

4.3 Factors attributable to the Failure of Administrative Receivership in Kenya

In an attempt to attain this research objective, the effectiveness of the insolvency practitioners and the Central Bank as the regulator and supervisor of Kenya's financial sector were analyzed. It was important to analyses the effectiveness of the insolvency practitioners in older to identify if administrative receivership has failed to restore ailing institutions back to profitability because of incompetence and inexperience of the insolvency practitioners, as well as the bodies regulating them. The general causes of bank failure in Kenya were also analyzed in order to help deduce the general causes of administrative receivership failure.

4.3.1 General information on the effectiveness of the Insolvency Practitioners

Table 3-5 shown below give a summary of the responses on the questionnaire about the general information on the effectiveness of the banks insolvency practitioners.

Table 3: Summary on the period the bank's liquidating officers have been practicing

No. Of practicing years	Frequency	Percentage %
Less than 1 year	0	0 •
1-3	0	0
3-5	4	67
Over 5	2	33
Total	6	100

Table 4

Summary on the working experience of the liquidating officers interviewed

Level of experience	**No. of liquidators**	**Percentage %**
Never appointed as a liquidator outside the banking sector	2	33
Appointed as a liquidator of different companies	4	67
Total	6	100

Table 5

Summary on the effectiveness of the liquidator's regulatory body

Is Liquidators' regulating body effective?	**Frequency**	**Percentage %**
Effective: **yes**	6	100
Not effective: **no**	0	0
Total	6	100

Table 3 above shows that none of the banks liquidating officers has worked for less than 3 years while table 4 shows that 67% of the practitioners interviewed have been appointed as liquidators of other companies outside the banking sector. All the respondents indicated that the liquidator's regulatory body is effective. This is an indication that the respondents are well informed about the bank problems and the process of administrative receivership both in the financial sector and outside. Therefore their failure to turn around the institutions could not be attributed to incompetence and inexperience.

4.3.2 Effectiveness of the Central Bank as the Regulator and Supervisor of Kenya's Financial Sector

The Central Bank considers both financial and non-financial performance measurement to determine the performance of the financial institutions under its control. This has been established from the questionnaires responses to questions 4,6,7,8 and also available at the banks supervisory report (BSR) 2002 as shown in table 6 below.

Table 6

A summary on the banks performance using CAMEL rating for year 2004-5

Cash and liquidity ratios*(%)

	Apr	May	Jun	Sept	Oct	Nov	Dec	Jan	Feb	Mar	Apr
Commercial Banks	]										
Average liquidity	47.3	49.5	46.4	46.0	45.8	44.6	42.4	42.0	42.6	43.2	
Minimum liquidity	20.0	20.0	20.0	**20.0**	**20.0**	20.0	20.0	20.0	20.0	20.0	6.2
Cash ratio -all banks	8.6	7.4	7.1	6.5	6.9	6.6	6.4	6.5	6.4	6.3	6.0
Minimum cash ratio**	6.0	**6.0**	**6.0**	6.0	6.0	6.0	6.0	6.0	6.0	6.0	
NBFIs	59.0	61.2	60.3	56.0	37.2***	38.2	36.3	35.0	34.7	34.7	
Average Liquidity	20.0	**20.0**	**20.0**	20.0	20.0	20.0	20.0	20.0	20.0	20.0	
Minimum liquidity	6.0	6.0	6.0	6.0	6.0	6.0	6.0	6.0	6.0	6.0	6.0
Cash ratio	6.0	**6.0**	**6.0**	60.	6.0	6.0	6.0	6.0	6.0	6.0	6.0

Minimum cash Ratio*'

* Monthly average liquidity and cash ratios

** Commercial banks and NBFIs must observe a daily minimum of 6% cash ratio
The requirement became effective from 1st July 2003

*** Ratio include NBfs and Mortgage companies

The Commercial banks and NBFIs met the daily 6% cash ratio requirements in April 2005. Commercial banks maintained 6.23% of their deposit liabilities at the Central Bank. In addition, commercial banks maintained an average of Ksh 1.0 billion as excess reserves at the Central Bank compared with Ksh 1.2 billion in March 2005.

The data collected indicated that CAMEL (Capital adequacy, Asset quality, Management efficiency, Earnings and Liquidity ratios) rating and risk management are used to determine the performance of the banks. Risk management is the Value at Risk (VaR) of a business, which is a measure of how much money the business might loose over a period of time in the future. The data indicated that VaR is widely adopted as the primary quantitative measure of risk within banks and other financial service organizations (Economic Review 2005). As at December 2005, risk management was made mandatory and all the banks are expected to file their returns on risk management with central bank (BSR 2002). Further, from the questionnaire as the response in question 8 indicated the banks regulating body meets the international standards.

However the data collected from the central bank indicated that cash and liquidity ratios are the most used measures of performance in the financial sector while other measures are ignored. Financial ratios are subject to the limitations of accounting data, which is subject to manipulations and window dressing especially when a corporation is in financial distress. Where this actually happens, it is then an indication that matters will deteriorate until it is not possible for the management to cover up. Therefore there will be pressure from all sides to take action which most likely is to appoint a receiver manager who is appointed when it's too late to help revere the situation.

4.4 General Causes of Bank Failures in Kenya

There are many causes of bank failures as cited by varies authorities such as, Chesang 2003, Wetzel 2003, Cheserem 1999, and Lingard 1989. This section sought to establish the specific factors that contribute to failure of banks in Kenya including; management incompetence, undercapitalization, political interference, over borrowing, poor financial management, poor investment decisions, fraud, excessive competition, poor economic growth, high interest rates, liquidity problems, exchange rate fluctuations, high rate of non-performing loans, loose monetary policies taken by management, and high external risk. The effects of these factors are as summarized in table 7, 8 and 9 below. This was necessary to help achieve the researcher's second objective.

Table 7: Summary on the factors that could be attributed to banks failure in Kenya as was stated by the bank liquidators

Causes of failure	Weight attributed to each factor										
	Highest(5)								Least(l)		
	5		4		3		2		1		Total	
	Freq.	%	Freq.	%	Freq.	%	Freq.	%	Freq.	%	Freq.	%
Management incompetence	0		0		3	50	3	50	0		6	100
Under capitalization	0		0		1	17	4	66	1	17	6	100
Political interference	4	67	2	33	0	-	0		0		6	100
Over borrowing	6	100	0		0	-	0		0		6	100
Poor financial management	6	100	0		0	-	0		0		6	100
Poor investment decision	4	67	2	33	0	-	0		0		6	100
Fraud	0		0		6	100	0		0		6	100
Excessive growth	0		0		1	17	1	17	4	66	6	100
Others: High interest rate	6	100	0		0	-	0	-	0		6	100

Table 7 Indicates that 50% of the liquidators give management incompetence and inexperience the weight of 3 while the other 50% give it the weight of 2 in a scale of 1 (least) to 5 (highest). Regarding under-capitalization 17% rated it lowest (1), another 17% give it the weight of 3 while 66% give it the weight of 2.

Political interference was highly rated with 67% giving it the weight of 5 and 33% giving it 4 while none considered it as a least important factor. All the liquidators rated over borrowing and poor financial management highest giving it the weight of 5. Poor investment decisions were given the weight of 5 by 67% of the liquidators and 4 by 33% while none give it to the weight of 3, 2 or 1 which are considered least important. Fraud was rated 3 by all the liquidators.

Most of the liquidators felt that poor economic growth in the country is a least important factor with 66% giving it the weight of 1, 17% the weight of 2 and the rest 17% the weight of 3. One Liquidator felt that high interest rate is also a major cause of bank failures in Kenya giving it the weight of 5.

Table 8: Summary of the different causes of bank failures in Kenya as was reported by bank supervisory officers

Cause of failure	**Extent of weight given** (**5Strong** … **1 weak**)											
	5		4		3		2		1		Total	
	Freq	%	Freq	%	Freq	%	Freq	%	Freq	%	Freq	%
Liquidity	2	100	0		0		0		0		2	100
Mismanagement	0		1	50	1	50	0		0		2	100
Interest rate fluctuation	0		1	50	1	50	0		0		2	100
Exchange rate fluctuation	0		1	50	1	50	0		0		2	100
Fraud	1	50	1	50	0		0		0		2	100
Non-performing loans	2	100	0		0		0		0		2	100
Loose monetary policies	2	100	0		0		0		0		2	100
Political interference	2	100	0		0		0		0		2	100
External risk	0		0		0		0		2	100	2	100

As shown in table 8 above the two supervisory officers interviewed rated liquidity, fraud, non-performing loans, loose monetary policies, and political interference highest. This is in line with the response received from the liquidators. However mismanagement, interest rate fluctuation and exchange rate fluctuations were rated moderate while external risk was given the lowest rate. Likewise the central bank monthly Economic Review and Statistical Bulletins data shows that liquidity, non-performing loans, and loose monetary policies are the major causes of bank failure in Kenya.

Other causes of failure as were reported in the two documents includes; defaults risk, market risk, liquidity risk, political risk, violation of the banking Act, and poor lending practices. Systematic risk, which means that one banks failure leads to another, was not considered as a major cause of failure in Kenyan banks. External risks were also attributed to cause the failure of the Meridian Bank where the collapse of the parent bank led to the collapse of its branch in Kenya.

Table 9 below gives a summary of all the data collected from the liquidators and bank supervisors as well as information available at the central bank monthly Economic Review and Statistical Bulletins. The table shows how each factor was considered to contribute highly or least to bank failures in Kenya.

Table 9: Summary of all the Bank Failure Factors

Causes of failure as mentioned by various authorities.	**Very Important**	**Least Important**
Mgt incompetence & Inexperience		
Under capitalization		•
Political interference	y	
Over borrowing	V	
Poor management		
Fraud	y	
Excessive competition		•
Poor economic growth		•/
High interest rate fluctuations	V	
Liquidity	y	
Exchange rate Fluctuations		
Non- performing loans	Y	
Loose monetary policies	•/	
External risk		s

In summary as shown in table 9 above, the data collected reviled that; political interference, over borrowing, poor financial management, fraud, high interest rate, liquidity, non-performing loans, and loose monetary policies are the major causes of bank failure in Kenya. Looking at those factors it is possible to deduce why the administrative receiver rarely succeeds in reviving an ailing business entity.

Considering political interference history has taught us that a bank must fail just before or after a general election. This indicates that some banks are politically formed in order to fund the campaigns and if not so, there is a powerful political interference that destabilizes the financial sector. Thus appointing an administrative receiver in such a case may be of no practical use.

Over borrowing, poor financial management that leads to non-performing loans, and loose monetary policies are all factors that weakens a bank. These factors can be prevented if management changes are made and prevention measures taken in time before the assets have already deteriorated making recovery seem difficult. However data has shown that none of these cases were revived despite the change of management through the receiver manager. This is attributed to the appointment of the receiver manager when it is too late for him/her to take any appropriate action.

Considering fraud and liquidity problems, the receiver equally comes in when the effect is too strong and the depositors who are the bank customers have started to see the symptoms of failure. This affects the depositor's confidence on such a bank. When the depositor's confidence is eroded even if the receiver manager brings in new administrative measures with all the necessary assistance he/she may never succeed. However if he/she does manage to turnaround the company, its survival potential in the future is very blank. This is because once depositors have lost confidence in a bank it is very hard if not impossible for the institution to build back its image or attract new customers.

CHAPTER FIVE

5.0 CONCLUSION AND RECOMMENDATIONS

5.1 Conclusion

Administrative receivership has been prevalent in Kenya as a strategic tool for financially distressed companies. Ailing financial institutions are placed under CBK statutory management in the hope to restore them back to profitability and facilitate total debt recovery. However this has not happened and almost all those cases result into liquidation. The researcher looked at the administrative measures put in place by the receiver managers in their effort to turn around ailing financial institutions and the reasons why those measures hardly succeed.

From the findings of the study, the main administrative measure put in by the receiver manager to revive an ailing bank is the scheme of arrangement, where the shareholders are expected to inject in more capital in the business, which they rarely do. Receivers are also not so pilloried in Kenya and the process of administrative receivership is perceived to be an expensive event that destroys a business. With such a perception the administrative receivers rarely get support from the company stakeholders, which is very crucial for the success of their efforts. Thus, however good the administrative measures implemented by the receiver managers, success hardly come. And if they succeed the revived bank is taken over by the big depositors who in most cases are not interested with the success of the institution but recovery of their deposits. This Conflict of interest further frustrates the administrative receiver's effort to save the institution.

Other factor that makes administrative receivership fail to turnaround under performing banks in Kenya was lose of a bank's image when under statutory management. This erodes depositor's confidence and the institution is unlikely to get new business as image building becomes difficult. We can as well generalize these findings to other sectors where sales are frequently lost because of both unfair or impaired service and loss of trust for any company managed by receivers.

Since administrative receivership is always associated with failure and poor management an ailing company will appoint a receiver manager when the company registers consistent losses in business and the its assets have deteriorated. That is receivers are appointed when it is too late to turn around the institutions. Like wise some company failure causes such as political interference, are beyond the powers and capabilities of the receiver managers. From the analysis of the research finding it may therefore be appropriate to conclude that under performing financial institutions should be liquidated immediately a downturn is noticed rather than placing them under statutory management.

5.2 Limitations of the Study

The study was limited to the following consideration:

1. The research relied mainly on data collected from the central bank officers and documents. Since this data come from the top management it may have been manipulated to give a desired picture. Further more due to time constraint all the company stakeholders opinion on administrative receivership was not sought.. Thus a comprehensive study was not done which could have been more desirable or could have produced different results.

2. The study was focused on the financial sector only. Hence generalization of the finding to other areas in the economy may not be very appropriate since most of the failure factors affecting the financial sector may not affect other economic sectors.

5.3 Suggestions for further Research

This research focused on the factors that contributed to the failure of administrative receivership in the financial sector only. It is recommended that a similar study be carried out in a different sector to compare the findings.

Research could also be conducted to determine the survival potential of companies placed under administrative receivership. This could be a research to the right direction before making a conclusion on whether administrative receivership has any potential to turn around a failed company.

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APPENDIX 1

Commercial banks and NBFIs that has being placed under statutory management and later liquidated between 1993-2003 (source central bank).

Name of Institution	Year of Liquidation	Liquidating Agent
1. Post bank credit Ltd.	1993	A. W. Muoki
2. Inter-Africa C. & Finance Ltd.	1993	C. K. Nduru
3. International Fin. Ltd.	1993	C. K. Nduru
4. Central Fin. Ltd.	1993	C. K. Nduru
5. Trade Bank Ltd.	1993	E. O. Okoth
6. Trade finance Ltd.	1993	E. O. Okoth
7. Diner Finance Ltd.	1993	E. O. Okoth
8. Nairobi finance Ltd.	1993	C. K. Nduru
9. Middle Africa Fin. Ltd.	1993	C. K. Nduru
10. Allied Credit Ltd.	1993	C. K. Nduru
11. Pan African Bank Ltd.	1994	R. A. Detho
12. Pan-African C. & Finance Ltd	1994	R. A. Detho
13. Thabiti Finance Ltd	1994	S. C. Ngeny
14. Meridian Biao Bank Ltd	1996	A. W. Muoki
15. Heritage Bank Ltd	1996	E. O. Okoth
16. Kenya Finance Bank Ltd	1996	
17. Ari bank Corporation Ltd.	1997	E. O. Okoth
18. Prudential Bank Ltd.	2000	D. L. Ngatuny
19. Reliance Bank Ltd.	2000	J.K. Kagura
20. Fortune Fin. Ltd.	2000	D. L. Ngatuny
21. Biashara Bank		
22. Bulleting Bank Ltd		
23. Delphis Bank Ltd.		
24. Daima Bank Ltd.	2003	
25. Universal Bank Ltd.		
26. Trust Bank Ltd.	2003	
27. Euro Bank Ltd	2003	

APPENDIX 2

Research questionnaires

To determine the factors that have attributed to the failure of administrative receivership in Kenya: The case of Commercial Banks and NBFIs in Kenya.

A questionnaire directed to Liquidators

1. How many years have you been practicing as a liquidating agent or insolvency practitioner

   Less than one year ( )
   Between 1 and 3 years ( )
   3 to 5 years ( )
   More than 5 years ( )

2. Have you ever been appointed as a liquidator of other companies other than banks?

   Yes ( )
   No ( )

3. Is the regulating body of practicing liquidating agents effective?

   Yes ( )
   No ( )

4. In your opinion of the banks that have failed what size were they?

   Small ( )
   Medium ( )
   Big ( )

5. The following has been identified as the general causes of banks failure. In order of importance, kindly indicate on a scale of 1 (lowest) to 10 (highest), the extent to which you think each factor has attributed to the collapse of Kenyan bank.

Factors of failure	Kindly tick the weight you attribute to each factor *5 (highest')* *1 (lowest)*				
	5	**4**	**3**	**2**	**1**
Management incompetence and inexperience					
Under capitalization					
Political interference and corruption					
Over borrowing					
Poor financial management					
Poor investment decisions					
Fraud					
Excessive competition					
Poor economic growth in the country					
Others Specify					

6. Do you think the CBK should place under performing financial institutions under statutory management or should call in a liquidating agent immediately the downturn is spotted?

- Call in a liquidating agent immediately ( )
- Place them under statutory management ( )

7. Do you think placing under performing commercial banks and NBFIs under CBK statutory management could reverse their status?

Yes	( )
No	( )

Give reasons if your answer (above) is **No**

i.

ii.

8. If your answer in 8 above is yes at what stage do you think the receiver should be appointed?

( ) Immediately a down turn in the company's performance is noticed.

( )When the management have tried all other rescue mechanism and failed

( ) Any time before the company collapses.

9. When liquidating the failed cases, are the interests of the unsecured creditors taken into consideration?

Yes	( )
No	( )

If yes how?

i.

ii.

10. Which among the two factors do you consider to cause a considerable challenge to the modern receiver in his duties?

( ) satisfying the claim of the debenture holder out of the security given by the debtor company

( ) Trying to preserve at least part of the business as a going concern.

11. Do you think the statutory managers/agents know the company problems well?

Yes ( )

No ( )

12. In your opinion which among the following is the most effective remedy to avert company failure?

Placing them under statutory management ( )

Margining under performing companies ( )

Changing the management the team ( )

Closing them ( )

13. Most of the factors listed below have been attributed to be the causes of administrative receivership failure in Kenya. Kindly indicate the extent to which you agree with this statement. (Tick where appropriate).

Causes of failure	**Never**	**Rarely**	**sometimes**	**Always**
Receivers are appointed when its too late				
Disregard of the old management opinions				
Political interference and corruption				
Direct and indirect costs associated with receivership				
Most administrative receivers appointed presents precipitate behaviour on the part of lenders causing companies to fail unnecessarily				
Most receivers objective is to secure payments for the one debenture holder who appoints him/her				
Unfair and inequitable re-organization plans Most insolvency practitioners are not well vested with the company's problems				
The company were destined to fail and nothing could change it				
Others Specify				