AN EVALUATION OF BANK RESTRUCTURING APPROACHES ADOPTED BY THE THREE LEADING COMMERCIAL BANKS IN KENYA.

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An Independent Study Paper submitted in partial fulfillment for the Degree of Doctor of Philosophy in Finance in the University of Nairobi

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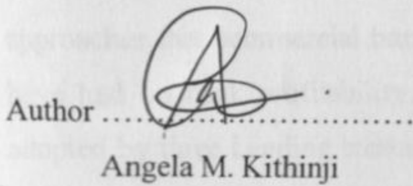
DECLARATION

This Independent Study Paper is my original work and has not been presented for a degree in any other University



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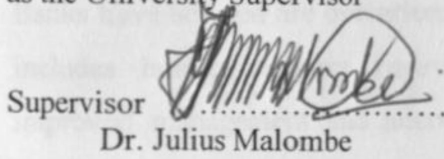

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ABSTRACT

Bank restructuring is an important aspect in minimizing bank failures and in improving the financial performance of banking institutions in both developed and developing countries. Bank restructuring is usually necessitated by bank failures where it serves as a medication for restoring financial health to individual banks and financial systems. Banks also restructure to avoid anticipated negative impact on performance of the banks either as a result of the changes in the broad macro-economic environment or changes in the business environment.

This study reviews literature on bank restructuring, and examines the related approaches that commercial banks in Kenya have adopted and the implications these have had on bank profitability. In this respect, the bank restructuring approaches adopted by three Leading banks that is, the Standard Chartered Bank, Barclays Bank and Kenya Commercial Bank have been analysed. The three banks control over 50 per cent of the total assets of commercial banks in Kenya.

The analysis shows that the main bank restructuring approaches that the three Kenyan Banks have adopted are operational restructuring and asset restructuring. The former includes human resource restructuring, rationalization of the branch network, improved management and accounting and better credit assessment and approval techniques, whereas the latter entails liquid asset expansion and minimization of non-performing loans.

Although the profitability for the study banks generally improved following the implementation of the restructuring measures, no clear correlation was established between bank restructuring approaches and bank profitability since other factors other than bank restructuring also played a role in influencing profitability. These include lucrative interest income from Treasury Bill investments occasioned by the need to finance government deficits and the reduction of cash and liquidity ratio requirements by the Central Bank.

DEDICATION

To my children; Edwin, Daisy and Cindel for their patience and my husband Gervasio for his unconditional understanding and encouragement.

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TABLE OF CONTENTS

DECLARATION.. ii
ABSTRACT iii
DEDICATION.. iv
ACKNOWLEDGEMENT.. v
TABLE OF CONTENTS.. vi
LIST OF TABLES.. viii
ACRYNOMS ix

CHAPTER ONE: INTRODUCTION.................................. 1

1.1 Background.. 1
1.2 Rationale for Bank Restructuring 3
1.3 Statement of the Problem........................ 5
1.4 Research Objectives.............................. 5
1.5 Organization of the Report...................... 5

CHAPTER TWO: GENERAL LITERATURE ON BANK RESTRUCTURING APPROACHES 7

2.1 Bank Failures... 7
2.2 Financial System and Financial Sector Reforms 8
2.3 Bank Restructuring 9
2.4 Country Classification for Bank Restructuring 13
2.5 Bank Restructuring Approaches 15

CHAPTER THREE: EMPIRICAL LITERATURE ON BANK RESTRUCTURING APPROACHES 26

3.1 Studies on Bank Restructuring Approaches... 26
3.2 Studies Focusing on Bank Restructuring and Profitability 28

CHAPTER FOUR: RESEARCH METHODOLOGY 32

4.1 Population.. 32
4.2 Sampling Plan 32
4.3 Data Collection 32
4.4 Data Analysis 33

CHAPTER FIVE: BANK RESTRUCTURING APPROACHES ADOPTED BY THE THREE LEADING COMMERCIAL BANKS IN KENYA AND BANKS' PROFITABILITY................. 35

5.1 Restructuring Approaches Adopted by the Three Leading Kenyan Banks.................. 35

5.1.1 Operational Restructuring…………… 35
5.1.2 Asset Restructuring…………………… 40
5.1.3 Human Resource Restructuring…….. 42
5.1.4 Change in Management…………….. 44

5.2 Implications of Bank Restructuring Approaches on Profitability of the Three Leading Kenyan Banks…………………….. 45

5.2.1 Profitability of Commercial Banks in Kenya……………………………… 45
5.2.2 Standard Chartered Bank…………… 46
5.2.3 Barclays Bank……………………….. 47
5.2.4 Kenya Commercial Bank…………… 48
5.2.5 Comparative Analysis of Profitability of the Three Leading Commercial Banks in Kenya……………………. 49

CHAPTER SIX: SUMMARY OF FINDINGS AND CONCLUSIONS, RECOMMENDATIONS, LIMITATIONS OF THE STUDY AND SUGGESTIONS FOR FURTHER RESEARCH 51

6.1 Summary of Findings and Conclusions.. 51
6.2 Recommendations……………….. 53
6.3 Limitations of the Study………………. 53
6.4 Suggestions for Further Research…….. 54

REFERENCES…………………………………………………… 56

Appendix I Bank Restructuring Experiences in Selected Countries …………………………………….. 60
Appendix II Commercial Banks in Peer Group 1 Category.. 64
Appendix III Profitability of Standard Chartered Bank ……. 65
Appendix IV Profitability of Barclays Bank ……………….. 66
Appendix V Profitability of Kenya Commercial Bank ……. 67
Appendix VI(a) StanChart, BBK and KCB Profitability(ROE) 68
Appendix VI(b) StanChart, BBK and KCB Profitability (ROTA) 69
Appendix VI(c) StanChart, BBK and KCB Profitability (ECR) 70
Appendix VII Standard Chartered Bank Data ………………. 71
Appendix VIII Barclays Bank Data ………………………….. 72
Appendix IX Kenya Commercial Bank Data ………………. 73
Appendix X StanChart, BBK and KCB (ROE, ROTA and ECR) …………………………………….. 74

LIST OF TABLES

Table 5.1 Branch Related Operational Restructuring Undertaken by Stanchart, BBK and KCB for the Period 1990-2001.......... 36

Table 5.2 Other Select Operational Restructuring Undertaken by Stanchart, BBK and KCB for the period 1990 - 2001.... 38

Table 5.3 Asset Restructuring Undertaken by Stanchart, BBK and KCB for the Period 1990-2001........................40

Table 5.4 Human Resource Restructuring Undertaken by Stanchart, BBK and KCB for the Period 1990-2001...43

ACRYNOMS

ABC's	-	Automated Banking Centers
A/R	-	Asset Restructuring
ATMs	-	Automated Teller Machines
BARS	-	Barclays Advisory and Registrar Services
BBK	-	Barclays Bank of Kenya
BFS	-	Business Financial Services Limited
BSA	-	Bank Support Authority
CBK	-	Central Bank of Kenya
DPF	-	Deposit Plus Facility
E.A.	-	East Africa
E/C	-	Express Counters
ECR	-	Equity Capital Ratio
EDI	-	Economic Development Institute
FGD	-	Deposit Guarantee Fund
GDP	-	Gross Domestic Product
H/RR	-	Human Resource Restructuring
H/O	-	Head Office
IMF	-	International Monetary Fund
IT	-	Information Technology
KCB	-	Kenya Commercial Bank
KCB(T)	-	Kenya Commercial Bank (Tanzania)
KCP	-	Kenya Capital Partners
KYTEC	-	Kenya Youth and Employment Creation
MBA	-	Masters of Business Administration
MICK	-	Magnetic Ink Character Recognition
NGOs	-	Non-Governmental Organizations
NIC	-	National Industrial Credit
NIM	-	Net Interest Margin
O/R	-	Operational Restructuring
POS	-	Point of Sale Terminals
ROE	-	Return on Equity
ROTA	-	Return on Total Assets

ACRYNOMS CONTD ....

SMEs	-	Small and Micro-Enterprises
StanChart	-	Standard Chartered Bank
TBF	-	Too Big To Fail
TQM	-	Total Quality Management
U.K.	-	United Kingdom
U.S.	-	United States of America
VER	-	Voluntary Early Retirement

CHAPTER ONE
INTRODUCTION

1.1 Background

Bank restructuring refers to the treatment banks or banking systems through liquidation of deeply insolvent mergers and privatization of publicly owned banks are included as an aspect of rehabilitation (De Juan, 1991:43). Bank restructuring is an aspect of good governance because bank failure is mainly about the failure of a key human institution money and banking, and about the restoration and maintenance of faith and confidence in government. Rose (1994:3) on the other hand states that restructuring usually means improving supervision and prudential regulation in order to add to the banking system's capacity for intermediation.

A number of authors have identified several approaches to restructuring of commercial banks. In particular, Rose (1994:10) and Dziobek and Pazarbasioglu (1998:2) identify four main types of bank restructuring approaches. *Financial restructuring* which attempts to restore solvency by improving banks balance sheets, *operational restructuring* which includes renewed attention to business strategy, improved management and accounting system and better credit assessment and approval techniques. The authors observe that eliminating branches and staff may cut operating costs. *Asset Restructuring* involves relieving corporate stress in banking by way of liquid asset expansion and strengthening of the performance of customer loans. *Capital restructuring* involves relieving stress in banking by way of debt substitution with short-term debt and junior long-term debt replacing some longer-term senior obligations (Rose, 1994:8). Sheng (1990:18) observe that capital restructuring to replace longer-term, senior debt commitments with shorter-term and junior debt obligations and the rewriting of restrictive nominal revenue or expense contracts usually accompanies the asset restructuring process.

Restructuring of banks usually means improving supervision and prudential regulation in order to add to the banking system's capacity for intermediation (Rose, 1994:3). This may also include providing deposit insurance and lender of last resort. Bank restructuring is not however preceded by failure but banks also restructure as part of management plan, the main objective here being cost cutting. Whereas a banking crisis is an event, bank restructuring is a process. Sheng (1990:326) identifies

four main steps; sometimes sequential, sometimes parallel that are followed in bank restructuring process. These include; diagnosis, damage control, loss allocation and restoration of the right incentive structure.
In attempting to identify a solution for bank restructuring, re-nationalization, carve-outs, mergers, resolution trusts, lifeboats, and wait and see have been tried; some of which worked while others failed (Sheng, 1996:342).

Bank restructuring does not have fixed rules and the right formula to adopt may depend on the circumstances prevailing in each particular country and historical situation (De Juan, 1991:51; Callier, 1991:6; Sheng, 1996:330; Bonish and Montes-Negret, 1998:89 Caprio (Jr) et. al., 1998). This raises the question of how nations should develop their institutional arrangements so that they have alternative ways to effectively respond to financial instability. The importance of the banking system for the economy and the extent and depth of insolvency, the maturity of the society and the political system, ownership of the banking system, the ownership and management alternatives in each country, and especially the political will to address the problem are some of the determinants of the right formula of restructuring. Some of the important issues to consider in bank restructuring include: diagnostics, rule reform, identifying who should bear the loss, identifying restructuring options, identifying restructuring approaches, restructuring borrowers, restructuring macroeconomic policies, and counting the costs (Sheng, 1990:228; Popiel, 1990:68).

Approaches to bank restructuring may vary according to the economic conditions of the country and resources available for restructuring. De-Luma Martinez (2000:12), De-Juan (1991:46) and Sheng (1990:238) identify the main approaches for bank restructuring as: market-based solutions, carving out bad assets, deposit insurance, changing the guard, creating phoenixes, changing macroeconomic policies, counting the monetary and fiscal costs, restructuring borrowers, recapitalization, rehabilitation, closing down insolvent banks according to bankruptcy act and liquidating the assets, intervention and interim management, new ownership and changing the institutional arrangements.

1.2 Rationale for Bank Restructuring

Bank restructuring may be necessitated by bank failures although sometimes banks may also restructure to avoid anticipated negative impact on performance of the banks either as a result of the changes in the broad macro-economic environment or changes in business environment. A rapidly growing literature on the financing of distressed companies finds that troubled firms often secure relief from stress through asset restructuring, capital restructuring or both (Rose, 1994:2;Dziobek and Pazarbasioglu, 1998:3; Moskow, 1998:16).

Bank failures are prevalent in many economies, irrespective of the economies' stage of economic development. In Kenya in particular, banking crises were experienced in the mid- 1980's, the early 1990's and the late 1990's. Following these crises, quite a number of banks failed while others were troubled and were placed under statutory management. The federal legislation (Financial Institutions Reform, Recovery and enforcement Act) mandates pro-active government involvement in stressed bank situations, including seizure of banks whose tangible capital to total assets ratio falls below 2 percent. These laws provide for civil penalties, grant regulatory agencies cease and desist powers, and mandate certain managerial decisions, such as prohibitions of mergers and restrictions against the payment of shareholder dividends, for banks experiencing corporate stress (Rose, 1994:3).

Guiding principles of restructuring banks must always be considered in the light of specific circumstances since individual country situations will always differ. A clear understanding of what has worked or failed in the past is important in guiding countries that are formulating their own plans for reforms. Research conducted in a number of countries indicates that countries that effectively diagnosed the nature and extent of the banking problems, identified the underlying causes and designed a restructuring strategy to address them all systematically are the ones that made substantial progress (Dziobek and Pazarbasioglu, 1998:4).

From the richest countries - Japan, the Scandinavian countries, the United States - to the poorest in Sub-Saharan Africa, from the fastest growing countries in East Asia to the new transition economies, few countries have been spared some form of banking crisis. Sheng (1990:225), Callier (1991:2), Roe et. al. (1990:7), Rose (1994:2) and

Sheng (1996:325) observe that microeconomic as well as macroeconomic factors are the main causes of bank failures.

As banking crises are clearly an important public policy issue, how to prevent them, or at least minimize their cost is an important concern of officials, advisers, academicians, and indeed, all those concerned with economic welfare. The issue of moral hazard is at the root of many of the recent financial crises in East Asia, as banks avoid due diligence in the belief that governments will cover their mistakes. Foreign lenders compound this problem by substituting implicit sovereign guarantees for their own financial due diligence and failing to discriminate among borrowers. Supervisory failures compound failures of corporate governance and systematically weak segments of the financial sector - ranging from short-term finance companies in Thailand to merchant banks in the Republic of Korea - precipitate systematically bank failures. Introduction of financial liberalization in many economies tend to be unaccompanied by proper supervision and regulation (Caprio et. al., 1998:328; Borish et.al., 1995:18; Cull, 2001:22).

John and John (1992:11) and Rose (1994:2) observe that corporate financial stress typically arises from lack of synchronization between a firm's current holdings of liquid assets and its "hard" contracts that demand inflexible performance from the distressed firm - a situation that may be remedied by asset restructuring, capital restructuring or through the restructuring of nominal contracts affecting revenue flows or expenses via private negotiation or through the bankruptcy courts.

The last two decades or so has witnessed bank insolvencies in nearly one hundred countries, the cost of bailout of which has been greater than 15% of Gross Domestic Product (GDP). These crises often recur, a reflection of fundamental weaknesses in the financial sectors of many countries. Empirical evidence reveals that troubled banking corporations display evidence of both financial and operating problems simultaneously, so that financial distress appears to be linked to operating stress in the majority of instances observed. Operating problems tend to be of longer duration than corporate financial problems, suggesting that either financial distress tends to be easier to address or is subject to more rapid resolution than are corporate operating problems (Rose, 1994:10; World Bank, 1997:2; Dziobek and Pazarbasiglu, 1998:3).

El-Nil (1990:67), Popiel (1990:205), Callier (1991:5), Bery and Garcia (1996:45) and Demirguc-Kunt and Detragiache (1997:10) observe that the correction of financial distress when it is present is a first and vital prerequisite for financial reform.

1.3 Statement of the Problem

Experience in Kenya is that some banks have been proactive and undertaken restructuring of their institutions to avoid potential failure whilst others have procrastinated and forced to restructure following failure. Bank restructuring does not have fixed rules and the right formula to adopt may depend on the circumstances prevailing in each particular country and historical situation. Moreover, different restructuring approaches can result to different levels of profitability.

This study reviews bank restructuring approaches undertaken by the three leading commercial banks in Kenya, viz, Standard Chartered Bank, Barclays Bank and Kenya Commercial Bank.

The questions to be addressed by this study are: What is the rationale behind bank restructuring? What restructuring approaches are available to commercial banks? What approaches have the three leading commercial banks in Kenya employed? Do the restructuring approaches adopted by commercial banks in Kenya have any implications on their profitability?

1.4 Objectives

(i) To review experience of bank restructuring approaches adopted in other countries.

(ii) To determine the bank restructuring approaches adopted by the three leading commercial banks in Kenya.

(iii) To investigate implications of bank restructuring approaches on bank profitability of the three leading commercial banks in Kenya.

1.5 Organization of the Report

The report is organized in six chapters. Chapter one is the introduction, which outlines the background to the study encompassing the rationale for bank restructuring. The

chapter also contains the statement of the problem, statement of objectives, the research questions and organization of the report.

Chapter two mainly addresses the general literature on bank restructuring and specifically looks at bank restructuring approaches, elaborates on bank failures, financial sector reforms modalities for bank restructuring, elements for bank restructuring, country classification for bank restructuring and summarises the bank restructuring approaches adopted by commercial banks in other countries. These are identified as; market-based solutions, carving out bad assets, establishing a bank hospital, changing the guard (management), creating phoenixes, changing macroeconomic policies, counting the monetary and fiscal costs, restructuring borrowers, recapitalization, changing ownership, interim actions, change in institutional arrangements, and operational reforms.

Chapter three focuses on the empirical literature on bank restructuring and categorises the aspects into two namely; the general bank restructuring approaches, and bank restructuring and profitability.

Chapter four summarizes the research methodology encompassing, the population of the study, the sampling design, data collection method and the data analysis.

Chapter five addresses the aspect of restructuring approaches adopted by the three leading Kenyan banks and the profitability of these banks, namely, Standard Chartered, Barclays Bank and the Kenya Commercial Bank. Chapter six presents the summary of findings and conclusions, limitations of the study, recommendations and suggestions for further research.

CHAPTER TWO

GENERAL LITERATURE ON BANK RESTRUCTURING APPROACHES

2.1 Bank Failures

A bank can be viewed as a financial institution that engages in intermediation through two basic sets of contracts: a civil contract between the depositor and the bank in which the bank borrows funds from the depositor and warrants to return the nominal value of the deposit plus interest at due date and another contract between the borrower and the bank on a loan in which bank restructuring is necessitated by contract failures (Callier, 1991:5).

De Juan (1991:46) identifies the main features of bank insolvency as negative net worth, non disclosure of certain material information, out of proportion operating costs, soar (before inflation rates) deposit rates, increased lending rates, deterioration of portfolio, and unsound corporate culture.

Two main causes of bank failures have been identified by Sheng, (1990:237), Callier (1991:13), Roe et.al (1990:13) and De Juan (1991:43). The first cause relates to microeconomic factors encompassing, weak bank management including lack of professional staff, poor reporting on income accrual and provisioning, inadequate internal controls, inadequate capital, and excessive political interference and inadequate bank supervision which includes over-reliance on external auditors, inadequate staffing and on-site surveillance capability, outdated laws and regulations, and inadequately punitive control powers. They identify the second cause as macroeconomic factors encompassing fiscal deficits and balance of payments problems, sudden changes in terms of trade, exchange rate, inflation rate and interest rate, and double digit changes in stock market prices, property prices, commodity prices and credit expansion.

Sheng (1990:227), De Juan, (1991:45), and Moskow (1998:16) argue that banks macroeconomic policies, where governments apply inflationary policies to finance fiscal deficits, impose excessively high statutory reserves on banks, maintain negative real interest rates and force banks to channel resources to inefficient projects, thus causing banks to fail.

Sheng (1990:230) advocates that civil and social contracts in general protect property rights through the warranty of solvency. On the part of the civil contract, the bank assures but
does not guarantee the depositor that so long as it is solvent, with strong capital adequacy, the nominal value of the banks deposits will be secure. The borrower on the other hand assures but does not guarantee the bank that he or she will repay his/her loans through either a personal pledge, or the specific charge against collateral assets. The social contract on the other hand is the contract between the state and the banks and between the depositors and borrowers. With the existence of a social contract, the citizens expect that the state will protect individual property rights by enforcing the civil contracts through regulatory agencies and an impartial judiciary system.

Property rights are not so well defined in many developing economies and little historical precedence exists to go by thus greater opportunities exist for cheating, shirking and opportunism, especially where enforcement of laws is lax and in instances where colonial contractual laws have been adapted, the social contracts are often an amalgam of western contractual or constitutional law, with customary and religious laws that can be contradictory to each other (Sheng, 1990:230; De Juan, 1991:46).

2.2 Financial System and Financial Sector Reforms

Financial systems are viewed as important in their own right for the mobilization of resources, for the efficient allocation of credit and for the pooling, pricing and trading of risk (Roe et.al, 1990:7; Hinds, 1990:79). Financial weakening of the financial sector tends to exacerbate the fundamental weaknesses of resource use in an economy associated with policies such as overvaluation and excessive industrial protection. Thus financial system characterized by broadly or even narrowly, based distress will not allocate credit resources efficiently (Callier, 1991:162).

According to Sheng (1996:332) and De Juan (1991:46), financial reform can be divided into two categories:

(i) Financial repair which is essentially the process of eliminating status of distress in the banks as well as their main causative factors.

(ii) Financial reform proper which is the process of changing institutions, adding new ones, eliminating distorting financial policies and practices, and generally establishing the basis for greater efficiency in both the mobilization and the allocation of scarce resources.

The correction of financial distress when it is present is a first and vital prerequisite for financial reform in the broader sense. There is little real prospect of moving toward a more market-based system of allocating resources through the financial system or to greater diversification of financial institutions and instruments while a major part of the established financial system is in distress (El-Nil, 1990:60; Popiel, 1990:205).

2.3 Bank Restructuring

Governments tend to engage in bank restructuring to ensure that financial distress does not generate massive misallocation of resources and to restore public confidence in banking and preserve therefore, the sanity of the social contract. If unchecked, financial distress can have implications for the economy (De Juan, 1991:65) which include; demonetization and capital flight, loan concentration and crowding out, high interest rates, disappearance of the sense of risk, fiscal and monetary distortions and conflict between insolvency and some macro policy.

In context of widespread insolvency, bank restructuring is a necessary medication to restore financial health to individual banks and financial systems. It is one of the foundations for deposit mobilization, effective allocation of resources and therefore sound economic growth and is also necessary to avoid the fiscal and monetary cost of permanent subsidization of ailing systems without the benefits of sound banking. Restructuring of insolvent banks is a must for the banking regulatory framework and supervisory system to be respected as a source of discipline and sound banking (Polizatto, 1990:174).

2.3.1 Modalities for Bank Restructuring

Bank restructuring does not have fixed rules and the right formula to adopt may depend on the circumstances prevailing in each particular country and historical situation (De Juan, 1991:62, Sheng, 1990:232). This raises the question of how nations should develop their institutional arrangements so that they have alternative ways to effectively respond to financial instability. The importance of banking system for the economy and the extent and depth of insolvency, the maturity of the society and the political system, ownership of the banking system (that is, state-owned or otherwise) the ownership and management alternatives in each country; and especially the political will to address the problem are some of the determinants of the right formula of restructuring.

Modalities of restructuring banks may thus vary. According to De Juan (1991:67), restructuring may be addressed: in a case-by-case as problems are unveiled, or across-the-board when insolvency is deep and generalized; may be run from the supervisory institution or specialized institution; financed by the government, by depositors and creditors, by the banking system or by a combination of the above; procedure may be addressed by deposit insurance or separately; and may be simultaneous with change of ownership and management by a specialized institution.

2.3.2 Elements of Bank Restructuring

According to Popiel (1990:5) and Sheng (1990:230), the elements of bank restructuring include; diagnostic, rules reform, who should bear the loss, restructuring options (which may include; regulatory forbearance, across the board solutions, rehabilitation, sale or merger or liquidation), restructuring mechanisms (which may involve market based solutions, carving out bad assets, bank hospitals, changing of the guard and phoenix from the ashes), restructuring macroeconomic policies, counting the costs (both monetary and fiscal) and restructuring borrowers.

2.3.2.1 Diagnostics

De Juan (1991:64) and Rose (1994:1) observe that there is a tendency of bankers to engage in cosmetic behaviour, every greening bad credits, assetizing losses, and hiding material risk and losses from the public and bank supervisors. Many governments have allowed banking laws to become outdated, neglected enforcement

of existing laws and regulations, or worse still, engage in perverse or financial repressive policies that use the banking system to finance large fiscal deficits. Bank failures have also been associated with large internal and external imbalances due to pursuit of inappropriate macroeconomic policies (Sundarajan's, 1988:2). In other instances, the bank failures have been the result of financial liberalization where liberalization was done without first putting in place appropriate regulatory and monitoring systems.

Hinds (1988:10), De Juan (1991:68) and Sheng (1996:15) note that when banking problems begin to surface, the supervisory authorities fear to face up to the issues because of the high budgetary costs involved, the sensitive political issues, and the bureaucratic wishful thinking that the problems would go away. At times the authorities even restrain from the reforms and even allow more and more ailing institutions to break the law, hoping that time and economic recovery will resolve the problems but these instead end up worsening the recovery process.

2.3.2.2 Rules Reform

These reforms should emphasize on the importance of prudential re-regulation, redrafting of banking laws, enforcement of powers, clearer bank entry requirements, regulations to prevent insider trading, connected lending, ownership concentration, and clearer bank exit rules (Polizatto, 1990:177). In many developing countries, banking laws and regulations were inherited from colonial regime and are long outdated to accommodate technological and other innovations in the banking sector. Government interference and existence of unionized employees who make it highly difficult to retrench staff to improve bank productivity are roadblocks to reforming the rules.

Rules reforms generally should entail improved competition and bank intermediation efficiency, preventing monopolistic or oligopolistic practices, defining more clearly the gains and losses of banking and providing a level playing field for banks, establishment of deposit insurance schemes to protect the small depositors and bank ownership dispersion rules to prevent concentration of ownership in single economic class (Sheng, 1988:11; Sheng 1990:232; De Juan, 1991:63). Actions to strengthen the legal framework the supervisory process, accounting and auditing, and the

institutions themselves should commence on parallel tracks (Polizatto, 1990:176). The regulators should however beware that the best bank laws and regulations are useless if they are not enforced.

2.3.2.3 Who Should Bear the Loss?

Whereas conventional thinking assumes that losses in banking should be borne in broad descending order by borrowers, shareholders, fellow bankers, other creditors/ employees in situation of liquidation, government and lastly the depositors then situation in developing countries has been quite different. In some cases, borrowers have been known to bribe bank management to lose security documents or delay enforcement by bribing court servers to lose their files (Sheng, 1996:325; Dziobek and Pazarbasioglu, 1998:7).

Callier (1991:6) observes that the bank losses in many developing countries do not necessarily occur because of poor credit evaluation, but because of borrowers' unwillingness to repay, reinforced by the delays in courts to enforce repayment and the use of political clout to pressure banks not to pursue repayment. Thus where governments do not enforce contracts, borrowers gain by cheating and shirking such contracts, passing on more losses to the banks.

Sheng (1996:320) argues that healthy banks at times are forced to absorb losses of failed banks by being forced to merge. Where banks are large employers, closure of banks, particularly government owned banks,, employees become a strong lobby against the closure of banks. Where retrenchment is inevitable, equitable retrenchment benefits are enormous which must be taken into account as part of the costs of restructuring. Where explicit deposit insurance schemes exist depositors are fairly protected from bank losses.

The public sector through the central bank may bear bank failure losses and a solvent central bank with net savings in foreign reserves should be able to finance the losses. However central bank with high interest-bearing liabilities and net foreign exchange liabilities do not have the capacity to absorb bank failure losses.

Experience suggests that where central banks do not have the capital and reserves to absorb bank failure losses, the treasury should absorb the losses. Sheng (1990:232) and Callier (1991:9) identify six options through which treasury can finance bank failure losses. They include; raising additional taxes, cutting expenditures, introducing domestic long-term borrowing, using inflation tax and selling its real or financial assets. The result of these options is to pass the burden of bank failure losses to either the taxpayer or the holder of public debt.

2.4 Country Classification for Bank Restructuring

According to Sheng (1990:237), bank restructuring can be broadly categorized into four major country groups:

(i) High-income countries with established banking systems. These include the United States, United Kingdom, Spain and Norway.

(ii) Low to medium-income countries with mixed developing banking systems and modest inflation levels, which include Kenya, Colombia, Philippines, Malaysia and Thailand.

(iii) Centrally planned economies with broadly nationalized banking systems in process of transition to market based economies, which include, Pakistan, Hungary, Poland and Leona.

(iv) High-inflation, high-debt economies and badly affected banking systems. These include; Argetina, Turkey, Chile and Yugoslavia.

The circumstances specific to each country will determine the options for use in restructuring distressed banks and countries may be divided into four groups in deciding the best option to adopt; developed countries, developing countries (with stable macroeconomic environment), centrally planned economies and highly indebted/high inflation countries.

2.4.1 Developed Countries

In these countries bank rescue schemes involve primarily liquidity support by either the Central Bank or a deposit protection scheme (funded by the government) but as most liquidity cases deteriorate into solvency problems, concrete restructuring techniques and mechanisms need to be developed. These countries tend to have; strong central banks and highly professional bank supervisors, a large pool of

professional bankers to help rehabilitate ailing banks, and a deep market for bank sales or mergers because of the existence of strong banks. These features are considered favorable for combating any banking crises (Polizatto, 1990:173).

2.4.2 Developing Countries With a Relatively Stable Macroeconomic Environment

In these countries, the central bank has been empowered to handle the banking crises when it emerges and in addition emergency legislation that allows the central bank to freeze assets of failing institutions, to allow time for investigation, and to apply to the high court for speedy decision of cases, such as important rulings on staff retrenchment, priority of claims and the principle of deposit – equity conversion is advocated.

2.4.3 Centrally Planned Economies Banking Systems

These economies tend to have nationalized banking systems and are normally faced with four main problems which include:

(i) Lack of banking professionals with good understanding of market based banking.

(ii) Lack of good pricing mechanism to determine asset valuation and quality.

(iii) Lack of experience in banks and that of bank supervisors in managing credit and other bank risks, which could cause some losses. Nationalized banking systems do not encourage competition and innovation thus all risks tend to be borne by the state. Incentives for professional bank managers may not be great in situations where key executives posts in the government – owned banks change with every new government, as has been the experience in many developing countries.

(iv) Difficulties exist in separation of ownership of banks from enterprise and the interconnection of loans to shareholder/enterprises. In order to develop independent and objective credit evaluation and supervision for the banks, this must be addressed.

Public owned banks management are fellow civil servants or political appointees with similar pay or equal rank to bank supervisors, rendering the supervisory mechanism less effective.

2.4.4 Highly Indebted/High Inflation Countries

These countries experience the most severe financial distress in their banking systems. The public sector attempts to transfer its high debt burden, arising from cumulative large fiscal deficits and the inability for one reason or another to tax the population sufficiently, to the private sector through the inflation tax. Inflation distorts allocation of resources, erodes the real value of private sector savings in currency and public debt and constitutes a distinct breach of the social contract, which erodes confidence in the government of a protector of private property rights. Shirking, cheating, opportunism as well as speculation occur in order to maximize individual gains.

Initially the public sector is able to finance its deficits from external borrowing but subsequently results to domestic borrowing or the printing press once the public sector cannot finance its deficits.

Bank restructuring in these countries cannot be divorced from drastic macroeconomic adjustments, including generating a primary surplus in the budget, debt rescheduling and part-forgiveness, removing the source of the inflationary pressure and major currency and banking reforms. It is necessary to restore public faith in the government, which may mean budget balancing, currency reform and general protection of property rights.

The above groups are not distinct and the grouping is based on the outstanding characteristics of the country banking system.

2.5 Bank Restructuring Approaches

Restructuring techniques may vary according to the economic conditions of the country and resources available for restructuring (Sheng, 1990:239; De Juan, 1991:65; Rose 1994:1; Dziobek and Pazarbasioglu, 1998:8; Sheng, 1996:326; World Bank, 1997:3; World Bank, 1999:2; De-Luma Martinez, 2000:35). The authors identify the following as the main approaches to bank restructuring.

2.5.1 Market-Based Solutions

This technique appears to be the most efficient and least costly to the taxpayers. The argument here is that if it is not economical to run a bank, liquidation is cheaper than keeping it open. In developing countries however, ailing public sector banks have been kept open for employment purposes or for purposes of national pride, which tends to impose a drain on public resources that few developing countries can afford (Rose, 1994:16; Dziobek and Pazarbasioglu, 1998:6).

Concern about asymmetric information, cost of information, and panic prevention may lead to a limited deposit insurance scheme to bail out small depositors as an exception to sheer application of bankruptcy law. However few governments opt for pure bank closure, especially when the whole system or a considerable part of it is in trouble and when the insolvent banks are large or critical elements in the system. Other governments let things be and buy time; others adopt the strategy of aggressive staff training and systems enhancement without addressing radical recapitalization and management restructure. Subsidizing banks removes the incentives for good management and perpetuates deterioration in resource allocation (Moskow, 1998:21).

In Cote d'Ivoire, the only state bank was liquidated and other approaches were used with World Bank support. In phase 2 of its restructuring process, the development bank of Mauritania was closed and its assets liquidated. Hungary recognized that markets needed to become increasingly linked and establishment of timetable for full privatization was undertaken.

Countries that have been most successful at restructuring their banking sector are also those which have had the resolve to eliminate banks that were not viable, either through merger or direct liquidation. Benin, Cote d'Ivoire and Ghana are examples. Most governments however consider prominent state-owned banks as implicitly or explicitly as being too big to fail (the "TBTF" syndrome) leading to desperate, often repeated - but ultimately fruitless - efforts to keep them afloat. The Uganda Commercial Bank, Tanzania's National Bank of Commerce and Banco Commercial de Mozambique are examples. In Sweden, Bank Support Authority (BSA) was started as the lead restructuring firm agency, and standards were set to determine which banks could and could not be saved.

2.5.2 Carving Out Bad Assets

Removing non-performing loans from the banks' balance sheets and transferring them to a separate loan recovery agency can be an effective way of addressing the banks' solvency problems. Although carving-out non-performing loans immediately improve the banks' balance sheets and free banks to focus attention on their core business, this doesn't however solve the problem of profitability (Dziobek and Pazarbasioglu, 1998:7). Much would depend on the legal issues of whether the new asset managers have full power of disposal of assets and whether the bank managers can be trusted to dispose of such assets at fair market value (Rose, 1994:6). In some countries such as Chile, the bad assets were carved out. In U.S. the disposal of assets of failed thrift banks have been centralized in a single corporation.

The business of loan rehabilitation, sale of assets and bank liquidation are best delegated to another agency other than the Central Bank such as a Rehabilitation Fund. If central bankers are involved in credit decision making this may compromise their supervisory authority.

Bad debt losses of banks have been viewed as a stock loss, which ideally should be written off against capital and reserves. If on the other hand the decision of the government is to replace the bad assets with government bonds, then the fiscal cost to the government is not the gross size of the bonds issued, but the annual interest burden on such bonds. The swap of bonds with the bad assets of government owned banks is only a financial transaction, recognizing explicitly losses and making transparent the fiscal cost of such losses. Bad assets of banks can be replaced by injecting government financial and real assets into the banks as part of a privatization package (Sheng, 1996:239).

This approach was applied in Poland, Spain, Cote d'Ivoire, and Mauritania where bad debts were written off against the remaining capital. In Sweden, most banks set up work out subsidiaries to deal with their non-performing loans, freeing bank management to deal with core business. In Philippines, assets privatization trust was established to conduct loan workouts and recovery operations. In Hungary, bad debts were placed in the credit-consolidated fund managed by the Hungarian Investment Development Corporation. In Ukraine restructuring of bad loans was done financially

through recapitalization and operationally through banks collection efforts. In Czech Republic, carve out of bad debts in the major banks was undertaken as an integral part of bank privatization program under the country's major privatization program. In Poland, banks retained responsibility for recovery even after recapitalization.

The approach taken by African governments to deal with an "overhang" of non-performing loans in the banking sector has been to remove them from the banking system and segregates them in some form of recovery trust. Unfortunately, with the exception of Ghana, the recovery record of such schemes has been rather poor in Africa. A careful, realistic assessment of a recovery trust likely effectiveness in recovering old loans is therefore warranted prior to its establishment. Where the trust option is retained, a major push should be made to collect up-front, followed by dissolution of the trust after a set period of time (World Bank, 1997:4).

2.5.3 Bank Hospital

The deposit insurance scheme is the vehicle for rehabilitation and liquidation. In transitional economies, both implicit and explicit insurance are popular with explicit insurance becoming more prevalent (World Bank, 1997:2). An independent and objective institution with the flexibility to recruit professionals to do the job, working closely with the bank superintendence or central bank, is probably a good way to deal with bank failures flexibly and pragmatically. Central banks in many developing countries have low civil service pay, restrictions on recruitment and limited powers to act in liquidation and rehabilitation work (Bery and Garcia, 1998:257).

The government normally buys bad debts from the Central Bank or from a special institution. Collection by the bank that made the loans has not been found to be effective. Setting an ad hoc institution to purchase and liquidate or recover bad assets may be a better alternative. A debt recovery agency may be established to be independent, run by private law and able to attract good professionals from the market in which case recovery is likely to be more effective.

This approach has been applied in Spain where bank activities were placed in Deposit Guarantee Fund (FGD), removing them from the bank's monetary policy and supervisory duties.

During Phase 2 in Mauritania, the government established a loan recovery agency operation and achieved its target and improved profitability was realized in 1995. In Czech Republic, a "bad bank" (Konsolidani Banka) was established to clean up the balance sheets of the commercial banks and to work out the non-performing loans without burdening the other banks with the clean up effort.

2.5.4 Changing the Guard

Cleaning up banks with government funds without significant change in ownership and management is unfair and ineffective since recurrence of the previous problems is most likely to happen shortly if the same people are left at the helm of ailing banks. Leaving old management to look after assets can lead to even greater losses. A Central bank manager in Malaysia was quoted as saying "You cannot allow monkeys to look after bananas."[1] Thus in many instances, retaining staff with suspect integrity has resulted in continuing weaknesses in control over asset quality.

The boards and managers who have led the bank to insolvency through wrong policies and serious mistakes are not the best candidates to reverse the situation. Even if competent and honest, it will be very difficult for the previous managers to implement the policies rehabilitation requires. They are likely to be faithful to their past and may even be an obstacle to proper disclosure in the new stage.

The managers of a bank in rehabilitation must thus be new because new management will tend to think that the problems remaining in the bank can be solved or diluted with simple growth (World Bank, 1997:4).

In Hungary improved governance and management at banks and firms was given recognition. World Bank (1997:4) observes that there is no substitute for qualified, private independent bank management fully responsible for its actions. Except in the case of Ghana, senior bank managers were in general retained too long after restructuring was initiated, permitting them not only to repeat the errors of the past, but worse, to subvert agreed reforms according to their own interested convenience.

[1] Sheng, (1990), "Bank Supervision: Principles and Practices'' EAI Seminar Series; The World Bank, Washington D.C. Pg. 229.

2.5.5 Creating Phoenixes

With this approach, a number of failed institutions are grouped together under one umbrella with new management with the objective of turning around the operations. In U.S., Malaysia and Kenya (Consolidated Bank) this has been tried. Where managerial talent is scarce it is not a bad idea to consolidate resources. Integrating diverse groups of staff and procedures into one new institution have however turned out to be much more difficult than initially envisaged and public appointed boards may not be as dynamic and market oriented as private sector ownership.

2.5.6 Changing Macroeconomic Policies

If macroeconomic policies are set right with the right price incentives, correct level of exchange rates, reduced fiscal deficit, and elimination of subsidies and market distortions, the banking sector would take care of itself. In developing countries, fiscal expansion or development planning must take into consideration the performance and behavior in the banking industry. Tying bank restructuring to wider adjustment operations tend to delay implementation, most often in situations where intervention in the banking sector can hardly afford delay. In Kenya, it would have probably have been best to organize efforts in the sector around a modest, but sector-specific operation (World Bank, 1997:4).

In designing the program, identification of measurable indicators has been poor, presentation of relevant data on the banking sector as well as on individual banks has been scant, few bank restructuring programs have included independently performed "aging" of arrears and loan classification of reviews and bank-restructuring operations, particularly those established in less-than-stable economic environments could have benefited from prior more targeted sector work (Rose, 1994:16; Miller, 1998:269).

Successful restructuring requires clear policies for determining when a bank is viable or when it should simply be permitted to fail.[2] Countries with successful reform efforts established clear standards and applied them consistently and no bank was

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[2] Dziobek and Pazarbasioglu, (1998), "Lessons from Systemic Bank Restructuring"; Economic Issue No.14, IMF, May, Pg.7.

considered "Too Big to Fail"(Dziobek and Pazarbasioglu, 1998:7). Experiences in Chile, Malaysia and Thailand show that strong supervisory laws and enforcement, together with appropriate macroeconomic adjustments, have aided the recovery process. In Hungary, there was restored commitment to macroeconomic stabilization, sustained political commitment to an enabling macroeconomic environment, and improved governance.

2.5.7 Counting the Monetary and Fiscal Costs

Central Bank lending to aid banks is generally expansionary on money supply but this could easily be offset by losses in foreign exchange assets arising from capital flight. Sundarajan (1988:7) observes that the money supply tracked the behavior of monetary aggregates during the crisis periods of six countries and observed tentatively that the money multiplier declined sharply during the crises.

In Philippines, tax privileges were withdrawn from banks and banks were subjected to private- external audits and government guarantees initially in existence were withdrawn.

2.5.8 Restructuring Borrowers

Bad loans may be due to ailing enterprise borrowers (Rose, 1994:6). Malaysia has attempted to establish a Special Enterprise Rehabilitation Fund to assist ailing but viable small to medium (indigenous) enterprises to revive, with seed capital, soft loans and professional advice.

In Philippines, the government directed banks to lend to enterprises in distress. At the same time, the supervisory agency (the Monetary Board) waived enforcement of banking standards to give troubled banks a chance to overcome finance difficulties. Two years later, the two largest state-owned banks became insolvent .

In Mauritania, banks continued to lend to troubled agricultural and fishing industries, which might have contributed to failure of restructuring process. Thus reform of the banking industry must include the development of its enterprise and knowledge of the operations and viability of its borrowers.

2.5.9 Recapitalization

An insolvent bank tends to have lost all or a sizeable part of its equity capital. When capital is lost partly, through conventional procedures; the bank will retain earnings to accumulate reserves and/or will call for capital injections from the market, through conventional capital increase or surrogate capital instruments. On the other hand, when equity capital is lost several times, candidates for a potential merger or acquisition are unlikely to be found unless special assistance by the government is supplied to make up for the stock of losses and the nonperformance of assets (Rose, 1994:8; Dziobek and Pazarbasioglu, 1998:7).

Writing off the previously existing capital against the existing assets should precede injecting new capital in a bank in the case of deep insolvency. The reconstruction should not just aim at replacing the lost capital in the books with new capital of an equivalent amount because the losses to be written off are much higher than the capital. Purchase of bad assets by a government institution is a good alternative to supplement the capital increase and complete recapitalization and reconstruct profitability. In view of the tight cash constraints most governments are living under available alternatives to address the problem tend to be limited involving in most cases the consolidation of unpaid obligations over time through some type of securitization (substitution of government bonds for bank claims on the public sector).

In Hungary (1995) the government recapitalized its troubled state banks to restore solvency and make them more privatizable. In Philipppines the non-performing loans were removed from the banks balance sheets by covering them with government debt. In Cote d'Ivoire, major banks obtained the right to rediscount most of government arrears with the regional central bank. FDG min Spain acquired controlling interest in banks, and later injected additional equity stakes, finally selling the bank to new owners. In Cote d'Ivoire commercial banks were recapitalized through settlement of government arrears and new capital from private owners. In Mauritania, during phase 2, four commercial banks were recapitalized and fully privatized (1992-1994). In Sweden, the government injected capital and gave loan guarantees, which were met from the government budget.

2.5.10 New Ownership

Removing former shareholders is one of the three key elements for a successful restructuring. No government should recapitalize a bank in favour of the private owners of an insolvent bank. The law on financial restructuring of enterprises and banks became effective in 1993 and established a bank privatization fund, the basis for a program not only to recapitalize the banks and restructure their balance sheets, but also to deal with state enterprises with bad debts.

Experience would appear to justify immediate conservatory actions on the part of authorities to check operating losses while the (typically lengthy), preparations for privatization get under way (World Bank, 1997:3). Indeed while banks have been awaiting privatization, precious time was lost as a result of government reluctance to take some of the critical defensive measures needed to restore viability.

Experiences in Chile and Mexico demonstrate that a rapid and ill-designed process of bank privatization can contain the seeds of subsequent banking crises. In both cases, preferential access to credit given to some bidders, overpricing of bank assets, and weak legislation against concentration of ownership allowed a few large business conglomerates to acquire a large portion of the financial system (Dziobek and Pazarbasioglu, 1998:8).

Foreign banks are likely, when investing in a state-owned bank to insist on being allowed to select the staff and assets especially loans and branches which they will agree to take over.

2.5.11 Need for Interim Actions

If the public perceives the bank is in trouble and the bankers realize their bank is a candidate for closure or government intervention, deposit runs becomes a serious danger. Two kinds of action would involve; intervention proper and interim management.

Interim management involves appointing management to temporarily take charge of the bank's affairs until the bank recovers. Interim intervention proper on the other hand is a mere safety mechanism, which may involve sending the government

officials to the bank with powers to fully inspect the accounts and veto any decision by management that might be detrimental to the bank or changing board management and replacing them by one or more intervenes with full powers to run the bank.

2.5.12 Institutional Arrangements

This might involve appointing new management, which might mean that the government sets up a specialized institution that can assume temporary ownership and also appoint and supervise new management according to similar policies in the different banks. Designating a separate lead agency to coordinate and implement the restructuring other than giving this responsibility to the Central Bank since the bank might be drawn into financing bank restructuring measures exceeding its resources, and taking actions that conflict with its basic responsibilities for monetary management. The lead agency must be equipped to undertake steady, focused monitoring of restructuring policies, as well as individual bank restructuring operations if necessary. However, even with the existence of a lead agency, the central bank must stand ready to provide liquidity support during restructuring to viable banks, minimize reliance on protracted liquidity support and should not provide long-term financing to banks, or engage in commercial banking activities, as these exceed its financial resources (Dziobek and Pazarbasioglu, 1998:6). In Mauritania (during phase 1) where operational reforms did not receive political support, and central bank was not effective in supervision, recovery of non-performing loans reached 50% of their credit to the private sector - an indication that restructuring had not succeeded. In phase 2 the central bank supervisory powers were strengthened.

2.5.13 Operational Reforms

This entails management changes, cuts in staffs and rationalization of branches of commercial banks, branch refurbishment and information technology. Governments must build practically the entire operating framework of the banking system, including the courts and legal system. Rose (1994:2) and Dziobek and Pazarbasioglu (1998:8) observe that successful reforms invariably requires resisting a tendency to be satisfied when solvency is restored, allowing troubled banks to resume lending. Unless conditions are established for restoring profitability, experience shows that the problem banks end up being in trouble. Thus changes in management and cutting operating costs should follow. More so, strengthening the accounting, legal and

regulatory systems and backing up reforms with firm, consistent supervision and compliance is necessary (Dziobek and Pazarbasioglu, 1998:5).

In Cote d'Ivoire the government strengthened framework of regulatory, accounting, fiscal, legal and monetary policies. A banking commission was formed which provided continued supervision. In Philippines, cost cutting measures were undertaken and prudential regulations strengthened.

CHAPTER THREE

EMPIRICAL LITERATURE ON BANK RESTRUCTURING

There exists minimal empirical literature on bank restructuring and on the correlation between bank restructuring and profitability. This is probably because of banks low level of disclosure on information pertaining to their costs and margins as well as their general unwillingness to allow researchers access to information relating to their operations for fear that this information might get to their competitors. The IMF and the World Bank have however published a number of cross-country studies that seem to suggest that the Brettonwoods Institutions somehow manage to overcome some of the above limitations. Most of the studies conducted by both institutions have been conceptualized within the context of financial sector reforms that the two institutions have spearheaded in these countries. The relevant credit and loan agreements for such reforms usually contain clauses that facilitate them much easier access to information on banking institutions compared to other researchers (Malombe, 1999).

The few empirical studies undertaken are categorized into two. Those studies that focus on restructuring approaches in general, and those that relate the bank restructuring approaches undertaken by the banks and bank profitability.

3.1 Studies on Bank Restructuring Approaches

World Bank staffers, Bonish and Montes-Negret (1998) carried out a study in Hungary, Poland, Czechoslovakia and Ukraine and found out that these economies realized the importance of moving to market oriented systems by breaking up the mono-bank systems into two tiers - a central bank responsible for the conduct of monetary affairs and state owned commercial and specialized banks responsible for mobilizing deposits lending and carrying out commercial banking activities. The authors find out that countries that have been most successful at restructuring their banking sector are also those which have had to resolve to eliminate banks that were not viable, either through merger or direct liquidation. Owners of insolvent commercial banks were given the choice of closing and liquidating, mergers or injecting fresh capital and no bank was considered too big to fail.

Sheng (1996), of the World Bank, undertook a cross-country study in Spain (1980), Chile (1983) and Philippines (1983) and found out that the Central Bank took the lead

in devising, carrying out and financing the restructuring strategy. The Central bank took over 14 out of 26 commercial banks and 8 out of 17 private domestic finance companies in Chile. All the finance companies and eight of the banks were liquidated becoming directly involved in the lending operations of the banks. In Spain however, the Central bank introduced cost sharing with the banking community and put in place other incentives for corporate governance and its bank activities as well as its supervisory duties, were placed in a separate Deposit Guarantee Fund and the bank achieved success more rapidly and at a lower cost, 15% of GDP. The Central Bank of Chile became actively engaged in debt rescheduling and in commercial bank lending, and in effect continued the operations of insolvent banks at a slightly higher cost of GDP. In Philippines, weakness in regulation and lax banking practices, government directive to lend to companies in distress saw two of the biggest banks become insolvent in 1985. A new agency, The Assets Privatization Trust (APT) was set up to conduct loan workouts and recovery operations. Measures to rehabilitate the state owned banks, which accounted for most of the problems concentrated on substantial operational restructuring, including new management and major cost reduction.

The World Bank (1997) reviewed bank restructuring operations in seven countries of Sub-Saharan Africa - Benin, Cote d'ivoire, Ghana, Kenya, Tanzania, Uganda and Mozambique. The study found out that experiences in Kenya, Tanzania and Mozambique tend to confirm that a lack of commitment to the restructuring process on the part of governments will seriously impair the success of bank restructuring. Benin, Cote d'Ivoire and Ghana provide the counter factual proof that restructuring will succeed when strong government backing is present (World Bank, 1997:1). The findings indicate that not all the efforts on bank restructuring have succeeded.

Caprio(Jr) et. al. (1998), of the Economic Development Institute (EDI) of the World Bank, carried out a cross-country study and contends that evidence from Cote d' Ivoire, Mauritania, Sweden, Chile, Spain, and Philippines indicates that it is important to adopt a comprehensive restructuring program approach. This approach mainly involves liquidation of the insolvent state banks, enactment of new laws to provide for the foreclosure and management of non-performing loans, placing activities of problem banks to a deposit guarantee fund and leaving the Central Bank to concentrate on monetary policy and supervisory duties, central bank emphasizing on

cost sharing with the banking community and putting in place other incentives for improved corporate governance and setting up assets privatization trusts to conduct loan workouts and recovery operations for problem banks. The comprehensive restructuring program in most of these countries was led and supported by the World Bank. In Cote d' Ivoire even the state banks were placed into liquidation, new laws were enacted to provide for the foreclosure and management of non - performing loans and commercial banks were recapitalized through the settlement of government arrears and new capital from private owners.

In Mauritania the government initially ignored operational reforms and failed in its first phase of restructuring which took place in 1988 - 1991. After failure of phase 1, Mauritania embarked on phase 2 where the government used enhanced structural adjustment facility from IMF to support a second effort at restructuring. In its second phase (1992 - 1995) the country concentrated on operational restructuring by closing the loss making development bank, recapitalizing and fully privatizing four commercial banks and adopting the government loan recovery agency and in 1995, Mauritania's banks showed signs of increased profitability. In the same study, the author observes that in Spain, the central bank took the lead but the bank emphasized on cost sharing with the banking community and put in place other incentives for improved corporate governance. Sweden used a special organisation loan collection agency tied to individual banks to undertake loan workouts in 1991. In Chile, Philippines and transition countries, loan workout was approached by providing debt relief to borrowers by engaging simultaneously the borrowing enterprises in the restructuring process.

3.2 Studies Focusing on Bank Restructuring and Profitability

Dziobek and Pazarbasioghu (1998) undertook a study financed by the IMF and analysed the experiences of 24 countries that initiated reforms in the 1980's and early 1990's. 4 of the study countries were industrialised, 15 were developing countries, and 5 countries were in transition to market oriented systems. The country experiences were ranked by relative progress in resolving banking sector problems, mainly banking performance and changes in financial system intermediation capacity. The concepts of solvency and sustainable profitability were considered as indicators of performance.

Solvency was assessed using; non - performing loans/total loans and capital to assets ratio while, bank profitability was assessed using; operating expenses/assets, interest income/assets and profits to assets. Improvement in financial intermediation capacity of the banking system was assessed using; ratio of growth of credit to private sector to growth in GDP, ratio of broad money to GDP, charges in interest spreads, Central Bank credit to banks/GDP, and changes in interest rates and experiences in recurrent banking problems.

The authors observe that countries that made substantial progress took action within a year of their banking problems. They effectively diagnosed the nature and extent of the problems, identifying the underlying causes and designed a restructuring strategy to address them all systematically. Countries making slow progress faced relatively more problems, and in particular, correction of taxation policies that distorted incentives in banking where state owned banks had problems, was ignored with the countries often failing to confront these banks.

Dziobek and Pazarbasioghu (1998:5) observe that operational reforms are necessary to return to profitability and solvency. The study showed that all countries that made substantial progress and most with moderate success emphasised operational restructuring while by contrast, the three slow - progress countries either addressed regulatory and accounting issues while only one dealt with poor management

Governments find it quick and relatively easy to make progress against insolvency through such means as swapping bonds for non - performing loans. Achieving profitability requires painful operational restructuring which is more difficult and time consuming than asset or even financial restructuring.

Countries surveyed that made slow progress all relied on the Central Bank, using it as a lead agency for restructuring and both for immediate liquidity support and medium term financing. The moderate progress countries relied significantly less on their Central Banks, while those making substantial progress used the Central Bank as lead agency in only a fifth of the cases. Less than half of these countries used the Central Bank for liquidity support and just one half for medium term financing. Countries that

achieved the best results addressed the bank insolvency problem at an early stage and did not consider it as a mere lack of liquidity. This precluded the extensive use of Central Bank Lender of Last Resort facilities (Rose 1994:3).

Removing non - performing loans from banks' balance sheets and transferring them to a separate loan recovery agency has been found to be an effective way of addressing the banks' solvency problems. Carving out non - performing loans immediately improved the banks' balance sheets and freed them to focus attention on their core business. Loan workouts were found useful in recovering some of the cost of bank restructuring and send signals to delinquent borrowers.

Notably all countries included in the study were much more successful in addressing solvency problems than profitability ones. Whereas improvement in bank solvency emanates chiefly from shorter term financial restructuring, a return to profitability requires more difficult, longer term operational restructuring. Swapping bonds for non - performing loans for instance improves solvency indicators, but does not necessarily affect costs, earnings or profits. Dziobek and Pazarbarsioghu (1998:14) observe that in practice, the design of bank restructuring packages is often somewhat unbalanced, focusing more on financial restructuring measures at the expense of operational restructuring measures.

Another study which focused on bank restructuring approaches and profitability was undertaken by Rose (1994). The author examined the financial and operating changes affected by nearly 730 U.S. insured commercial banks that experienced corporate stress in the form of negative profitability for at least two consecutive years during the 1980 - 90 period. The principal measures by most of these banks included asset and capital portfolio restructuring, operating performance and external factors examined included; assets portfolio restructuring measures, operating performance measures and market factors. The banks restructured reported positive and consistent increase in net profitability in the latter half of the decade.

Rose (1994:6), identify solvency and sustainable profitability indicators for assessing bank solvency as; ratio of non performing loans to total loans, ratio of capital to assets, ratio of operating expenses to assets, ratio of interest income to assets and ratio

of profits to assets.[3] The author argues that the structural measures available for assessing solvency and profitability include; central bank as the sole restructuring agency, central bank liquidity support, loan workout units (public or bank-based), closure of insolvent banks, merger of insolvent banks, privatization (where applicable), enterprise restructuring to improve creditors and twinning with foreign banks.

The author also found that banks under stress reported more assets committed to risky loans and leases through the study period than banks not experiencing financial stress, suggesting less flexibility in the troubled firms' asset portfolios. Only failing banks reported persistently higher loan - to asset ratios except at the year - end that occurred immediately before the latter institutions collapsed when the banks passing through corporate stress reported higher loan - asset ratios than even failing institutions. It was noted that it is the quality of the individual loans, regardless of type or category that determines the degree of risk exposure and financial stress faced by individual banking firms.

[3] Rose, (1994), "The Rescue of Troubled Banks: Consequences for Corporate Strategies to Deal with Financial and Operating Stress", Journal of Financial and Strategic Decisions. Pg.16

CHAPTER FOUR

RESEARCH METHODOLOGY

4.1 *Population*

The population of this study comprised all commercial banks operational in Kenya as at 31st December, 2001.

4.2 *Sampling Plan*

Commercial banks in Peer Group 1, according to the Central Bank of Kenya categorization were selected for this study. The Central Bank of Kenya has categorized commercial banks into five Peer Groups (CBK, 2001), on the basis of their size as measured by the value of the total net assets. The categories are; Peer Group 1, Peer Group 2, Peer Group 3, Peer Group 4 and Peer Group 5. Peer Group 1 are those banks with total asset value in excess of ksh10,000million. There are eight commercial banks in Peer Group 1 as indicated in Appendix II. The Peer Group 1 banks were selected because they are the largest commercial banks with varied ownership structure and that they have undertaken significant restructuring compared with the other four Peer Group category.

Barclays Bank, Kenya Commercial Bank and Standard Chartered in Peer Group 1 were selected because the three banks in this category are the largest commercial banks in Kenya and the three in total control about 50% of the assets of the banking industry in Kenya. They also lead in terms of market share, total deposits and capital reserves. The three banks are some of the banks that have undertaken extensive restructuring, have been the trendsetters, and therefore their practices tend to influence the practices of other banks. The time limit within which this paper was to be completed did not allow an analysis of all commercial banks operating in Kenya.

4.3 *Data Collection*

Literature on bank restructuring and related approaches, especially those adopted in developing countries in Asia, Latin America, as well as other African countries, was reviewed with a view to identifying the strategies available for restructuring banks that may also be utilized in Kenya.

Financial information on total assets, shareholders' equity and interest income as well as explanatory notes that accompany the accounts was obtained from the financial statements of the commercial banks under study to assess their profitability. Information on bank restructuring approaches adopted by commercial banks in Kenya was obtained from the annual accounts of the study banks, the annual reports of the Central Bank, the CBK Supervision bank department and the Deposit Protection Fund. Information on Peer group bank categorization and characteristics was obtained from the CBK bank Supervision department annual reports.

The World Bank and the IMF internet web-sites were visited to provide the most recent literature on bank restructuring, including types of bank restructuring, bank restructuring approaches and financial ratios for assessing bank profitability.

4.4 *Data Analysis*

To achieve objectives one and two of the study (as stated in section 1.3), data was analyzed using content analysis and descriptive statistics. The former involves analyzing aspects and situations in detail while the later involves the use of narratives to explain the situation as it is, or use of averages and percentages to analyze situations. To accomplish objective three, which set to investigate implications of bank restructuring approaches on bank profitability of selected commercial banks in Kenya, financial ratios were estimated. The information was further presented by way of tables, charts and graphs. Trend analysis was used to assess the profitability of the three leading commercial banks for the period 1992 to 2001. The profitability of the study banks during the restructuring period was analyzed using ROE, ROTA, ECR and the spread.

According to Thygerson (1995:50), Yeager and Seitz (1989:84) and Rose (1994:6), the most common measures of financial institution performance are measures of profitability. The authors observe that profitability can be measured using financial ratios. These ratios include:

-Return on equity (ROE) = Net Income/Equity

-Return on Assets (ROTA)=Net Income/Total Assets

-Equity capital ratio (ECR)= Equity/Total Assets

-Spread = Net interest revenue/Total assets

-Net interest spread = [Interest income/Average earning assets] - [Interest expenses/Average interest paying liabilities]

-Net interest spread to Average assets = [Interest income-Interest expense]/Average assets

-Non-interest income to average assets

-Net operating cost ratio = Net operating costs/Total assets

Due to limited disclosure of information for the period 1992 to 1997, most of the financial ratios could not be estimated. Even for the period after 1997, the limitation in terms data segregation made it difficult for the estimation of these ratios. In this regard, the financial ratios used for this study included;

-Return on equity (ROE)=Net Income/Equity

-Return on Assets (ROTA)=Net Income/Total Assets

-Equity capital ratio (ECR) = Equity/Total Assets

-Spread = Net interest revenue/Total assets

Whereas ROE, ROTA and ECR for the whole study period were estimated since data was available for these parameters, the Net Interest Spread was only estimated for the period 1998 to 2001. Owing to the limitation of data segregation for the period 1992 to 1997, it was however not possible to estimate the Net Interest Spread to Average Assets, Non-interest Income to Average Assets and Net Operating Cost Ratio. It is important to note that although the Central Bank disclosure guidelines came into being in 1996, most banks did not implement them until the fiscal year 1998.

CHAPTER FIVE

BANK RESTRUCTURING APPROACHES ADOPTED BY THE THREE LEADING COMMERCIAL BANKS IN KENYA AND BANK PROFITABILITY

5.1 Restructuring Approaches Adopted by the Three Leading Commercial Banks in Kenya

Four main restructuring approaches were identified among the three commercial banks selected for this study; operational restructuring, asset restructuring, management change, and human resource restructuring. Change of ownership was observed in the case of Kenya Commercial Bank in which the government of Kenya off-loaded part of its share of ownership in the Bank in 1993 and in 1996 through the government of Kenya divestiture program. Among these approaches operational restructuring was given the greatest emphasis during the study period.

5.1.1. Operational Restructuring

In Standard Chartered, operational restructuring was undertaken throughout the study period. In 1993 for example, the bank improved personal banking by introducing express counters in all branches and also introduced superior queuing system, which reduced waiting time and was extended to all branches in 1994. ATM's were introduced and several independent back office functions were amalgamated into the bank where all the support is provided. Standard Chartered Financial Services Ltd, the merchant banking, leasing and specialist financial services subsidiary was integrated into the bank. 14 branches were closed in 1994, while 2 branches were merged with existing ones. Branch refurbishment to incorporate a more customer friendly design together with enhanced security features, rationalization of business corporate entities and a reorganization of the bank's structure was completed in 1995 with sale of 7 branches, merger of 2, relocation of 1 and closure of 2. Improved computerization saw 6 branches fully centralised by 1995.

The Kenya Commercial Bank introduced Quick Serve (ATM's) in 1997, which were increased by 20 in 1998 and further increased by 35 in 1999. The bank closed 42 branches, 74 mobile centres and 6 satellites considered unprofitable in the period 1999-2001. In the case of Barclays Bank, branch refurbishment program was

Table 5.1: *Branch Related Operational Restructuring Undertaken by Stanchart, BBK and KCB for the Period 1990-2001*

O/R	StanChart		BBK		KCB	
	Year	**Outcome**	**Year**	**Outcome**	**Year**	**Outcome**
Branch Comput-erisation	Prior to 1992, contin-ously updated	Centralisation of all branch operations including those in the EA region which improved efficiency, reduced overheads, improved efficiency in transfer of information among branches.	Prior to 1992, continu-ously updated	Centralisation of all branch operations, branches able to share information, efficiency improved, costs reduced and it is now easier to consolidate bank results	Prior to 1992, continu-ously updated	Concentration of operations in the H/O. Main data centres were established at H/O and Gigiri to accumulate data and information for all branches at a central point to facilitate planning and decision making for effective monitoring and enhanced efficiency
Branch Refur-bishment	1995 2001	Introduced E/C in all branches and Transferred managers in B/H to serve customers. Customer complaints are now fewer.	2000	Senior staff were transferred to the banking hall to serve customers. Managers are now more accessible and customer grievances reduced	2001	Introduced a customer care desk to address customer enquiries. Made it easier to send customers to relevant managers. Complaints from customers reduced.
Branch Rational-ization	1994/ 1995	14 loss making branches were closed, and 2 were merged which led to reduction of operating costs	2000	35 branches were deemed unprofitable were closed. Led to reduction in operating costs.	1999-2001	Closed 42 branches, 74 mobile centres and 6 satellites deemed unprofitable. Operating costs decreased

Source: Research Data
Key: B/H-Banking Hall H/O-Head Office O/R-Operational Restructuring

completed in some branches in 2000 while 35 loss making branches were closed in the same year as part of branch rationalization program.

The main branch related restructuring approaches are summarised in Table 5.1, which include, branch computerisation, branch refurbishment and branch rationalisation. Notably the most popular operational restructuring approaches undertaken by the three banks were mainly branch related possibly because one of the objectives of bank restructuring is usually contraction and centralisation of similar bank activities. Usually the more branches a bank has the larger the bank is likely to be.

In Standard Bank, personal banking was improved by 1993 by introducing express counters in most branches. Refurbishment of the main branches was completed during 1996 and majority of branches were centralized in their computerised programs. Computer systems were updated geared at integrating many features that offer simplification of internal procedures so as to provide enhanced customer service. By 1997, the centralised project was completed where all branches were interconnected with Tanzania and Uganda branches being centralized into Nairobi computer centre. In 1999, a new signage was installed in 9 branches.

By 1998, the improved technology made it possible for customers to deposit cash and cheques via ATM's. Automated Banking Centres (ABC's) were on line real-time. The bank also launched ability to pay electricity bills through ATMs in conjunction with Kenya Power and Lighting Company in the year 2000. ATMs were upgraded the same year to enable the satellite to be paid through the ATMs. Business technology division became operational and service delivery arm of the bank, covering all the online front office branch terminals, ATMs, data centre, international payments, trade and treasury operations were fully operational by the end of 2000. Technology and service delivery division was enhanced in 2001 to provide information technology and operational service delivery arm of the bank covering all the online, front office terminals in branches, ATMs, data centre, international payments, trade and global market operations. Operations of Uganda and Tanzania and Zambia were hubbed in the Nairobi operations, in 2001 and mobile top-up service facility was launched in the same year.

In Barclays Bank, computerisation and implementation of a new front office system took place in 1993. Counter automation was extended to more than 30 branches in 1994 while 1300 terminals to modernise card business was attained through expansion of point of sale network. Staff were transferred from back office to the banking hall to service customers. In 1995, a full corporate branch was opened at the Barclay Plaza, office automation system was installed throughout the head office and main branches and ATM's were introduced in 1995.

***Table 5.2**: Other Select Operational Restructuring Undertaken by Stanchart, BBK and KCB for the Period 1990-2001*

O/R	StanChart		BBK		KCB	
	Year	**Outcome**	**Year**	**Outcome**	**Year**	**Outcome**
ATM	Prior to 1990	ABCs were established, queues in the B/H shortened	1995-1996	ABCs were established, queues in the B/H shortened	1997-1999	Installed over 55 ATMs, queues in the B/H shortened
Strengthening of the SME Unit	Before 1990	Creation of the Deposit Plus Facility (DPF) that targeted the small business sector. The SMEs are now able to access loans from the bank more easily. Thus more SMEs became customers	1990	Created the retail sector and entered into an arrangement to partner with donors in provision of loans to SMEs. Advises and provides loans to SMEs. Increased customers from SMEs sector	1993	Created Special Loans Division, including the creation of SMEs Program (KYTEC). Loans were granted to fishermen in Lake Victoria, SMEs are advised and granted loans by the division, thus customers from SMEs increased
Enhancement of Treasury Operations	1991	Introduced the Treasury Division. Trading in derivatives was enhanced	1996	Introduced the Treasury Division. Enhanced trading in financial derivatives	1993	Revamped the treasury division . Enhanced fund management operations and trading in financial derivatives

Source: Research Data

Key: B/H-Banking Hall H/O-Head Office O/R-Operational Restructuring

Table 5.2 summarises the main non-branch related restructuring methods adopted by the three commercial banks under study which include, installation of ATMs, strengthening of the SME unit and enhancement of treasury operations. These were the approaches that could be obtained from the financial statements.

In 1996, Barclays Advisory and Registrar Services Limited (BARS) was restructured and upgraded. Successful transition from old accounting system run on 6 separate databases to a newer improved system known as (BRAINS) with the entire business of the bank run on a single database.

Bankmaster forex module, a computer module to improve the handling of forex transaction was installed while electronic banking was introduced to benefit corporate customers in 2000 and on-line-real time was introduced the same year. Several independent back office functions were amalgamated into the bank where all the support is now provided. Treasury operations were reorganized in 2001 leading to split into 3 complementary functions enhancing customer focus in delivery of Treasury services. Branch network was reconfigured into 4 clusters, West, Rift, Westlands-Nairobi, Mt. Kenya and Coast Region. Business was reorganized in 1998 to create the retail sector, comprising personal sector and small business sector.

In Standard Chartered Excel Banking offering improved personalised service with each customer having a dedicated relationship manager, dedicated tellers and special discounts at a variety of establishments through the use of the excel privilege card. Deposit Plus Facility that targeted small business sector, forex short-term loans and foreign exchange forward contracts to minimize the volatility in exchange rates for import-oriented customers was put in place in 1993. Customer segmentation into corporate and business financial services (BFS) for SMEs was designed in Barclays and in addition the creation of a resource unit to proactively manage corporate depositors, NGO's and non-profit making organizations was put in place. Barclays Premier banking and prestige banking was introduced in 2001.

Kenya Commercial Bank had its corporate customers connected to bank direct, a service which allows them to access their accounts from the comfort of their homes and offices.

5.1.2 Asset Restructuring

Table 5.3*: Asset Restructuring Undertaken by Stanchart, BBK and KCB for the Period 1990-2001*

A/R	StanChart.		BBK		KCB	
	Year	Outcome	Year	Outcome	Year	Outcome
Physical Asset Expansion	N/A		1992-1993 1998	Invested in NIC and 3 new branches as part of business expansion Built a training complex in Karen, a storage facility for archives, opened 3 branches. Staff training became cheaper and training sessions more frequent	1993-2000	Opened 17 branches, 13 sub-branches, 14 satellites and KCB(T) as part of business expansion within Kenya and Tanzania. Was able to reach more customers which increased customer deposits.
Physical Asset Contraction (branch mergers, and sale)	1994-1995	Sold 7 loss making branches and generated exceptional income and reduced and interest income increased	1996 2001	Sold NIC, due to duplication of activities with those of main bank 35 loss making branches were closed and operating costs decreased significantl	1999-2001	Sold Kencom house, closed 74 mobile centres, 42 sub-branches and 6 satellites, sold non-core assets to generate exceptional income.
Focus on NPLs Realization	1994-1996	20 managers assigned to collection of NPLs for a period of 18 to 24 months. NPL reduced and profits increased	1997	Focused on NPLs realization and part of the loans became performing	2000	40% of non-performing loans became performing

Source: Research Data

Key: N/A-Not Applicable NPLs-Non-Performing Loans A/R-Asset Restructuring

Table 5.3 summarises the main asset restructuring approaches employed by the three commercial banks as physical asset expansion, physical asset contraction (branch mergers and sale) and focus on non-performing loan realisation. Provision for bad debts was a key emphasis in Standard Chartered throughout the study period. In 1994 for example, 20 managers were assigned to collection of non-performing accounts for a period of 18 to 24 months. In pursuance of debt recovery, any possible losses on loans were fully provided for in 1996. Despite the efforts however, the credit culture led to increase in non-performing loans towards the end of 1990's. Branch rationalization program saw the sale of 7 branches in 1995.

Barclays Bank on the other hand invested in NIC building, a residential training complex in Karen (completed in 1993) as well as a large storage facility for archives and stationery in 1992. In 1996 however, NIC was sold because of duplication of activities (business and products) between NIC and Barclays Bank. Three new branches were opened in 1998 branch refurbishment program was completed in some branches in 2001 which saw an increase in capital expenditure. As part of rationalization of the branch network, 35 branches were closed.

Kenya Commercial Bank saw rapid branch expansion between 1993 and 1995 by opening 4 new branches and 7 satellites in 1993 while 5 additional branches and 5 satellites were further opened in 1994. In 1995, 8 branches and 2 satellites were opened and later, KCB Tanzania was opened in 1997. The period 1999 and 2000 were contracting years for the bank, which saw closure of 74 mobile centres, 42 sub-branches, and 6 satellite branches. In 2001, a new IT system was installed (which did not become operational) and non-core assets were identified for sale to generate exceptional income to cover restructuring costs. Branch and ATM networks were improved through installation of 9 flexible IT systems. KCB (T) extended branch network to Mwanza in 2000. 40% of non-performing loans became performing in 2000.

Asset diversification was a main feature during the study period. Barclays launched Barclaycard, MasterCard, Visa and JCB cards in 1992 and Barclay's business Master Service in 1995. Barclays Merchant Finance Limited was able to offer merchant banking advisory services for companies contemplating privatisation. EFTPOs

terminals were installed in hotels, shops as service stations in 1993. Small Business Unit was expanded through partnering with donors, while point of sale terminals (POS) were introduced in 1997.

In the case of Standard Chartered, personal loans were introduced in 1999, primarily targeted at salaried individuals, while the Millennium Fixed Deposit account, which gives preferential rates on deposits and credit facilities, was introduced. The Visa Electronic Photos Debit Card enabling customers to access their money at ATM location worldwide was launched in 1999. Barclays continued to rebrand and modernize its branches in 2000 and new products set for personal customers tailored to meet changing customer needs and ensure the bank remains competitive were introduced. Kenya Commercial Bank started the Small Scale Enterprise Program, the Kenya Youth and Employment Creation (KYTEC) project and Lake Victoria Fishermen's Credit Scheme in 1993. KCB Visa Gold Card and KCB Visa Card were introduced in 1995 and in 1997; KCB Quick Serve (ATM) was launched. The Bank introduced the Magnetic Ink Character Recognition (MICK) automated debit clearing services. 20 ATMs were installed across the country in the same year while KCB Golden and KCB Gold Plus were launched in 1999. In 2000, KCB Visa card and KCB consumer loan were introduced. Business Banking solutions and fixed deposit instruments was launched in 2001in Standard Chartered. The Bank adopted branding in the same year by emphasizing on "Courageous, Responsive, International, Creative and Trustworthy".

5.1.3 Human Resource Restructuring

Training of staff was extensively undertaken, both locally and overseas. In the case of Standard, their Nairobi Training Centre continued to host the Groups management development programs with participants from other parts of Africa, Asia and Seychelles. The bank continued to utilize training materials and personnel from other parts of the Group as a strategy of migrating best practice and resources within Group companies. Focus 300, which was conducted in 1991, which was designed to give the Group new impetus and direction, covered 300 managers within the group. Focus 2000 covered the next 2000 middle managers trained in U.K, Malaysia and Zimbabwe. Inter-Group exchange program was also put in place under which a number of the Kenyan managers on overseas assignments within

***Table 5.4**: Human Resource Restructuring Undertaken by Stanchart, BBK and KCB for the Period 1990-2001*

H/RR	**StanChart**		**BBK**		**KCB**	
	Year	**Outcome**	**Year**	**Outcome**	**Year**	**Outcome**
Training : Local	Cont-inous	All senior staff were trained in IT and attended the Group management training. Staff now able to use computers in their offices	Conti nous	All mangers and staff were trained in IT, who are now able to use computers in their offices	Contin ous	All managers and staff were trained in IT, management of change, TQM, marketing and customer care. Staff became customer friendly, now use computers in their offices, aggressively marketed bank products.
:Over-seas	1991	300 top managers and 2000 middle managers trained in U.K, Malysia and Zimba-bwe.	N/A		N/A	
Inter-Group Ex-change		Kenyan managers attended inter-group programmes overseas which emphasized in team work. This improved managerial efficiency				
Volun-tary Early Retire-ment (VER)	1994	Substantial staff reduction as a cost-cutting measure. Reduced employee costs significantly	1995	Substantial reduction in staff as a cost cutting measure. Reduced employee costs significantly	1999-2000	Substantial reduction in staff as a cost cutting measure. Although the objective was to reduce staff costs, this was not achieved because high level managers were recruited who were paid much higher salaries than their previous counterparts

Source: Research Data

Key: H/RR-Human Resource Restructuring

the Group. All managers attended the Horizon Training Initiative conducted in Nairobi aimed at preparing managers for challenges facing the financial industry. Staff development was also enhanced through distance learning programs with some pursuing postgraduate courses (mainly MBA). Barclays introduced profit sharing and management bonus scheme in 1995.

The main human resource restructuring approaches adopted by the banks are summarised in Table 5.4.

Teamwork was emphasized, particularly between senior management and the Board of Directors. Voluntary Early Retirement (VER) was introduced in Standard Chartered in 1994, which saw a substantial reduction of staff, while it was introduced in KCB in 1999 where it was effected in 1999 and 2000. The main objective in these cases was to cut costs related to staff salaries. Staff training was on a continuous basis in KCB, Barclays Bank as well as Standard Chartered. Computer training was emphasized in KCB in 1997 to enhance the computer skills of its employees. In 1999, training emphasized on IT, management of change, and Total Quality Management (TQM), marketing and customer cares and training both locally and overseas including running of inter-group exchange programs and implementation of voluntary early retirement schemes was introduced.

5.1.4 Change in Management

Change in management arising from normal retirement and natural causes are not included in this analysis. Change of management was undertaken on a regular basis for the banks under study. For example, in Standard Chartered, change in top management took place in 1993, 1994, 1996, 1998, 2000 and 2002. In Kenya Commercial Bank, management change, in terms of top management and change of directors, was observed during the years of study as this took place in 1993, 1996, 1998, 1999, and 2000.

5.2 Implications of Bank Restructuring Approaches on Profitability for the Three Leading Commercial Banks in Kenya

5.2.1 Profitability of Commercial Banks in Kenya

Profitability refers to the excess of revenues over costs. To neutralise the effects of inflation however and to enable comparability among businesses of different sizes, relativity is emphasised by normalising each variable using the total asset value. Financial ratios, which are based on relativity, are thus commonly used as measures of profitability and are used in this study.

For this study, three banks were analysed; the Standard Chartered Bank which is the leading bank in Kenya in terms of product innovations and information as well as operational technology, Barclays Bank which is the largest multinational bank in terms of total assets, and the Kenya Commercial Bank which is the largest indigenous bank in terms of value of total assets. In addition these banks are the largest in Peer Group 1 category under the Central Bank of Kenya classification, a category with the largest commercial banks in Kenya.

Profitability was measured using Return on Equity (ROE), Return on Total Assets (ROTA), Equity Capital Ratio (ECR), Interest Spread and Non-interest income to average assets ratio. Some ratios, although recommended for assessing profitability were not used in this study because it was difficult to disaggregate the data due to limited disclosure. One interesting observation was that although the disclosure guidelines were introduced in 1996, most banks implemented the disclosure requirements in 1998 fiscal year. Although the period 1992 to 2001 was selected for the study, available data could only allow a thorough analysis for the period 1998 to 2001.Thus for the period 1992 to 1997 fiscal years only ROE, ROTA, and ECR could be estimated.

The following sections discuss the implications of bank restructuring approaches on profitability of the banks. The implications are discussed hand in hand with profitability because it was not possible to attribute changes in profitability wholly to restructuring approaches adopted. The researcher has however attempted to explain any changes in profitability to restructuring approaches adopted by the banks.

Whereas adopting lagged profitability data would have recognised the fact that restructuring approaches do not realise results immediately, the lagging period could not be estimated with certainty

5.2.2 Standard Chartered Bank

This is the leading bank in terms of product innovation and operational as well as information technology. As indicated in Appendix III, ROE for the bank decreased from 37.67 % to 24.9% in 1992-93. Over the same period ROTA decreased from 2.89% to 1.95%. This is probably due to high provision for bad loans and shocks associated with financial liberalization. The equity capital ratio slightly increased from 7.67% to 7.81%. For the period 1993 to 1994, ROE increased from 24.9% to 38.44% and to a further increase to 53.11% in 1995. During the same period ROTA increased from 1.95% to 2.71% and to a further 4.16%in 1995. This could be due to realization of non-performing loans following the assignment of 20 managers to collection of non performing loans over the period (18 to 24 months spilling over 1994 and 1995). In addition, the closure of the 14 branches and the merger of two others during 1994 and 1995 could have contributed to profitability if the branches were loss making. Product innovation during the same period could have started realizing results.

In 1996, ROE decreased to 41.36% further dropping to 33.02% in1997. ROTA followed the same pattern by dropping to 3.73% in 1996 and further to 3.26% in 1997. Due to computerization and branch refurbishment, proceeds from sale of 7 branches might have been wiped away by the VER and award to staff from industrial courts. ROE increased to 35.95% in 1998 and further to 38.41% in 1999, which was the same trend, observed in case of ROTA, which increased from 3.79% to 4.06%. However whereas ROTA increased from 4.06% in 1995 to 4.4% in 2000, there was a decrease of 4.1% in 2001.

Over the same period ROE decreased from 38.41% in 1999 to 35.04% in 2000 but increased to 38.54% in 2001. This could possibly be due to the huge costs incurred to ensure that the bank was 2000 compliant. Over the period 1994 to the year 2000, equity capital ratio increased steadily from 7.05% to 12.58% but slightly decreased from 12.58% in 2000 to 10.65% in 2001. Over the period 1998 to 2001, both the

spread and non-interest income to average assets ratio decreased from 9.18% to 7.35% in the case of the former to 5.78% to 4.57% in the case of the later. The trend could be explained by equipment maintenance costs to meet the year 2000 compliant challenge. Additional costs of upgrading ATMs and centralization of operations within the Business Technology Division could possibly have led to increased costs.

The bank continued to absorb the costs associated with enhanced technology and enhancement of the Service Delivery Division to provide information technology and to serve the operational service delivery arm of the bank covering all the on-line front office terminals in branches, ATMs, data center, international payments, trade and global operations possibly explain the decline in profitability over the period 1998 to 2001 in addition to hard economic times. Hubbing operations of Uganda, Tanzania and Zambia would have impacted on the overall bank results.

5.2.3 Barclays Bank

Appendix IV indicates that ROE increased in 1992 from 39.1% to 53.35% in 1993 and to a further 97.39% in 1994. Over the same period ROTA increased from 2.69% to 3.34% and to a further 7.93%. This could be due to the sale of NIC in 1993, which possibly led to a decrease in assets values thus increasing the ROTA. ROE declined to 46.17% to a further 39.71% in 1996 and to a further 39.11% in 1997. ROTA decreased from 7.93% in 1994 to 4.59% in 1995 and further to 4.36% in 1996, increasing slightly to 4.44% in 1997. This was possibly due to the cost of introducing ATMs and automation of the head office and other main branches. The bank also expanded its activities into the venture capital market by being a founder member of Kenya Capital Partners Ltd (KCP). Point of Sale (POS) terminals were introduced which had cost implications to the bank. ROE decreased from 51.9% in 1998 to 38.03% in 1999 and further decreased to 20% in 2000 and decreased further to 18.03% in 2001. ROTA also decreased steadily from 6.03% in 1998 to 2.8% in 2001. This could possibly be due to increased capital expenditure on computer equipment and refurbishing of branch premises as well as increase in the number of ATMs. Closure of 35 branches as part of rationalization of the branch network probably meant existence of idle assets, which were contributing nothing to profits. Over the period, there were swings in the levels of profitability as measured by interest spread. In 1995, interest spread was 8.65% increased to 9.88% in 1996, decreased to 9.46% in

1997 increased to 9.61% in 1998 decreased to 9.38% in 1999,increased to 10.05% in 2000 and again decreased to 9.19% in the year 2001.

5.2.4 Kenya Commercial Bank

Over the period 1992 to 1993, ROE increased from 21.91% to 40.14% . ROTA increased over the same period from 1.85% to 3.33%. Despite the fact that share capital increased in 1993 and that four new branches and seven satellites were opened, profitability appears to have increased, possibly due to income from the small-scale program, the Kenya Youth and Employment Creation (KYTEC) project and the Lake Victoria Fishermen's credit scheme. During 1994, ROE decreased to 25.4% and further to 21.96% in 1996. Over the same period, ROTA decreased to 1.91% but slightly increased to 2.44% in1995. This is possibly due to the opening of 5 branches and 5 satellites in 1994 and establishment of branches in the East African Community sub-region, all of which involved a substantial capital outlay, leading to an increase in total assets. The further decline in ROTA and ROE in 1995 could be due to the increase in total assets as a result of opening of 8 branches and 2 satellites.

In 1996, ROE increased to 30.73% but decreased to 26.17% in 1997 and further to 26.17% in 1997. Over the same period ROTA slightly increased to 3.66%, but decreased slightly to 3.5% in 1997%. This was possibly due to the introduction of the KCB Quick Serve and the opening of a KCB branch in Tanzania which all involved substantial capital outlay. The increase in ROTA to 2.45% in 1995 was probably due to the introduction of KCB visa Gold card and KCB visa card.

In 1998, ROE further decreased to 10.88% while ROTA decreased to 1.43%. This could be due to increase in staff costs due to increased industrial court awards, and revised salaries in accordance with collective bargaining agreements. 20 ATMs were also installed across the country, implying increase in total assets, possibly explaining the decrease in ROTA. Profitability deteriorated in 1999 when this was –17.67% improved to –5.77% in 2000 and further slightly improved to –4.56% in 2001. In 1999, ROTA hit a negative mark to stand at –2.075%, improved to –0.68% in 2000, but reported a positive ROTA of 3.49% in 2001. This could be due to increased provision for bad debts in 1999. Following closure of 74 mobile centers 42 sub-

branches and 6 satellite branches and increase in ATMs by 35% in 1999 costs could have increased significantly leading to a fall in profitability.

Equity capital ratio decreased from 8.44% in 1992 to 8.30% in 1993, but increased to 11.09% in1995 to a further 11.93% in1996 and further increases to 13.34% in 1997. This ratio however decreased to 13.10% in 1998,further decreased to 11.70% in 1999,decresed further to 10.98% in 2000 but increased to 12.85% in the year 2001. Generally the interest spread deteriorated during the period from 8.03% in 1998 to 7.14% in 1999, further decrease to 6.06% in 2000 but slightly improved to 6.28% in the year 2001(Also refer to Appendix V).

Profitability slightly improved in the year 2000 as a result of proper management of operating costs, staff reduction, product innovation through introduction of visa KCB card, KCB consumers loan and the fact that 40% of the non-performing loans became performing. KCB (T) extended branch network to Mwanza in 2000 leading to an increase in the value of total assets possibly explaining why the increase in ROTA was not substantial. The improvement in profitability in 2001 was as a result of the sale of non-core assets to generate exceptional income to cover restructuring costs. The improvement in profitability was not significant possibly due to installation of new technology, which did not become operational.

5.2.5 Comparative Analysis of Profitability of the Three Leading Commercial Banks in Kenya

In terms of ROE, Barclays Bank reported a higher profitability than the other two banks under study. ROE for Standard Chartered was less than that of Barclays Bank but profitability for Standard Chartered was more stable during the period. Profitability of Kenya Commercial Bank remained low recording a negative or a loss during the last three years of the study period (See Appendix VI(a)).

ROTA further shows that Barclays Bank reported a high but a more volatile profit during the period as it remained higher than that of Standard Chartered and Kenya Commercial Bank. The profit of Standard Chartered remained less than that of Barclays Bank but remained fairly stable, while the Kenya Commercial Bank profits remained generally lower than those of standard chartered and Barclays, reporting a

negative ROTA at the end of 1999 and 2000. But generally, whereas profitability of Barclays Bank and Kenya Commercial Bank was more volatile as measured by ROTA, that of Standard Chartered appeared more stable over the study period (See Appendix VI(b)).

In terms of ECR, Barclays Bank and Kenya Commercial Bank achieved almost the same level of profitability during the study period with minimal fluctuations. ECR for Standard Chartered however appear to have shot up in 1997, but remained relatively stable and at the same levels with that of Barclays Bank and Kenya Commercial Bank over the study period. (See Appendix VI©).

Generally, profitability of Standard Chartered appears to be more stable over the study period, though lower than that of Barclays Bank but higher than that of Kenya Commercial Bank. Standard Chartered Bank appears to be ahead of Barclays Bank and Kenya Commercial Bank in terms of restructuring approaches possibly explaining why the profits of the bank are more stable. This could also be an indication of better management who set predetermined profit targets which are subsequently achieved. Generally, stable profits is an indication of proper planning which is an aspect of good management.

CHAPTER SIX

SUMMARY OF FINDINGS, CONCLUSIONS, RECOMMENDATIONS, LIMITATIONS OF THE STUDY AND SUGGESTIONS FOR FURTHER RESEARCH

6.1 Summary of Findings and Conclusions

The World Bank (1997:2) observe that tying bank restructuring to wider adjustment operations will tend to delay implementation, most often in situations where intervention in the banking sector can hardly afford delay. In addition, identifying measurable indicators in the preparation of bank restructuring operations is important as well as ensuring availability of relevant data on the banking sector as well as on individual banks. More so, bank restructuring programs should be reviewed independently and "ageing" of arrears and loan classification undertaken. The possibility of bank-restructuring operations, particularly those established in less-than –stable economic environments, and possibilities of benefiting from prior, more targeted sector work should be considered.

Despite its sensitive nature, the question of bank governance needs to be addressed head-on in bank restructuring operations. Indeed, there is no substitute for qualified, private, independent bank management, fully responsible for its actions. In some cases, for example in Ghana, senior bank managers were, retained for too long after restructuring was initiated, permitting them not only to repeat the errors of the past, but, worse, to subvert agreed reforms according to their own interests and convenience.

Policy makers and individual banks should note that budgets often deteriorate immediately following the onset of bank restructuring in part because the costs of economic restructuring are so high even though bank restructuring programs may be initiated in a time of economic stagnation or severe recession, positive economic growth helps banks to resume lending and return to profitability.

Designating a separate lead agency to coordinate and implement the restructuring and monitoring the bank restructuring exercise is vital since large public expenditures are involved. The central bank on the other hand should be supportive and not involved operationally. In cases where the central bank is the lead agency, it often gets drawn

into financing bank restructuring measures, exceeding its resources and taking actions that conflict with its basic responsibilities for monetary management. Most successful countries in bank restructuring minimized the use of the central bank financing and avoided central bank lending to insolvent banks. Government financial support for illiquid banks was unavoidable in most instances. Loss sharing among the state, the banks and the public is integral to successful bank restructuring.

Deposit insurance entity funded by contributions from banks should be used as a strategy for incorporating loss-sharing arrangements. Removing non-performing loans from the bank's balance sheets and transferring them to a separate loan recovery agency can be an effective way of addressing the bank's solvency problems.

Loan workouts (foreclosure or asset sales) are important to recover some of the cost of bank restructuring and to send signals to delinquent borrowers. Loan workouts can be done by a central organization, usually operated by the state or by special loan collection agencies tied to individual banks. Clear policies for determining when a bank is viable or when it should simply be permitted to fail is important for successful restructuring. These should be clear and should be applied consistently.

The study findings revealed that commercial banks in Kenya have adopted four main restructuring approaches; operational restructuring, asset restructuring, change in management and human resource restructuring. No direct link was however established between bank restructuring approaches and bank profitability although changes in bank profitability during the study period was interpreted within the context of adoption of the restructuring approaches. The change in profitability could however be attributed to other factors such as changes in macroeconomic environment and quality of lower level and middle level managers.

From the study, Standard Chartered was observed to be ahead of the Kenya Commercial Bank and Barclays Bank in terms of bank restructuring and the bank also reported more stable profits during the period. Barclays however reported higher but more unstable profits than Standard Chartered, while Kenya Commercial Bank reported the lowest, yet volatile, profits and indeed reported losses towards the end of the study period. Generally, Barclays Bank appears to be second to Standard Chartered

in terms of adopting bank restructuring approaches while Kenya Commercial Bank appears to be a market follower in adopting the restructuring approaches, possibly explaining why the bank reported a lower profitability than Barclays Bank and Standard Chartered, during the study period.

6.2 Recommendations

Banks should undertake restructuring even if they are not troubled or have not failed because restructuring helps in reduction of costs and in adapting to environmental, technological and other changes that have implications on their performance.

It is evident that Standard Chartered Bank adopted the restructuring approaches ahead of other banks, possibly explaining why the bank reported higher profitability throughout the period of study. Banks should also set aside funds for restructuring so that they too can be competitive and thus report high profits.

Banks that were aggressive in training their staff, particularly organizing exchange programs reported higher profitability than those that concentrated on local in-house training. Banks should generally expose their staff to various on the job training, and more so those that have branches in other environments should expose their staff through exchange programs.

The Central Bank in consultation with the Kenya Bankers Association should formulate and issue prudential guidelines on restructuring of commercial banks.

Commercial banks should adopt technological and related restructuring techniques, such as installation of ATMs, networking of their branches and departments, and computerisation of their operations for reduction of costs and improvement in efficiency. In particular, small banks should pool resources together to enable them minimize on technological costs.

6.3 Limitations of the Study

The results of this study should be interpreted with caution since it is difficult to directly linking bank restructuring approaches to bank profitability. Other factors such as, lucrative interest income from treasury bills, investments occasioned by the need to

finance government deficits and reduction of cash and liquidity ratio requirements by the Central Bank of Kenya might in addition have influenced profitability of the banks.

The study assessed only three banks, thus the results may not be generalized for the Kenya banking industry, which has 47 banks. In addition, the banks under study were the three biggest banks. Small and medium size banks might give totally different results.

Time and resources for undertaking this study was limited, thus certain information that could have been useful for this study was probably not assessed. The study assumed that restructuring approaches affected profitability the same year when they were introduced which may not be the case. Effects of restructuring could even have been felt two or many years after the approaches were implemented.

Analysis of profitability of the commercial banks was limited because the disclosure of information relating to costs as well as both interest and non-interest income was inadequate.

The study assumed that restructuring approaches affected profitability the same year when they were introduced and in the same magnitude. The effects of the restructuring could have been felt even two or three years after the undertaking the restructuring. More so, the impact of different restructuring approaches on profitability was probably not uniform.

6.4 Suggestions for Further Research

Bank restructuring is a very wide area. Other studies should address specific aspects of bank restructuring, such as asset restructuring, capital restructuring, operational restructuring and financial restructuring and their impact on bank performance in Kenya.

The effect of bank restructuring on deposits of commercial banks should be evaluated to determine whether banks that are ahead in terms of restructuring are able to attract

huge customer deposits. More so, it would be useful to determine whether certain customers cluster in certain banks on the basis of the banks' restructuring pace.

A study on the relationship between bank restructuring approaches and the level of non-performing loans is important to determine whether banks that emphasize on certain restructuring approaches have similar levels of non-performing loans.

Linking bank restructuring and profitability of commercial banks appears to be rather difficult. A study to develop a model that could possibly link bank restructuring and bank profitability is necessary.

A study to estimate the time lag between adoption of restructuring approaches and when the impact is actually felt in the banks is necessary. This will be useful in determining how long, on average, the banks should wait to realise profits following restructuring.

A study on the correlation between bank restructuring approaches and bank profitability is recommended. Possibility for data segregation should thus be explored to determine whether certain restructuring approaches contribute more to profitability than others. This will enable the banks to identify which restructuring approaches to give priority.

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Appendix 1

Bank Restructuring Experiences in Selected Countries

Country	Start of restructuring	Story	Restructuring approaches used
Cote d' Ivoire Deteriorating prices of world market prices of cocoa and coffee began in 1986. By 1990, 14 commercial banks were experiencing a sharp drop in deposits and credits from foreign bank.	1991-92	Success	Comprehensive with world Bank support (involved, liquidation of the last state bank, enacting new laws to provide for the foreclosure and management of non-performing loans. - Recapitalization of commercial banks through settlement of government arrears and new capital from private owners. - Owners of insolvent commercial banks were given the choice of closing and liquidating, mergers or injecting fresh capital none was considered too big to fail. -Operational reforms to restore liquidity (management changes, cuts in staffs and branches of commercial banks). Government strengthened framework of regulatory, accounting, fiscal, legal and monetary policies. - Formed regional banking commission, which provided continuing supervision. 1994, bank's return on capital and most banks had returned to compliance with newly lighted prudential rules. -Economic recovery improved following currency devaluation

Country	Start of restructuring	End	Story	Bank Restructuring approach used
Phase 1 Mauritania 1988-89 triggered by weak world market prices of agriculture and fishing. Put severe pressure on poorly managed banking system	1988-90		Failure	Non-comprehensive -Government built banks balance sheets by absorbing their large overdrafts with the central bank. -Operational reforms did not receive political support. -Banks continued to lend to troubled agricultural and fishing industries. -Central bank was not effective in supervision (including compliance with its prudential requirements) -Privatization plans lagged and -Recovery of non-performing loans bogged down in long, costly procedures. -1991, non-performing loans reached 50% of their credit to private sector –indication that restructuring had not succeeded.
Phase 2	1992-94		Success	-Government used the enhanced structural adjustment facility (from IMF) to support a second effort at restructuring. -Development bank was closed and its assets liquidated. -Four commercial banks were recapitalized and fully privatized. -Central banks supervisory powers were strengthened. Government established a loan recovery agency operation and achieved its target for 1995. -Banks showed all signs of increased profitability in 1995. Lesson learned – banking problems would recur if financial restructuring is not by reforms.

Country	Start of Bank restructuring	End	Story	Bank restructuring approach used
Sweden Crisis started in late 1990 due to recession and over lending to real estate industry	1990-1994		Success	-Government injected capital and gave loan guarantees which were met from the government budget -1992 Bank support authority (BSA) was started as the lead restructuring firm agency Standards were set to determine which banks could and could not be saved. -Most banks set up work out subsidiaries to deal with their non-performing loans, freeing bank management to deal with core business. -The government in 1994-96 received no applications for support and the guarantee program was phased out.
Chile	1983			-Comprehensive bank restructuring Central bank took the lead in divisive, carrying out, and financing the strategy. -Central bank took 14 out 26 commercial banks and 8 out of 17 private domestic finance companies. -Central bank liquidated 8 of the banks and all the finance cost; becoming directly involved in the lending operations of the banks -Central Bank undertook continuing fiscal expenditures by assuming the financial costs of bank rescue operations. -Central bank absorbed much of the losses; Central Bank actively engaged in debt rescheduling and commercial bank lending and continued operations of insolvent banks.
Spain	1983			-Comprehensive -Central bank took the lead -Central bank emphasized cost sharing with the banking community and put in place other incentives for improved corporate governance. -Bank activities were placed in deposit guarantee fund (FGD) were removed from its monetary policy and supervisory duties. -Existing bad debts were written off, against remaining capital. -FGD acquired controlling interest in the bank, and later injected cash for additional equity stakes, finally selling the bank to new shareholders.

Philippines 1983 bank capital flight and weak regulations banking practices			Success	-Government directed banks to lend to enterprises in distress. -Supervisory agency (the monetary board waived enforcement of banking standards to give troubled banks a chance to overcome financial difficulties. -End 1985, two largest state –owned banks were insolvent. -Comprehensive rehabilitation program, which involved. • Getting non-performing loans off the two banks balance sheets and covering them with government debt. • Assets privatization trust was set up to conduct loan workouts and recovery operations. -Proper diagnosis -Operational reforms including new market and major cost reduction to back up the financial restructuring. -Strengthened regulation and prudential standards. -Tax privileges were withdrawn from banks. Banks subjected to private external audits -Government withdrew all further guarantees.

Source: Caprio, (jr)G. et.al (1998); Sheng, A. (1996); IM, (1997) and World Bank, (1997).

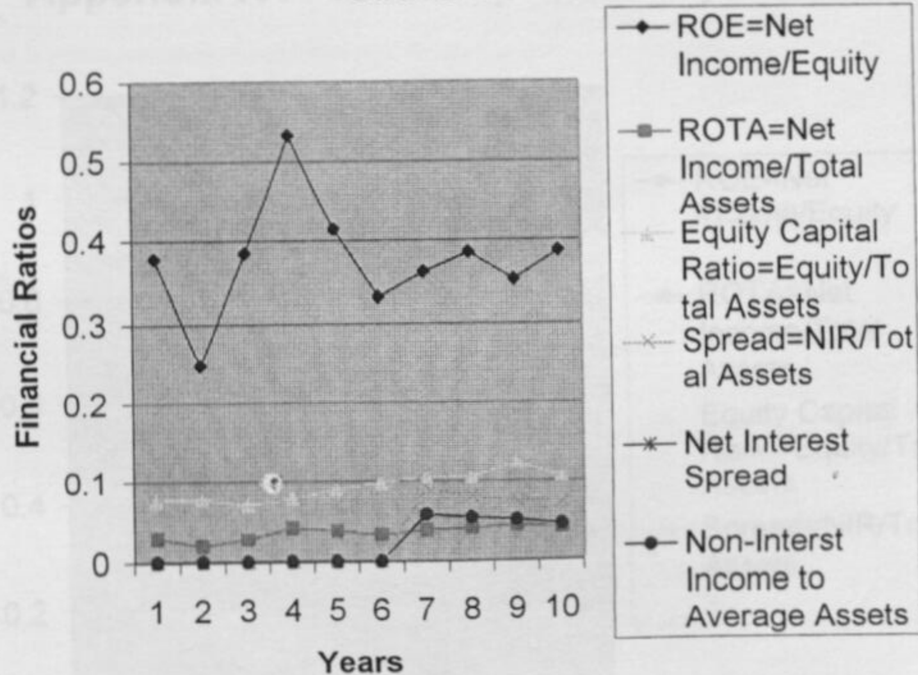
Appendix II

Commercial Banks In Peer Group 1

(Ksh million)

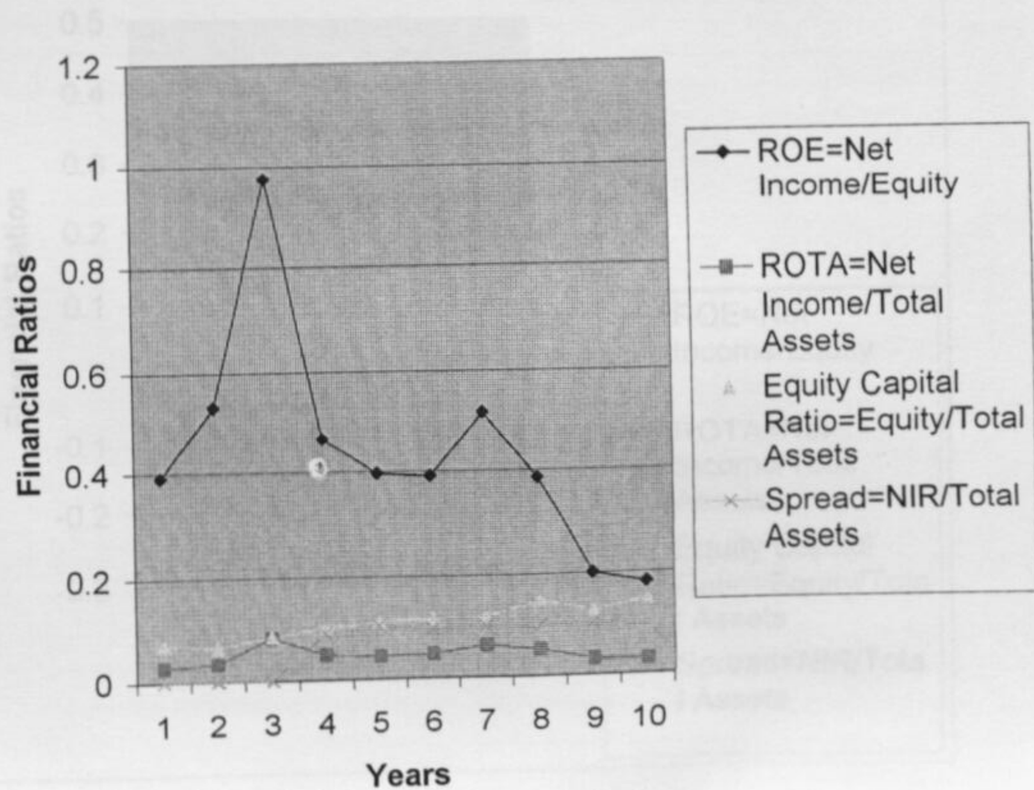
Serial Number	Name of Bank	Net Assets	Total Assets and Contingencies
1.	Barclays Bank of Kenya Ltd	74,178	89,923
2.	Kenya Commercial Bank Ltd.	61,115	89,904
3.	Standard Chartered Bank Ltd.	54,410	67,479
4.	Citibank, N.A.	27,710	41,850
5.	National Bank of Kenya Ltd.	23,956	50,394
6.	Co-operative Bank of Kenya	21,338	30,786
7.	Commercial Bank of Africa	16,156	20,374
8.	Housing Finance Co. of Kenya	11,598	15,645
9.	CFC Bank.	8,300	10,569

Source: Bank Supervision Annual Report (2001), The Central Bank of Kenya.



Source:Researcg Data

Appendix IV: Profitability of Barclays Bank



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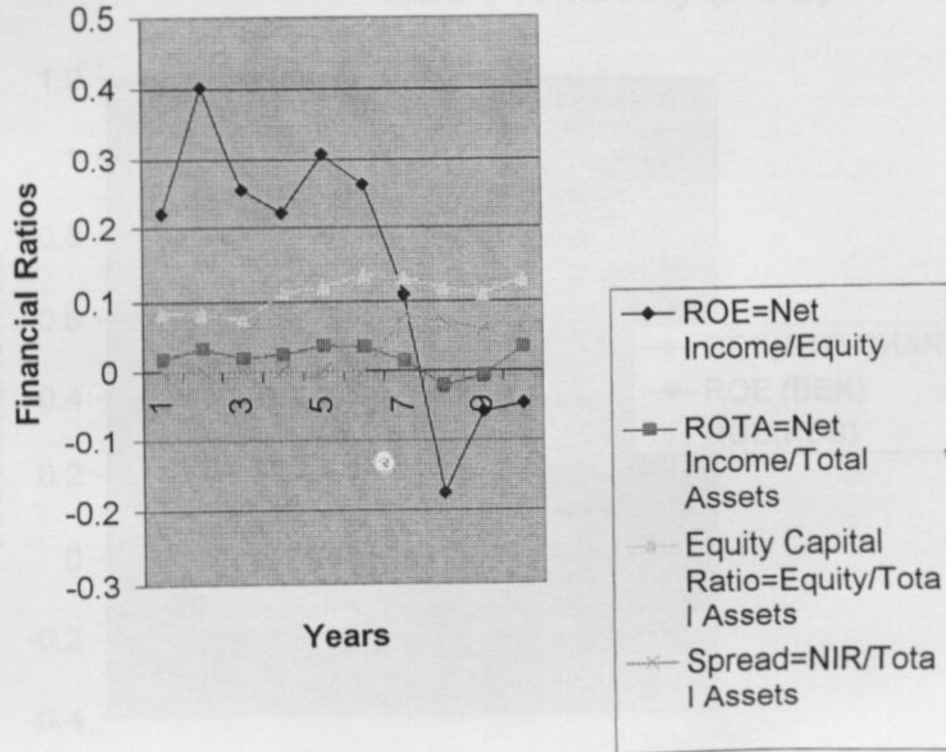

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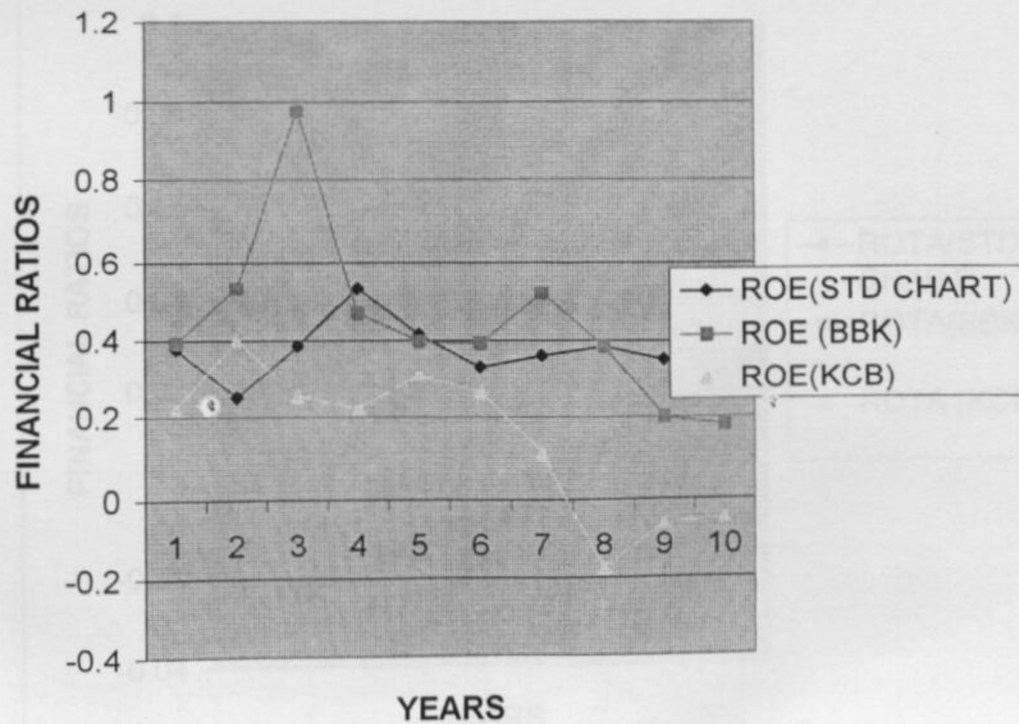

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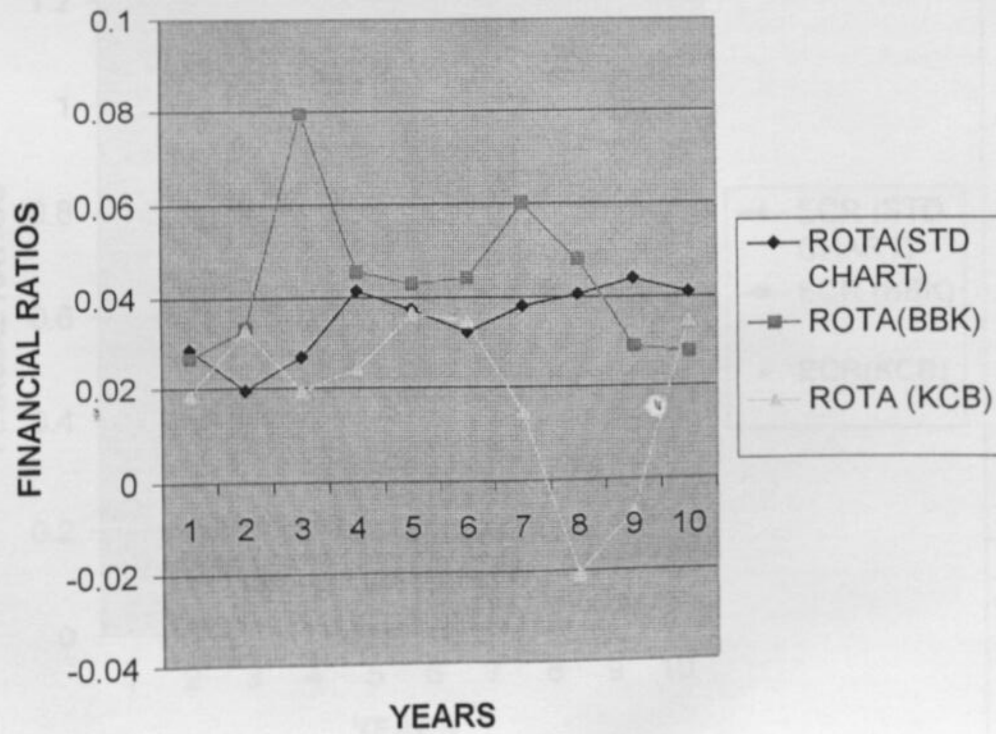

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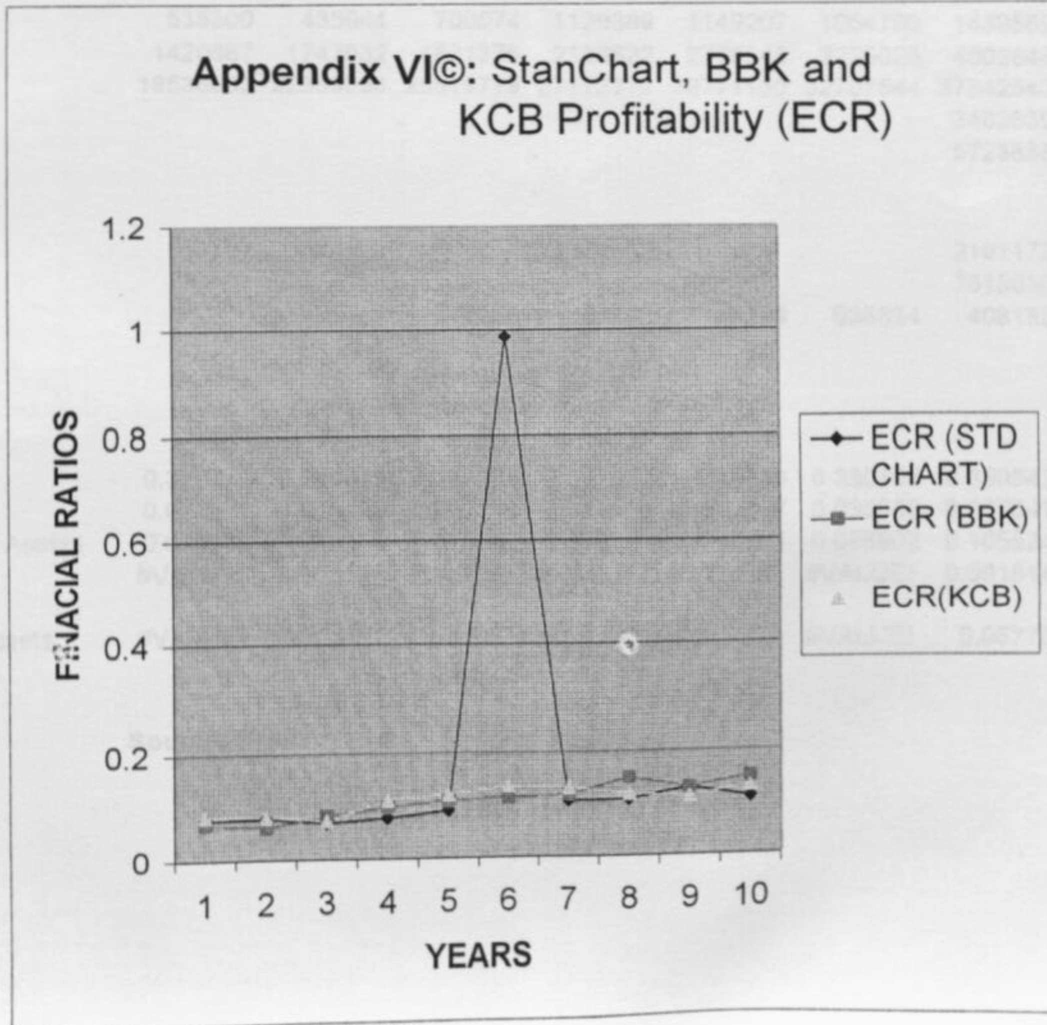

Source: Research Data

Appendix VII: Standard Chartered

	92	93	94	95	96	97	98	99	0	1
Net Income	535300	435044	700074	1129389	1149207	1064790	1439569	1737119	2167520	2235228
Equity	1420867	1747032	1821378	2126622	2778345	3225026	4003844	4522087	6185968	5800415
Total Assets	18536682	22359056	25819719	27172872	30771150	32707544	37942543	42772169	49188750	54480344
Net Interest Revenue	.	.	.	.	.	.	3483639	3435831	3700710	4005317
Interest Income	.	.	.	.	.	.	5723858	4619507	4943558	5381175
Interest Earning Assets	.	.	.	.	.	.	.	.		.
Interest Paying Liabilities	.	.	.	.	.	.	.	.	.	.
Non-Interest Income	.	.	.	.	.	.	2191172	2307079	2519734	2487655
Total Income	.	.	.	.	.	.	7815030	6926586	7463292	7868820
Bad Debt Provision	.	.	572288	86498	47234	636834	408188	325640	214823	185589
FINANCIAL RATIOS										
ROE=Net Income/Equity	0.376742	0.249019	0.384365	0.531072	0.41363	0.330165	0.359547	0.384141	0.350393	0.385357
ROTA=Net Income/Total Assets	0.028878	0.019457	0.027114	0.041563	0.037347	0.032555	0.037941	0.040613	0.044065	0.041028
Equity Capital Ratio=Equity/Total Assets	0.076652	0.078135	0.070542	0.078263	0.090291	0.098602	0.105524	0.105725	0.12576	0.106468
Spread=NIR/Total Assets	#VALUE!	#VALUE!	#VALUE!	#VALUE!	#VALUE!	#VALUE!	0.091814	0.080329	0.075235	0.073519
Net Interest Spread										
Non-Interst Income to Average Assets	#VALUE!	#VALUE!	#VALUE!	#VALUE!	#VALUE!	#VALUE!	0.05775	0.053939	0.051226	0.04566[illegible]
Net Operating Costs/Total Assets										

Source: Research Data

Appendix VIII: Barclays Bank

	92	93	94	95	96	97	98	99	0	1
Net Income	694	1313	3398	2120	2274	2687	4242	3361	2068	2055
Equity	1775	2461	3489	4538	5726	6870	8169	8738	10343	11400
Total Assets	25793	39322	42834	46235	52693	60563	70362	69292	70377	73647
Net Interest Revenue				4001	5206	5728	6759	6502	7071	6771
Interest Income				5780	7685	8597	10250	8202	8749	8129
Interest Earning Assets			33966	44138	42549	51634	59794	61047	64096	60014
Interest Paying Liabilities			5217	4920	6901	6750	9149	3766	3332	3432
Non-Interest Income				2787	3282	3609	3551	4297	4253	4491
Total Income				8567	10967	12206	13801	12499	13002	12620
Bad Debt Provision				83	72	222	258	440	1641	1037
Operating costs				3679	4588	5141	5810	6998	6648	5990
FINANCIAL RATIOS										
ROE=Net Income/Equity	0.390986	0.533523	0.973918	0.467166	0.397136	0.391121	0.51928	0.384642	0.199942	0.180263
ROTA=Net Income/Total Assets	0.026907	0.033391	0.07933	0.045853	0.043156	0.044367	0.060288	0.048505	0.029385	0.027903
Equity Capital Ratio=Equity/Total Assets	0.068817	0.062586	0.081454	0.098151	0.108667	0.113436	0.1161	0.146966	0.126104	0.146966
Spread=NIR/Total Assets	0	0	0	0.086536	0.098799	0.094579	0.09606	0.093835	0.100473	0.091939
Net Interest Spread										
Non-Interst Income to Average Assets										
Net Operating Costs/Total Assets										

Source: Research Data

Appendix IX: Kenya Commercial Bank

	92	93	94	95	96	97	98	99	0	1
Net Income	478.3	1283.285	1157.3	1410.9	2500.933	2566.412	1126.25	-1554.67	-464.469	381.98
Equity	2183.216	3196.947	4555.675	6423.753	8139.286	9806.503	10355.9	8797.512	8048.418	8379.804
Total Assets	25866.6	38511.8	60608.16	57930.78	68238.617	73535.22	79033.24	75216.65	73328.49	65206.21
Net Interest Revenue							6344.68	5368.053	4442.958	4097.002
Interest Income							15097.29	10452.74	8785.274	6608.506
Interest Earning Assets							60020.7	57213.73	12685.67	13051.36
Interest Paying Liabilities										
Non-Interest Income							2805.507	3931.297	4927.042	4693.389
Total Income					15914.484	17041.03	17902.79	14384.04	13712.32	11301.9
Bad Debt Provision							2009.816	5113.709	4359.799	2771.995
Operating Costs										
Interest Expense							8752.606	5084.686	4342.316	2511.52
FINANCIAL RATIOS										
ROE=Net Income/Equity	0.21908	0.40141	0.254035	0.219638	0.307266878	0.261705	0.108754	-0.17672	-0.05771	-0.04558
ROTA=Net Income/Total Assets	0.018491	0.033322	0.019095	0.024355	0.03664982	0.0349	0.01425	-0.02067	-0.00681	0.0349
Equity Capital Ratio=Equity/Total A	0.084403	0.083012	0.075166	0.110887	0.119276831	0.133358	0.131032	0.116962	0.109758	0.128512
Spread=NIR/Total Assets	0	0	0	0	0	0	0.080279	0.071368	0.06059	0.062831
Net Interest Spread										
Non-Interst Income to Averag: Assets										
Net Operating Costs/Total Assets										

Source: Research Data

Appendix X: StanChart, BBk and KCB (ROE, ROTA and ECR)

FINANCIAL RATIOS COMBINED	92	93	94	95	96	97	98	99	0	1
ROE(STD CHART)	0.376742	0.249019	0.384365	0.531072	0.41363	0.330165	0.359547	0.384141	0.350393	0.385357
ROE (BBK)	0.390986	0.533523	0.973918	0.467166	0.397136	0.391121	0.51928	0.384642	0.199942	0.180263
ROE(KCB)	0.219081	0.40141	0.254035	0.219664	0.307267	0.261705	0.108754	-0.17672	-0.05771	-0.04558
ROTA(STD CHART)	0.028878	0.019457	0.027114	0.041563	0.037347	0.032555	0.037941	0.040613	0.044065	0.041028
ROTA(BBK)	0.026907	0.033391	0.07933	0.045853	0.043156	0.044367	0.060288	0.048505	0.029385	0.027903
ROTA (KCB)	0.018491	0.033322	0.019095	0.024355	0.03665	0.0349	0.01425	-0.02067	-0.00681	0.0349
ECR (STD CHART)	0.076652	0.078135	0.070542	0.078263	0.090291	0.98602	0.105524	0.105725	0.12576	0.106468
ECR (BBK)	0.068817	0.062586	0.081454	0.098151	0.108667	0.113436	0.1161	0.146966	0.126104	0.146966
ECR(KCB)	0.084403	0.083012	0.075166	0.110887	0.119277	0.133358	0.131032	0.116962	0.109758	0.128512

Source: Research Data