THE EFFECTS OF FINANCIAL LIBERALIZATION ON THE
FINANCIAL PERFORMANCE OF COMMERCIAL BANKS IN
KENYA

BY

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DECLARATION

I declare that this project is my original work and has not been submitted for examination in any other university.

Signed

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D61/75194/2012

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

Signed

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DEDICATION

I wish to dedicate this project to my Children Sasha and Marcus, for their endurance and moral support during the period of study.
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<td>Central Bank of Kenya</td>
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<td>CR</td>
<td>Credit Risk</td>
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<td>Credit Risk Management</td>
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<td>FIs</td>
<td>Financial Institutions</td>
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ABSTRACT

The banking industry is one of the sectors that play an important role in the allocation and distribution of capital resources and risk sharing of future flows in any given economy or country. The objective of the study was to determine the effect of financial liberalization on the financial performance of commercial banks in Kenya. The study adopted a descriptive survey of commercial banks in Kenya. The target population for this study included all commercial banks that are registered and currently operating in Kenya. The study used secondary data since the nature of the data was quantitative. The data was collected from a number of sources such as the audited financial statements of the sample commercial banks; the Central Bank of Kenya and the Kenya National Bureau of Statistics. The data collected was sorted and organized before capturing the same in Statistical Packages for Social Sciences (SPSS) for analysis. The study focused on five key variables namely the dependent variable which was measured using return on equity (to measure financial performance of commercial banks), financial liberalization index was measured using the independent variables namely: local deposits, level of financial intermediation, financial liberalization and financial growth. A regression analysis was conducted to assist the researcher in establishing the effect of financial liberalization on the financial performance of commercial banks in Kenya. Coefficient of determination was used to determine whether the model was a good predictor. Correlation was used in establishing the relationship between financial liberalization and financial performance of commercial banks in Kenya. A t-test was used to test the hypothesis that a particular coefficient is significantly different from zero or whether the estimated coefficient value occurred by chance in equation. The data tests was performed at 95% level of confidence. The study concluded that there was negative relationship between financial liberalization and financial performance of commercial banks in Kenya. The researcher therefore recommends that there is need to measure the financial performance of commercial banks with other variables other than financial liberalization index.
CHAPTER ONE

INTRODUCTION

1.1 Background of the Study

The banking industry is one of the sectors that play an important role in the allocation and distribution of capital resources and risk sharing of future flows in any given economy or country. An efficient and effective banking industry in any economy is likely to facilitate increased growth and welfare, and it enhances business cycles. There are several functions that are performed by banks thus making them sensitive to both internal and external factors (Banderia, Caprio, Honohan and Schiantarelli, 2000). For instance banks provide money changing and payment processing services; transformation of assets in terms of their maturity, quality, and denomination and more recently management and control of risks. These functions give banks a central position within the process of saving and investment allocation. However, these functions make banks vulnerable to different sources of shocks, and they have both negative and positive effect(s) on the economy because of banks’ central role in the economy (Brautigam and Knack, 2004).

A large number of developing countries in the late 1980s including Asian, Latin America and Sub Saharan African (SSA) Countries widely adopted Structural Adjustment Programs (SAPs) in view of reviving their deteriorating economies (World Bank, 1994). SAPs were basically meant to encourage governments to pursue measures of economic liberalization in order to remove restrictions in financial
intermediation process (Serieux, 2008), improve resource mobilization, productivity and operational efficiency which had made process of economic development unachievable (Aryeetey, Hettige, Nissanke, and Steel, 1997). One of the major economic liberalization measures was reform of the financial sector which is best known as financial liberalization.

It was argued that financial sector could play a greater role in increasing national savings and encouraging efficiency in capital accumulation if only price controls and directed credit programs were ended. This could encourage competition in financial system (Fry, 1995). Financial liberalization was therefore viewed as a process of delegating the authority to determine who is to receive and give credit to the market as well as the price at which it was given. The financial liberalization measures that were to be adopted included deregulation of interest rates; elimination or reduction of directed credit control; allowing free entry in the banking sector as well as giving autonomy to commercial banks; allowing private ownership of banks; and liberalizing international capital flows (Odhiambo, 2009).

1.1.1 Financial Liberalization

Financial liberalization is the easing of restrictions on the capital account (essentially the flow of funds) and the financial transactions of individuals and businesses in the effort to make financial transactions more efficient and thereby promote a more productive allocation of resources (Allen and Saunders, 2004). More generally, it is the policy process through which a country establishes an open financial market in which market forces and not the government determines financial outcomes (Alfaro, Kalemli-Ozcan, and Volosovych, 2008).
Financial liberalization, in turn, has come to be most commonly associated with freeing of interest rates. The term ‘financial liberalization’ is defined by various economists in different ways. Patnaik (2011) states that financial liberalization is used to cover “a whole set of measures, such as the autonomy of the Central Bank from the government; the complete freedom of finance to move into and out of the economy, which implies the full convertibility of the currency; the abandonment of all “priority sector” lending targets; an end to government-imposed differential interest rate schemes; a freeing of interest rates; the complete freedom of banks to pursue profits unhindered by government directives; the removal of restrictions on the ownership of banks, which means de-nationalization and full freedom for foreign ownership (Bayoumi, 1993).

Similarly, Baden (1996) advocates that “financial liberalization means the removal of government ceilings on interest rates and of other controls on financial intermediaries. It is concerned with macroeconomic aggregates (interest rates, savings and investment) and conditions in formal financial markets”. There are several elements of financial liberalization. This includes elimination of credit controls, freeing of foreign exchange rate, deregulation of interest rates, free entry into the banking sector and financial market, bank autonomy, privatization of the banking sector and liberalization of the international capital flows.

Financial liberalization can be measured using several indicators used in construction of financial liberalization index. The common measures include; average annual nominal interest rate, Commercial bank assets as a percentage of total financial assets (Liquid liabilities as a percentage of GDP). Liquid liabilities are the sum of currency
plus demand and interest-bearing liabilities of banks and other financial intermediaries’ divided by GDP. This is the broadest financial indicator of financial intermediation because it looks at the overall size of the financial sector, private credit by commercial banks as a percentage of GDP. It measures the ability of financial intermediaries to carry out their primary function to direct savings to investors. Private credit by commercial banks and other banking institutions as a percentage of GDP, the ratio of commercial bank assets over central bank assets, a widely used measurement of financial development and finally the ratio of stock market capitalization to GDP, an indicator of the size of the stock market (Quispe and Mcquerry, 2001).

1.1.2 Financial Performance

There are different definitions of organizational performance that have been coined by different researchers and authors. According to Maria, Florica and Catalina (2002), the performance of an organization is equated to a state of competitiveness of that organization which is reached through attaining a given level of efficiency and productivity which ensures a sustainable market presence. Carton (2004) also defines financial performance of an organization as the measure of the change of the financial state of an organization or the financial outcomes that results from management decisions and the execution of those decisions by members of the organization. He further argues that the outcomes are not universal in nature but largely depend on the organizational context hence selection of the measures that represent performance of a particular organization is done based upon the circumstances of the organization being rated.
The common financial indicators of financial performance applied by most commercial banks include: sales growth, return on investment (ROI), return on sales, return on equity (ROE), and earnings per share. The popular ratios that measure organizational performance can be summarized as profitability and growth: return on asset (ROA), return on investment (ROI), return on equity (ROE), return on sale (ROS), revenue growth, market shares, stock price, sales growth, liquidity and operational efficiency. Return on average assets (ROA) and return on equity (ROE) are used as financial measures when determining the level of financial performance of commercial banks (Maria et al, 2002).

Organizations can adopt any of these measures depending on the suitability and context. These financial performance measures are however grouped into five major categories: The first category contains profitability measures such as return on equity, return on assets, return on capital, return on sales and operating margin; The second category of measures includes growth measures calculated on sales, total assets and total employees; The third group of financial performance measures includes Leverage, Liquidity, and Cash Flow Measures such as Debt to equity ratio, operating cash flow to equity ratio and growth rate of operating cash flow; there are also market based measures such as cost of equity capital and price to book ratio; The last category of measures are referred to as Economic Value Measures such as residual income and Residual income return on investment. This paper will regard the performance of commercial banks strictly as being determined by their profit levels. The underlying assumption is ‘the higher the profit, the higher the performance’ of any particular bank (Carton 2004).
1.1.3 The effect of Financial Liberalization and Financial Performance of Commercial Banks

Andries and Capraru (2013), investigated on the impact of financial liberalization and reforms on the banking performance in 17 countries from Central and Eastern European Countries for the period 2004–2008 using a two-stage empirical model that involves estimating bank performance in the first stage and assessing its determinants in the second one. The results from this analysis showed that banks from CEE countries with a higher level of liberalization and openness are able to increase cost efficiency and eventually to offer cheaper services to clients. Banks from non-member EU countries are less cost efficient but experienced much higher total productivity growth level, and large sized banks are much more cost efficient than medium and small banks, while small sized banks show the highest growth in terms of productivity.

Financial liberalization has led to financial performance of commercial banks; this is attributable to an increase in customers’ deposits, assets and increase in profits. The financial sector faced two major banking crises as a result of financial liberalization attributed to poor credit risk management and the consequent increase in loan non-performance in the mid-1980s and during the early and late 1990s (CBK 1990). Between 1993 and 1996, 6 commercial banks and 12 NBFIs faced insolvency problems while in 1998, 5 banks were placed under statutory management (Waweru and Kalani, 2009).

Financial liberalization has impacted on freeing of interest rates, reduced reserve requirements, and elimination of directed credit schemes leading to financial
performance of commercial banks. This has led to stable price level and thus creating a conducive environment for rapid growth of investments, this has led to an increase in financial performance of commercial banks (Athukorala and Sen, 2001). The need to accumulate funds to undertake lumpy investments would make money and capital complementary (rather than substitutes) or because of a “credit availability effect” has increased savings into the banking system leading to an increase in investment through enhanced credit availability (Christen and Pearce 2005).

Positive real interest rates resulting from financial liberalization has led financial performance since the demand for money, defined as savings and term deposits as well as checking accounts and currency increases as a proportion to national income, which in turn, is supposed to promote economic growth (Balioune-Lutz, 2006). Given the important role played by interest rates in all this, removal of controls over interest rates has become the centerpiece of the liberalization process (Awan, Munir, Hussain and Sher, 2010).

1.1.4 Commercial Banks in Kenya

The government in an attempt to contain the worsening state of the economy, it introduced a number of control measures to commercial banks. These measures included imposing controls on bank lending, import quotas, price controls on goods and interest rate controls. With these measures in place, the deteriorating economic performance still persisted (Mwega, Ngola and Mwangi, 1990).

Government resources were squeezed further making revenues to fall short of expenditure. By early 1980s the situation was not any better since the overall deficit
had reached 8.9% of GDP in 1981 compared to one that prevailed in 1960s of below 3%. The government went ahead and introduced budget rationalization so as to reduce spending. This still did not work out because fiscal deficit was reportedly high at 7.2% in 1987 (Republic of Kenya, 1988).

The measures that the government had resulted to in order to contain the dropping economic performance distorted the financial market rendering real interest rates to decline below zero from 1973 to 1978. The government took the largest share of domestic credit to finance its budget deficit and fund its parastatals (Republic of Kenya, 1979, 1987). This threatened fall of the sector with 1986 reporting institutional undercapitalization problems. A crisis was therefore looming in the financial sector. This crisis created room for implementation of financial liberalization policies to facilitate financial performance of commercial banks in Kenya (Ngugi and Kabubo, 1998).

Currently there are 44 commercial banks licensed under the (CBK, 2013). The commercial banks in Kenya are currently operating in a more dynamic business environment than before, since the market has been liberalized. Financial reforms in Kenya were initiated as from 1989. They were later intensified in the 1990s with the following reforms being initiated: interest rate were freed in July 1991; enforcement of credit guidelines were relaxed from 1991; exchange rate were allowed to float from 1993; offshore borrowing was allowed from 1994; and foreign investors allowed to participate in local stock market from 1995 (Ndung’u, 1997). The share of government ownership in major banks was also reduced (Ngugi, 2000) (Republic of Kenya, 1978, 1980 and 1982). Ceilings on bank lending rates were not removed until
July 1991. The central bank announced the recommended guidelines for the sectoral composition of bank credit expansion; however, these guidelines were not strictly enforced after interest rate liberalization. International financial liberalization is the most recent, offshore borrowing by domestic residents has been permitted only since early 1994, and portfolio capital inflows from abroad were restricted until January 1995. Supporting structural and institutional reforms is yet to be fully implemented. To date, most banks remain publicly owned and thus competition among them is relatively low (Robin, 2008).

1.2 Research Problem

Liberalization of financial sector creates a financial environment suitable to enhance positive returns on money capital as well as an appropriate institutional framework which eventually leads to an increase in deposits and investment leading to financial performance of banks (Ngugi, 2000). Full implementation of financial liberalization leads to proper mix of increased market discipline and limiting guarantees, better regulation and supervision that includes encouraging greater market discipline of intermediaries, greater participation of reputable foreign banks, and capital market development this in turn leads to financial performance of banks. Government support play a fundamental role in supporting better markets, without intervening excessively in them, backed by an open political process that limits the distortions of finance in favor of well-connected parties (Ndungu, 2013)

Globally, financial liberalization was taken as an abrupt freeing of interest rates, is not that bright, as high interest rates, distressed borrowing, and numerous episodes of banking crises followed, most well-known examples being the early Latin American
experiences of the late 1970s and early 1980s for example Argentina, Chile, Uruguay) (Shaw, 1973). These countries made serious efforts to end high inflation and to deregulate and privatize their banking systems. Interest rates on both bank deposits and loans were completely freed; with the latter often increasing to unexpectedly high levels in real terms (Sen and Vaidya, 1997).

These attempted financial liberalizations generally ended in failure with an undue buildup of foreign indebtedness and government intervention to prop up failing domestic banks and industrial enterprises; this has triggered the need to investigate on the effects of financial liberalization on the financial performance of commercial banks (Annual Conference on Development Economics, 1993). The Republic of Kenya (2007) recognizes the major role that financial sector plays in its development agenda to achieve Vision 2030 goals. In this regard the government has endeavored to put in place mechanisms of a well developed financial system that enable the sector to reach its full potential in allocation of economic resources across the economy to boosts financial performance of commercial banks in Kenya (Stiglitz, 1994). This is aimed at providing a conducive environment for commercial banks in order to grow and boost the economy of the country (Republic of Kenya, 2012).

Empirical evidence has given substantial support to financial liberalization and its implications largely as conducted by (Chauhan, 2012; Olajide, 2011; Omondi, 2003 and Nasiebanda, 2009); these studies have concluded that financial liberalization leads to financial performance of banks. In reference to Brealey, Myers, and Marcus (2009), there is evidence that financial liberalization has increased both output and consumption volatility. These researchers indicate that financial liberalization has
made domestic financial markets more unstable and prone to crises. Perhaps the most robust finding is that the effects of financial liberalization vary substantially across countries as pointed out by (Baswir, 2007). Specifically, the effects of financial liberalizations depend on whether the liberalizing country is rich or poor, or whether it has developed or underdeveloped financial markets, and on whether it has high- or low-quality institutions (Sen and Vaidya, 1997).

In Kenya financial liberalization was initiated under the broader category of financial sector reforms introduced in Kenya in the late 1980s. There are various theoretical and empirical studies that have been done locally (Omondi, 2003; Nasiebanda, 2009; Mwigana 2013 and Ambunya, 2003) conducted on financial liberalization and their effects. From the studies it clearly shows that majority is limited to only descriptive analysis and the remaining that examined data empirically are subject to problem of limited data and omitted variable bias. Mwigana(2013) on the effects of financial sector liberalization on financial performance of commercial banks in Kenya for the period 2008-2012 concluded that ROA and ROE through financial development have positively and significantly affected financial development. The study however had limitations including; it focused on few variables of financial liberalization(e.g financial liberalization index, inflation, nominal lending rates, financial deepening)the study period was too short i.e five years and the model used was log linear that involved transformation of variables using their natural logs. Hence the results were not conclusive since inclusion of other variables like foreign deposits; average local deposits, credit risk and financial growth and increasing the
study period to more years could give a real effect on financial performance of commercial banks. Thus the results and conclusions may be misleading.

Therefore, this study seeks to address the following research question: what is the effect of financial liberalization on financial performance of commercial banks in Kenya?

1.3 Research Objective

To determine the effect of financial liberalization on the financial performance of commercial banks in Kenya.

1.4 Value of the Study

The findings from this study will assist in providing more literature to support existing theoretical propositions on the effect of financial liberalization on the performance of commercial banks. It will also be a significant source of literature on financial liberalization and performance of banks for future researchers or those in the academic field.

The government of Kenya will be able to understand the effect of financial liberalization on the performance of commercial banks. The government will also get to understand how this affects the economic growth and development of the country. The findings will therefore assist the government to come up with appropriate financial liberalization policies that can enhance not only the performance of banks but the economy at large.
The commercial banks in Kenya will be able to understand how changes and variations in financial liberalization ‘instruments’ by the existing government is likely to affect or impact on their financial performance. This will enable them to take necessary approaches to react to variations instruments of financial liberalization.
CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

This chapter contains the review of various studies that are relevant to financial liberalization and organizational performance. It presents a review of the relevant theories that explains financial liberalization and the performance of commercial banks.

2.2 Theoretical Framework

This study was guided by three theories namely: agency theory, theory of financial intermediation and financial liberalization theory. These theories provided theoretical evidence of various arguments by different scholars and researchers in relation to financial liberalization and financial performance in the banking sector.

2.2.1. The Agency Theory

The agency theory was proposed by Jensen and Meckling (1976). The theory indicates that corporate governance is based on agency theory, which is the relationship between agents and principals. Agency theory explains how best the relationship between agents and principals can be tapped for purposes of governing a financial institution to achieve financial performance (Donaldson and Davis, 1994). Interest on agency relationships became more prominent as a result of growth and expansion of financial institutions in order to ensure proper agent and management relationship to increase profitability of commercial banks (Eisenhardt, 1989).
There are entrepreneurs who have a knack for accumulation of capital, and managers who had a surplus of ideas to effectively use that capital. Since the owners of capital (principals) have neither the requisite expertise nor time to effectively run their enterprises, they hand them over to agents (managers) for control and day-to-day operations, hence, the separation of ownership from control, and the attendant agency problems (Fama, 1980). In an agency relationship, principals and agents have clearly defined responsibilities: Principals are select and put in place governors (directors and auditors to ensure effective management of commercial banks while agents are responsible for the day-to-day operations of the enterprise (Daily, Dalton and Canella, 2003).

The agency theory is gaining a lot of popularity in explaining the financial performance of organizations. The theory seeks to explain the relationship that exists between the management of an organization and the owners of the organization who are usually the people holding stocks for the organization (Donaldson and Davis, 1991). The theory posits that there is an agency conflict (Fama, 1980). The management of an organization is usually considered as an agent who has been contracted by the stockholders to work towards enhancing the stockholder value through good financial performance. The management is therefore expected to act in the best interests of the owners and enhance the financial performance of the organization (Donaldson and Davis, 1994).

However, the theory suggests that the managers who are agents may be involved in activities that are aimed at serving personal interest at the expense of the owners of the organization. The theory suggests that when this happens, the financial
performance of the organization may easily suffer. Stockholders therefore can employ a number of strategies to ensure the management acts in the interest on the organization. The theory suggests that management can be rewarded financially in order to motivate them to work for the interests of the company. The owners can also issue threats such as hostile takeover to force management to perform the required duties (Donaldson and Davis, 1994).

2.2.2. The Theory of Financial Intermediation

Diamond and Dybvig (1983), postulated the theory of financial intermediation, they argued that, financial intermediaries exist to solve three main problems: information problems, transaction costs and regulatory factors. The informational asymmetries generate market imperfections. These imperfections generate specific forms of transaction costs. Financial intermediaries appear to overcome these costs. Diamond and Dybvig (1983) consider banks as coalitions of depositors that provide households with insurance against shocks that affect their liquidity position. Diamond (1984) is also of the view that financial intermediaries act as delegated monitors on behalf of savers. The transaction cost approach contradicts the assumption of complete markets. Here, the financial intermediaries act as coalitions of individual lenders or borrowers who exploit economies of scale in the transaction technology. The notion of transaction costs encompasses not only exchange or monetary transaction costs (Tobin, 1963). But also search costs and monitoring and auditing costs (benston and Smith, 1976). Here the role of financial intermediaries is to transform particular financial claims into
other types of claims. As such, they offer liquidity (Pyle, 1971) and diversification opportunities (Hellwig, 1991).

The proponents of this theory argue that the third approach is based on the regulation of money production and of saving in and financing of the economy. Regulation affects solvency and liquidity within the financial institution. Diamond and Rajan (2000) show that bank capital affects bank safety, the bank’s ability to refinance, and the bank’s ability to extract repayment from borrowers or its willingness to liquidate them. Many view financial regulation as something that is completely exogenous to the financial industry.

Thus, to summarize, according to the modern theory of financial intermediation, financial intermediaries are active because market imperfections prevent savers and investors from trading directly with each other in an optimal way (Fischer, 1983). The most important market imperfections are the informational asymmetries between savers and investors. Financial intermediaries, banks especially, fill as agents and as delegated monitors’ information gaps between ultimate savers and investors. They screen and monitor investors on behalf of savers. To ensure the sustainability of financial intermediation, safety and soundness regulation has to be put in place (Towey, 1974).

2.2.3 Financial Liberalization Theory

Kaminsky and Schmukler (2003) advanced the theory of financial liberalization; the scholars explained that liberalization of the capital account is captured by the regulations on offshore borrowing by financial institutions and by non-financial
corporations, on multiple exchange rate markets and on capital outflow controls. In a fully liberalized capital account regime, banks and corporations are allowed to borrow abroad freely (Kaminsky and Schmukler, 2003). They may need to inform the authorities but permission is granted almost automatically. Reserve requirements might be in place but are lower than 10 per cent. In addition, there are no special exchange rates for either the current account or the capital account transactions; nor are there any restrictions to capital outflows (King, and Levine, 1993).

A fully liberalized domestic financial system is characterized by lack of controls on Lending and borrowing interest rates and certainly, by the lack of credit controls, that is, no Subsidies to certain sectors or certain credit allocations. Also, deposits in foreign currencies are permitted. In a fully liberalized stock market, foreign investors are allowed to hold domestic equity without restrictions and capital, dividends and interest can be repatriated freely within two years of the initial investment (Quinn, 1997).

Financial liberalization theory, then, argues for improved economic growth through financial sector reforms (Kaminsky and Schmukler, 2003). The supporters of financial liberalization base their arguments on the works of McKinnon and Shaw. According to the theory, positive real deposit rates raise the saving rate, thus increasing the flow of financial savings (Trabelsi, 2004). Developing countries with repressed financial systems thus mounted financial reforms aiming at: mobilization of financial resources with increased amounts of domestic savings channelled through the formal financial sector, reducing the role of direct controls in determining the allocation of credit,
increasing reliance on market based system of monetary control and broadening the range of domestic sources of finance (Stiglitz, 2000).

2.3 Determinants of Financial Performance

2.3.1 Financial liberalization

Financial liberalization indicators used in determining financial performance of commercial banks include; average annual nominal interest rate, Commercial bank assets as a percentage of total financial assets (Liquid liabilities as a percentage of GDP). This is the broadest financial indicator of financial intermediation because it looks at the overall size of the financial sector, private credit by commercial banks as a percentage of GDP. It measures the ability of financial intermediaries to carry out their primary function to direct savings to investors. Private credit by commercial banks and other banking institutions as a percentage of GDP, the ratio of commercial bank assets over central bank assets, a widely used measurement of financial development and finally the ratio of stock market capitalization to GDP, an indicator of the size of the stock market(Quispe and Mcquerry, 2001)

2.3.1 Other Determinants

The macroeconomic variables used in determining the financial performance of commercial banks are GDP which is measured using growth rate by Growth in real GDP in per cent, Inflation rate is measured by change in annual average retail consumer price level in per cent (IR), Level of financial intermediation is measured using domestic credit provided by banking system percentage of GDP, and Interest
rate spread which is determined using the lending rate minus deposit rate percentage (IRS) (Allen and Bali, 2004).

The common financial indicators of financial performance applied by most commercial banks include: sales growth, return on investment (ROI), return on sales, return on equity (ROE), and earnings per share. The popular ratios that measure organizational performance can be summarized as profitability and growth: return on asset (ROA), return on investment (ROI), return on equity (ROE), return on sales (ROS), revenue growth, market shares, stock price, sales growth, liquidity and operational efficiency. Return on average assets (ROA) and return on equity (ROE) are used as financial measures when determining the level of financial performance of commercial banks (Maria et al, 2002).

From the literature review, Return on Assets (ROA) is used to reflect the bank’s management ability to use the resources the bank disposes of for the purpose of optimizing profit (Beck, and Hesse, 2006). Bank capital adequacy is measured as the equity to assets ratio, quantified as the value of total equity divided by the value of total assets (Athanasoglou, Delis and Staikouras, 2006). To express the risk profile of the banks we use two different types of risk namely credit risk measured as ratio of loan loss provisions to total loans (Boyd and Runkle, 1993). Liquidity risk is measured as a ratio of liquid assets to total deposits and borrowing funds. The other variable used in the analysis is the bank’s size measured as logarithm of total assets (TAL) (Angbazo, 1997).
Bank performance is expected to be sensitive to macroeconomic control variables. The impact of macroeconomic variables on bank risk has recently been highlighted in the literature (Boyd and Runkle, 1993). GDP growth is used as a control for cyclical output effects, which we expect to have a positive influence on bank profitability (Brock and Rojas Suarez, 2000). As GDP growth slows down, and, in particular, during recessions, credit quality deteriorates, and defaults increase, thus reducing bank returns. In line with the previous literature, we include a variety of macroeconomic variables in our model (Allen and Saunders, 2004).

2.4 Empirical Studies

Extensive research has been conducted to investigate the effects of financial liberalization on the performance of commercial banks. However, this literature is subject to important data limitations such as the political environment and banking policies applicable in the economy under study.

Bhattacharyya (1997) in The Impact of Liberalization on the Productive Efficiency of Indian Commercial Banks examined the productive efficiency of 70 Indian commercial banks during the early stages (1986–1991) of the ongoing period of liberalization. The study used data envelopment analysis to calculate radial technical efficiency scores. The study then employed stochastic frontier analysis to attribute variation in the calculated efficiency scores to three sources: a temporal component, an ownership component, and a random noise component. The study concluded that publicly-owned Indian banks to have been the most efficient, followed by foreign-owned banks and privately-owned Indian banks. It also found a temporal improvement in the performance of foreign-owned banks, virtually no trend in the
performance of privately-owned Indian banks, and a temporal decline in the performance of publicly-owned Indian banks.

Omondi (2003) in The Impact of Liberalization on the Financial Performance of the Kenyan Banking Industry examined the effect of financial sector reforms on bank profitability as measured by capital adequacy, asset quality, earnings, liquidity and managerial efficiency ratios. The study focused on profitability ratios. The study established that government owned banks recorded the lowest profitability in terms of ROA and ROE during the study period. Operating expenses continues to undermine the profits of the banks and that foreign owned banks were more efficient in the utilization of resources thereby posting the lowest managerial efficiency ratio. The evidence in the study showed that some signs of financial repression still exist, although some positive developments have taken place. The results showed that, financial liberalization has not significantly increased financial performance of the banking industry. Furthermore, it revealed the existence of excess liquidity in the local banking industry due to low demand for loans by individuals and businesses and scarcity of profitable investment opportunities. Government owned banks were found to be less profitable compared to private banks. The study finds a significant positive relationship between management quality and commercial bank profitability.

Ambunya (2003) in The Financial Liberalization and Economic Growth in Kenya traced the impact of financial liberalization on financial deepening and growth through the increment in credit channel to the private sector following financial deregulation. Based on the evidence of the sample period 1991-2002, it was found that the growth of the financial sector and the real sector moved interdependently in
the period of financial liberalization (reverse-causation) in Kenya. The results showed that financial reforms undertaken in Kenya impacted positively on economic performance. There was an improvement in financial deepening but deeper financial liberalization still needs to be undertaken. Credit to the private sector continued to rise.

Nasiebanda (2009) in his study titled, The Effect of Financial Liberalization on the Efficiency of Commercial Banks in Kenya” the effect of financial liberalization on the X-efficiency of commercial banks in Kenya. The study hypothesized that there exists a positive relationship between liberalization and X-efficiency of commercial banks in Kenya. This hypothesis was based on the argument that after liberalization with the increase in commercial banks and the relaxation of regulations, competition would intensify. The study used secondary data that was obtained from the audited financial statements of the commercial banks as well as the Banks’ Supervision Department of the Central Bank of Kenya (CBK). The sample period was 1986 to 2007. The analysis was based on stochastic cost frontier analysis approach. The findings indicated that the average cost efficiency estimates were significantly different between the post-financial liberalization period and the pre- and during liberalization. In conclusion, financial liberalization in Kenya led to a decline in cost efficiency across the sampled banks.

Olajide (2011) in the Impact of Financial Sector Reforms on Banks Performance in Nigeria examined the impact of financial reforms on banks’ organizational performance in Nigeria between 1995 and 2004. It specifically determined the effects of policies of interest rates deregulation, exchange rate reforms and bank
recapitalization on banks performance, and analyzed how banks internal characteristics and industry structure affect the performance of Nigerian banks. The study utilized panel data econometrics in a pooled regression, where time-series and cross-sectional observations were combined and estimated. The result of econometric panel regression analysis confirmed that the effects of government policy reforms, bank specific characteristics and industry structure has mixed effects on banks profitability level and net interest margin of Nigerian banks.

According to Chauhan (2012) in the study of the Effects of Financial Liberalization in Emerging Market Economies many countries failed to reap the benefits of liberalization because of weaknesses in the regulatory structure, undercapitalized banks, volatile markets and contagion effects. A descriptive survey of was used; the aim of the study was to show the effects of financial liberalization on emerging market economies, how these economies removed restrictions on financial institutions so that they can be globally integrated, and to show the flow of international finance in and out of a country. Secondary data was used since the nature of the data was quantitative. A regression model was used for data analysis, it was concluded that the long-term gains of liberalization certainly supersede short-term instability of liberalization.

Thus, for financial liberalization to have predominantly positive effects, attention should be drawn to the importance of a more prudent regulatory and supervisory environment. Furthermore, financial liberalization must be accompanied by a sound institutional infrastructure, proper conduct of monetary and fiscal policies, a reduction
in corruption, and an increase in transparency. In addition, liberalization should be a gradual process whereby the right measures are taken in the right sequence.

Bundi (2013) in Effects of Financial Liberalization on Private Domestic Savings in Kenya examined the effects that interest rate liberalization, opening of financial sector to foreign investors and credit control elimination has had on private domestic savings in Kenya using annual time series data for the period 1975-2011. In the study, the Error Correction Model (ECM) was utilized to capture the short run dynamics toward the long run equilibrium. The results indicated that interest rate liberalization together with credit control elimination have a negative effect on private domestic savings. Opening of financial sector to foreign investors was found to positively affect private domestic savings. The study therefore concluded that financial liberalization worked only through financial intermediation.

Mwigana (2013) in The Effect of Financial Liberalization on Financial Performance of Commercial Banks in Kenya analyzed the effects of financial sector liberalization on financial performance of commercial banks in Kenya for the period 2008-2012. The specific objectives were to evaluate the impact of financial liberalization on return on equity and return on assets. The study focused on six key variables: return on assets, return on equity (measures of financial performance), financial liberalization index, inflation, nominal lending rates, financial deepening over the study period.

Data was from the 2008 World Development indicators and analysis of financial statements of 12 commercial banks from their annual reports. The study used Augmented Dickey Fuller test to establish the order of integration of the variables,
Johansen Maximum Likelihood ratio test to establish the existence of co-integration and the number of co-integrating equations among the variables in the models. Pearson correlation coefficient was used to establish Multi-collinearity while Durbin Watson statistic was used to test for normality of the study variables. Log linear model was used to estimate the model parameters. The study established that financial liberalization policies introduced in Kenya in the late 1980s have had a positive impact on return on equity and return on assets. On the other hand, return on equity and return on assets through financial development have positively and significantly affected financial performance of commercial banks.

Elryah (2014) in financial Liberalization, Reforms and Banks Performance Malaysian Islamic Banks examined the impacts of liberalization and reforms on Islamic bank’s performance in Malaysia. Data was collected from 16 Islamic banks. Online statistical datum used in the study was extracted from Bank Negara Malaysia (BNM), World Bank, IMF and financial report of the selected banks; the study considered annual datum from 2002 until 2012. To test the hypotheses, panel regressions model was used to investigate the relationship between the Islamic banks performance and financial liberalization and reforms, although its relation with return on assets and equity on return was measured by Z-score. The findings indicated that financial liberalization and openness, assets, profitability, return on assets and inflation have statistically positive impacts on Islamic banks performances.

2.5 Summary of Literature Review

Three general factors provided an impetus for the move to financial liberalization: poor results, high costs, and pressures from globalization. Poor results together with
the limited mobilization and inefficient allocation of financial resources slowed economic growth (McKinnon 1973; Shaw 1973). Low interest rates discouraged the mobilization of finance, and bank deposit growth slowed in the 1980s in many countries. Capital flight occurred despite capital controls (Dooley et al. 1986). Allocation of scarce domestic credits and external loans to government deficits, public sector “white elephants,” and unproductive private activities yielded me under increasing pressure from the growth of trade, travel, and migration as well as the improvement of communications.

The increased access to international financial markets broke down the controls on capital outflows on which the supply of low-cost deposits had depended. Capital controls may be effective temporarily, but over time mechanisms (such as over invoicing imports and under invoicing exports) develop to subvert them (Arioshi et al. 2000; Dooley 1996). These mechanisms became more accessible as goods and people became more internationally mobile.

From the studies reviewed, it is evident that very few of them have tried to establish the effect of financial liberalization on performance of commercial banks. Mwigana (2013) concludes that ROA and ROE through financial development have positively and significantly affected financial development though his study only focused on few variables and short study period. A financially liberalized economy tends to generate more financial resources than a repressed economy. This is an old lesson (McKinnon 1973; Shaw 1973) that points to a positive correlation between the performance of commercial banks and the degree of liberalization in an economy. The studies are few
and far between and there is need to carry out more studies in order to ascertain the authenticity of the findings.
CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Introduction

This chapter discussed the methodology the researcher employed in investigating the effect of financial liberalization on financial performance of commercial banks in Kenya. Among the elements discussed in this section are the target population, the sample size and the sampling technique that was used, the data collection techniques and tools as well as the techniques that was used to analyze the data that was collected.

3.2 Research Design

The study adopted a descriptive survey of commercial banks in Kenya. The main reason for selecting descriptive research design is because it provides a knowledge base when little is known about a phenomenon or such things as clarification of a situation, classification of information, or description of subject characteristics that will aid in the refinement of the research problem, formulation of the hypothesis, or design of data collection and analysis procedures (Mugenda and Mugenda, 2003). It also allows one to establish a relationship between variables. According to Rajendra (2008) a research design is the linkage and organization of conditions for collection and analysis of data in a manner that aims at combining relevance to the research purpose with economy in the procedure. Vaus (2005) also asserts that that research design focuses on the structure of an enquiry, which leads to the minimization of the chance of drawing the wrong casual inferences from the data.
3.3 Population and Sampling

The target population for this study included all 44 commercial banks that are registered and currently operating in Kenya. According to the Central Bank of Kenya, there are currently 44 commercial banks that are operating in the country (CBK, 2013). The study collected data for all the 44 commercial banks since this was enough population for the study.

3.4 Data Collection

The study used secondary data since the nature of the data was quantitative. Data collection is gathering empirical evidence in order to gain new insights about a situation and answer questions that prompt undertaking of the research (Kothari, 2004). The data was collected from a number of sources such as the audited financial statements of the sample commercial banks; the Central Bank of Kenya and the Kenya National Bureau of Statistics. A data collection schedule was prepared to assist in gathering the information. The data collected was for the duration of nine years from 2004-2012. This duration was considered appropriate since a number of financial liberalization measures were made hence it was prudent to find out how they affected the performance of commercial banks.

3.5 Data Analysis

Secondary data from the audited financial statements of the commercial banks reports and library was reviewed for completeness and consistency in order to do statistical analysis. According to Mugenda (2003), data must be cleaned, coded and properly analyzed in order to obtain a meaningful report. The data collected was sorted and
organized before capturing the same in Statistical Packages for Social Sciences (SPSS) for analysis. The study focused on five key variables namely the dependent variable which was measured using return on equity (to measure financial performance of commercial banks), financial liberalization index was measured using the independent variables namely: local deposits, level of financial intermediation, financial liberalization and financial growth. A regression analysis was conducted to assist the researcher in establishing the effect of financial liberalization on the financial performance of commercial banks in Kenya. The researcher was to address the weakness of the model that was used by Mwigana (2013). Below is the analytical model that was adopted by the researcher to achieve the objective of the study:

\[ P_f = a + b_1x_1 + b_2x_2 + b_3x_3 + b_4x_4 + e \]

Where:

\( P_f \) = The financial performance was measured using Return on Equity (ROE).

\( X_1 \) = Financial growth was measured using Net Assets (Total Assets - Total Liabilities)

\( X_2 \) = Local average deposits was measured using increase in average deposits to GDP ratio

\( X_3 \) = Level of financial intermediation was measured using domestic credit provided by banking system as a percentage of GDP

\( X_4 \) = Financial liberalization was measured using commercial banks assets expressed as a percentage of GDP.
b= Gradient/Slope of the regression measured the amount of the change in Y associated with a unit change in X

€=Error term within a confidence interval of 5%

3.5.1 Significance Testing

Coefficient of determination was used to determine whether the model was a good predictor. Correlation was be used in establishing the relationship between financial liberalization and financial performance of commercial banks in Kenya. A t-statistic test was used to determine the significance of the independent variables in influencing financial performance of commercial banks in Kenya. t-test was used to test the hypothesis that a particular coefficient is significantly different from zero or whether the estimated coefficient value occurred by chance in equation. The data tests was performed at 95% level of confidence.
CHAPTER FOUR
DATA ANALYSIS, RESULTS AND DISCUSSIONS

4.1 Introduction

This chapter provides the results of the data analysis and findings. Secondary data was obtained from a number of sources: audited financial statements from sample commercial banks, Kenya national bureau of statistics and reports from CBK. The study reviewed secondary data for a period of nine years (2004-2012).

4.2 Response Rate

The study sought to collect data from audited financial statements of commercial banks, Kenya national bureau of statistics and reports from CBK involving sampled commercial banks in Kenya for a period of nine years laying more focus on audited financial statements. The researcher managed to collect the data from commercial banks operating in Kenya.

4.3 Descriptive Statistics

The objective of this study was to determine the effect of financial liberalization on the financial performance of commercial banks in Kenya. Descriptive statistics was used to determine the minimum, maximum, mean, median and the standard deviation. The figures below have been presented in the form of Kenya shillings and ratios below are the results of the findings provided in the table 4.1:
## Table 4.1 Descriptive Statistics

<table>
<thead>
<tr>
<th></th>
<th>Minimum</th>
<th>Maximum</th>
<th>Mean</th>
<th>Median</th>
<th>Std. Deviation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Financial Growth</td>
<td>2332M</td>
<td>48126M</td>
<td>15161M</td>
<td>11954M</td>
<td>14179M</td>
</tr>
<tr>
<td>Financial Liberalization</td>
<td>.0024</td>
<td>.0262</td>
<td>.006985</td>
<td>.005051</td>
<td>.0073735</td>
</tr>
<tr>
<td>ROE</td>
<td>.0817</td>
<td>.1829</td>
<td>.142393</td>
<td>.146175</td>
<td>.0315273</td>
</tr>
<tr>
<td>Local Average Deposits</td>
<td>.0163</td>
<td>.0467</td>
<td>.029193</td>
<td>.028885</td>
<td>.0094791</td>
</tr>
<tr>
<td>Level of Financial</td>
<td>.0137</td>
<td>.0276</td>
<td>.020791</td>
<td>.019923</td>
<td>.0048508</td>
</tr>
<tr>
<td>Intermediation</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Valid N (listwise)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: Researcher 2014

From the above findings in table 4.1 above, the financial performance of commercial banks is shown. The maximum value of the financial growth is Kshs. 48,126Millions while the minimum value was found to be Kshs. 2,332Millions while the mean value for growth to be Kshs. 15,161Millions with a standard deviation of Kshs. 14,179Millions.
The maximum value for Return on Equity is 0.18 while the average for financial performance of commercial banks was found to be 0.14 with a standard deviation of 0.32. Similarly, Financial liberalization had maximum value of 0.03 with a minimum value of 0.0024 and the average value of financial liberalization was found to be 0.0069 with a standard deviation of 0.0074. The local average deposits was found to have an average of 0.029 with a standard deviation of 0.0095. Similarly, average level of financial intermediation was found to be 0.028 with a standard deviation of 0.0048.

**Figure 1: Return on Equity 2004 to 2012**

![Return On Equity](image)

Source: Researcher 2014

From the figure above, in the year 2008 return on Equity commercial banks registered over 40% growth. However from the year 2009 to 2012 indicates a negative growth hence the financial performance of commercial banks in relation to financial liberalization is poor. The study therefore concluded that the financial performance of commercial banks decreased regardless of financial liberalization being in place.
4.4 Correlation Analysis

The study determined the effect of financial liberalization on the financial performance of commercial banks in Kenya by use of correlation analysis to measure the strength between the variables in this study. Below are the results of the findings below

Table 4.2 Correlation coefficient between variables

<table>
<thead>
<tr>
<th>FACTOR</th>
<th>Financial Growth</th>
<th>Financial Liberalization</th>
<th>Return On Equity</th>
<th>Local Average Deposits</th>
<th>Level of Financial Intermediation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Financial Growth</td>
<td>1</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Financial Liberalization</td>
<td>.976(**)</td>
<td>1</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Return on Equity</td>
<td>-.088</td>
<td>-.077</td>
<td>1</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Local Average Deposit</td>
<td>.129</td>
<td>.562</td>
<td>.039</td>
<td>1</td>
<td></td>
</tr>
<tr>
<td>Level of Financial Intermediation</td>
<td>.191</td>
<td>.601</td>
<td>-.025</td>
<td>.103</td>
<td>1</td>
</tr>
</tbody>
</table>

** Correlation is significant at the 0.01 level (2-tailed).

Source: Researcher 2014

From the findings in the table 4.2 above, the correlation between financial liberalization and financial performance of commercial banks in Kenya shows a negative correlation of -0.077. However the correlation between financial liberalization and financial growth, local average deposits and level of financial intermediation indicates positive. From p values generated above its clear that this values are above 0.5 and close to 1. The study therefore concludes that that there is no statistically significant correlation between the two variables of study. This means that there is negative relationship between the two variables.
4.5 Regression Analysis and Hypothesis Testing

This study tested the relationship between financial liberalization and financial performance of commercial banks in Kenya using a regression analysis. Below are the results of the findings:

4.5.1 Model Summary

The summary of the model was used to determine the correlation between the variables (R) and then coefficient of determination (R\(^2\)) of the study variables in order to establish whether the model was a suitable predictor in determining the relationship between the variables. Below are the results of the findings in table 4.3

Table 4.3: Model Summary

<table>
<thead>
<tr>
<th>Mode</th>
<th>R</th>
<th>R Square</th>
<th>Adjusted R Square</th>
<th>Std. Error of the Estimate</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>.534(a)</td>
<td>.285</td>
<td>-1.145</td>
<td>.08580</td>
</tr>
</tbody>
</table>

a Predictors: (Constant), LFI, LAD, FINANCIAL GROWTH, FINANCIAL LIBERALIZATION

Source: Researcher 2014

The results showed that 28.5% variation was explained by the variables under the study. This means that the regression model used is a good predictor. Similarly, the correlation between the variables was found to be R=0.534 which implies the variables contributed 53% on the relationship between the independent and the dependent variables. Below are the results of the findings:
4.5.2 Analysis of Variance

Analysis of variance was used to test the homogeneity of variances in order to establish the relationship between the variables. Below are the results of the findings provided in table 4.4 below:

**Table 4.4: ANOVA**

<table>
<thead>
<tr>
<th></th>
<th>Sum of Squares</th>
<th>df</th>
<th>Mean Square</th>
<th>F</th>
<th>Sig.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Regression</td>
<td>.006</td>
<td>4</td>
<td>.001</td>
<td>.199</td>
<td>.919(a)</td>
</tr>
<tr>
<td>Residual</td>
<td>.015</td>
<td>2</td>
<td>.007</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>.021</td>
<td>6</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

a Predictors: (Constant), LFI, LAD, NET ASSETS, FINANCIAL LIBERATION

b Dependent Variable: ROE

Source: Researcher 2014

From the above findings, there is no much difference between the two mean squares (0.001 and 0.007) resulting into a significance difference (F=0.199, Sig.=0.919). This means that H₀ must be accepted. This means that the regression model was statistically significant in predicting the relationship between the financial liberalization and financial performance of commercial banks in Kenya.

4.5.3 Tests of Coefficients

The researcher conducted the statistical significance of the relationship between the financial liberalization and financial performance of commercial banks in Kenya. The
results provide the statistical tests by determining whether the mean difference is significant at 5% level.

Table 4.5: Test of Coefficients

<table>
<thead>
<tr>
<th>FACTOR</th>
<th>Unstandardized Coefficients</th>
<th>Standardized Coefficients</th>
<th>t</th>
<th>Sig.</th>
</tr>
</thead>
<tbody>
<tr>
<td>(Constant)</td>
<td>.161</td>
<td>.227</td>
<td>.709</td>
<td>.552</td>
</tr>
<tr>
<td>FINANCIAL GROWTH</td>
<td>-1.21E-008</td>
<td>.000</td>
<td>-2.820</td>
<td>.481</td>
</tr>
<tr>
<td>FINANCIAL LIBERALIZATION</td>
<td>77577</td>
<td>103208</td>
<td>2.523</td>
<td>.531</td>
</tr>
<tr>
<td>LAD</td>
<td>-472</td>
<td>4437</td>
<td>-.090</td>
<td>.925</td>
</tr>
<tr>
<td>LFI</td>
<td>3080</td>
<td>7955</td>
<td>.337</td>
<td>.736</td>
</tr>
</tbody>
</table>

a Dependent Variable: ROE

source: researcher 2014

Below is the regression model that was obtained from the results of the analysis

Financial Performance = 0.161-1.21X_1+77577X_2-472X_3+3080X_4

The regression model in Table 4.3 explains 28.5% of the variance in the financial liberalization and financial performance of commercial banks in Kenya. In other words, all the variables in the model can only contribute 53% of level of explanation. This is statistically significant as it was confirmed in Table 4.4 by F-value of 0.199 that is significant at 95% confidence interval.
Hence, the hypothesis that the financial liberalization has no positive influence on financial performance of commercial banks in Kenya is accepted while the alternate hypothesis that financial liberalization on financial performance of commercial banks has no positive influence is rejected. Therefore, from the above analysis, all the predictor variables were not significant since their p-values were more than 5%.

4.6 Discussion of Research Findings

The effects of financial liberalization on the financial performance of commercial banks in Kenya. From the results of the findings, the correlation analysis indicates that there is a negative correlation of -0.077 between financial liberalization and financial performance of commercial banks in Kenya. The findings concurs with Omondi(2003) in The Impact of Liberalization on the Financial Performance of the Kenyan Banking Industry examined the effect of financial sector reforms on bank profitability as measured by capital adequacy, asset quality, earnings, liquidity and managerial efficiency ratios. The study focused on profitability ratios. The study established that government owned banks recorded the lowest profitability in terms of ROA and ROE during the study period.

The regression model used was a good predictor. Similarly the correlation between the variables was found to be R=0.534 which indicates that variables contributed to 53% on the relationship between the dependent and independent variables. This indicated that a unit increase in financial liberalization led to a unit decrease in financial performance of commercial banks. Regarding the ANOVA, there was no much difference between the two mean squares (0.001 and 0.007) which resulted into a significance difference (F=0.199,sig=0.919) thus indicating that the regression
model was statistically significant in predicting the relationship between the study variables.

The results of the tests of coefficients revealed that there was a direct relationship between financial liberalization and financial performance of commercial banks in Kenya. According to the findings, 28.5% of the variance in financial liberalization on the financial performance of commercial banks in Kenya. The variables in the model can only contribute 53% of level of explanation.

The result of correlation however also indicates that the correlation between financial liberalization and financial growth, local average deposits and level of financial intermediation is positive. The study therefore concludes that that there is statistically significant correlation between the independent variables of study. The findings concur with the findings of Olajide (2011) in the Impact of Financial Sector Reforms on Banks Performance in Nigeria. It specifically determined the effects of policies of interest rates deregulation, exchange rate reforms and bank recapitalization on banks performance, and analyzed how banks internal characteristics and industry structure affect the performance of Nigerian banks. The results concluded that the effects of government policy reforms, bank specific characteristics and industry structure has mixed effects on banks profitability level and net interest margin of Nigerian banks.

The results of the hypothesis that the financial liberalization has no positive influence on financial performance of commercial banks in Kenya is accepted while the alternate hypothesis that financial liberalization on financial performance of commercial banks has no positive influence is rejected. Therefore, from the above
analysis, all the predictor variables were not significant since their p-values were more than 5%.
CHAPTER FIVE

SUMMARY OF FINDINGS, CONCLUSIONS AND DISCUSSION

5.1 Introduction

This chapter presents summary of the findings, conclusions, recommendations, limitations of the study and suggestions for further research

5.2 Summary of Findings

According to the findings, the researcher managed to collect data for all commercial banks in Kenya. The maximum value of the financial growth is Kshs. 48,126 Millions while the minimum value was found to be Kshs. 2,332 Millions while the mean value for growth to be Kshs. 15,161 Millions with a standard deviation of Kshs. 14,179 Millions.

The maximum value for Return on Equity is 0.18 while the average for financial performance of commercial banks was found to be 0.14 with a standard deviation of 0.32. Similarly, Financial liberalization had maximum value of 0.03 with a minimum value of 0.0024 and the average value of financial liberalization was found to be 0.0069 with a standard deviation of 0.0074. The local average deposits was found to have an average of 0.029 with a standard deviation of 0.0095. Similarly, average level of financial intermediation was found to be 0.028 with a standard deviation of 0.0048.

The correlation between financial liberalization and financial performance of commercial banks in Kenya shows a negative correlation. However the correlation
between financial liberalization and financial growth, local average deposits and level of financial intermediation indicates positive. From p values generated above it's clear that this values are above 0.05. The results of the tests of coefficients revealed that there was a direct relationship between financial liberalization and financial performance of commercial banks in Kenya. According to the findings, 28.5% of the variance in financial liberalization on the financial performance of commercial banks in Kenya. The variables in the model can only contribute 53% of level of explanation.

5.3 Conclusion

From the regression model, results indicate that there was a negative correlation between financial liberalization and financial performance of commercial banks in Kenya. However the results concluded that there was a positive correlation between financial liberalization and financial growth, local average deposits and level of financial intermediation. The regression model used was a good predictor. Similarly the correlation between the variables contributed to good relationship between the dependent and independent variables. This indicated that a unit increase in financial liberalization led to a unit decrease in financial performance of commercial banks.

The study also concluded that there was no much difference between the two mean squares which resulted into a significance difference thus indicating that the regression model was statistically significant in predicting the relationship between the study variables.

The hypothesis of the financial liberalization has no positive influence on financial performance of commercial banks in Kenya is accepted while the alternate hypothesis
that financial liberalization on financial performance of commercial banks has no positive influence is rejected.

The results of the descriptive statistics revealed that, the maximum value for Return on Equity is 0.18 while the average for financial performance of commercial banks was found to be 0.14 with a standard deviation of 0.32. From the figure above, in the year 2008 return on Equity of commercial banks registered over 40% growth. However from 2009 to 2012 indicates a negative growth hence the financial performance of commercial banks in relation to financial liberalization is poor. The study therefore concluded that the financial performance of commercial banks decreased regardless of financial liberalization being in place.

5.4 Recommendations

In line with the findings and conclusion of the study, the researcher would make the following recommendations as a precursor to improving the effects of financial liberalization on the financial performance of commercial banks in Kenya. The banking industry is one of the sectors that play an important role in the allocation and distribution of capital resources and risk sharing of future flows in any given economy or country. The Study recommends that financial liberalization must be accompanied by a sound institutional infrastructure, proper of conduct monetary and fiscal policies, proper management of resources and increase in transparency.

The study also recommends that the government should put proper policy measures in order to achieve financial growth. Since the study revealed that there has been upward
growth in return on Equity from the year 2004-2008 and then a decline from year 2009 onwards.

The study also recommends financial performance applied by most commercial banks should include, Return on Investment (ROI), return on sales and earnings per share. The governments should put in place mechanisms of well-developed financial systems’ that enable the sector to reach its full potential in allocation of economic resources across the economy to boost financial performance of commercial banks in Kenya.

5.5 Limitations of the Study

The study used a regression model in relation to financial performance of commercial banks and financial liberalization. The study made assumed that all data will be obtained; the researcher will be able to accomplish the research within the time frame, that the researcher will be able to finance the project. Some of the limitations experienced include; lack of all data required for the study from the banks e.g. foreign deposits, provision for loans to cater for credit risk figures. The study had proposed to cover ten years period, however nine years data was available i.e. the year 2004 to 2012. The 2013 data was not available for commercial banks.

The other challenge faced by the researcher was time and cost constraints. The researcher conducted this project within a very short period of time. Secondly, accessing the right data was not easy and computing the measurements in line with the variables under study took so much time. The process of putting the secondary
data together, cleaning, sorting and coding took so much time notwithstanding the fact that the project had to be done and submitted within a very strict deadline.

The researcher used secondary data however it was appropriate for the researcher to use primary data to give the needs and expectations of the researcher from the study variables. As such the secondary data may not provide actual information required and therefore, the outcome of the study could be exposed to bias and thus may not be reliable for decision making.

5.6 Suggestions for Further Research

The study suggests further research on studies to include missing variables which were not captured in this study. They include; foreign deposits and credit risk. The study also proposes that further research should cover more than nine years period and evaluate whether these results will still hold.

The researcher also suggests that further research on Financial liberalization should be take into consideration both macro and economic variables. These should include other variables such as Return on Investment (ROI), Return on Sales (ROS). This study will be instrumental in especially in determining the best investments for the commercial banks.

The study recommends that future researchers interested in this area should conduct further studies on other areas such as on Small Micro Enterprises(SMEs) other than commercial banks and determine the effect of financial liberalization on financial
performance of Small Micro Enterprises. Then, findings can be compared and conclusions be made based on facts.

A comparative study should be conducted on the effect of financial liberalization on the economic growth of Kenya. Through the study the government of Kenya will be able to understand the effect of financial liberalization on the economic growth. The government will also get to understand how this affects the development of the country. Thus the government will be able to come up with appropriate financial liberalization policies that can enhance economy at large.
REFERENCES


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APPENDICES

Appendix I: Commercial banks in Kenya

1. Kenya Commercial Bank Ltd
2. Equity Bank Ltd
3. Barclays Bank of Kenya Ltd
4. Standard Chartered Bank Ltd
5. Cooperative Bank of Kenya Ltd
6. CFC Stanbic Bank Ltd
7. Commercial Bank of Africa Ltd
9. Citibank NA
10. Diamond Trust Bank Ltd
11. NIC Bank Ltd
12. I&M Bank Ltd
13. Prime Bank Ltd
14. Bank of Baroda Ltd
15. Savings and Loan Ltd
16. Housing Finance Company of Kenya Ltd
17. Bank of Africa Ltd
18. Bank of India
19. Imperial Bank Ltd
20. Ecobank Ltd
21. Family Bank Ltd
22. Chase Bank Ltd
23. Fina Bank Ltd
24. African Banking Corporation Ltd
25. Development Bank of Kenya Ltd
26. Gulf African Bank Ltd
27. Habib AG Zurich
28. K-Rep Bank Ltd
29. Giro Bank Ltd
30. Consolidated Bank of Kenya Ltd
31. Guardian Bank Ltd
32. Fidelity Commercial Bank Ltd
33. Victoria Commercial Bank Ltd
34. Habib Bank Limited.
35. Equatorial Commercial Bank Ltd
36. First Community Bank Ltd
37. Credit Bank Ltd
38. Trans-National Bank Ltd
39. Middle East Bank Ltd
40. Paramount Universal Bank Ltd
41. Oriental Commercial Bank Ltd
42. Dubai Bank Ltd
43. UBA Kenya Bank Ltd
44. City Finance Bank Ltd

Source: Banking Survey (2013)