

**INFLUENCE OF THE LEGAL AND REGULATORY  
ENVIRONMENT ON THE BUSINESS OPERATIONS OF  
FOREIGN MULTINATIONAL BANKS IN KENYA**

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## **DECLARATION**

This research project is my original work and to the best of my knowledge has not been presented for the award of a degree in any other university.

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This research project has been presented for examination with my approval as the university supervisor.

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## **DEDICATION**

I dedicate this research project to my loving family. My dear father, Joseph Adala, my selfless mother Fidelis Tabu Juma, and my loving siblings, Eugene, Ronald, Mike, Andrew and Laurine. This could not have happened without you.

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## **ABBREVIATIONS AND ACRONYMS**

<b>BSD</b>	Bank Supervision Department
<b>CAMEL</b>	Capital Adequacy, Asset Quality, Management Quality, Earnings and Liquidity
<b>CBK</b>	Central Bank of Kenya
<b>CRBs</b>	Credit Reference Bureaus
<b>FDI</b>	Foreign Direct Investment
<b>IMF</b>	International Monetary Fund
<b>MFBs</b>	Microfinance Banks
<b>MNBs</b>	Multinational Banks
<b>MNCs</b>	Multinational Corporations
<b>OECD</b>	Organisation for Economic Cooperation and Development
<b>PEPs</b>	Politically Exposed Persons
<b>UK</b>	United Kingdom
<b>USA</b>	United States of America
<b>UN</b>	United Nations
<b>UNCTC</b>	United Nations on Transnational Corporations
<b>UNCTAD</b>	United Nations Conference on Trade and Development
<b>WTO</b>	World Trade Organisation

## **ABSTRACT**

The prime motivational forces behind globalization are the giant economies of the world, developed countries and multinational companies. The study set out to establish the influence of the legal and regulatory environment on the business operations of foreign multinational banks in Kenya which are a category of MNCs in the banking sector. The study involved the analysis of the different types of laws that govern the operations of foreign MNBs in Kenya, how these laws affect their business operations when compared to their homegrown rivals. A trend analysis was established on the basis of which a descriptive analysis was conducted to determine the influence of the regulatory environment. An overall analysis showed that MNBs operate in a complex legal environment characterised by their home country laws, host country laws, international treaties and other laws formulated by other bodies relevant in the banking sector. This regulatory environment influences their competitiveness and their governance and as a consequence, these banks face some restrictions that do not affect the local banks in Kenya. These banks have therefore put in place structures to ensure completeness and consistency with these set of laws. The research however established that some of these banks do not have in-hose legal departments and made a recommendation that those without should put in place the departments and the CBK should enforce that. The research was also able to establish that Kenya can through CBK borrow a lot from the home country regulations of these banks for purposes of strengthening the governance of the banking sector.

# CHAPTER ONE: INTRODUCTION

## 1.1 Background of the Study

A multinational corporation (MNC) is a business concern with operations in more than one country. Thus a multinational company carries on business operations in two or more countries. Its headquarters are located in one country, that is, the home country but its activities are spread over in other countries, that is, the host countries. MNCs may engage in various activities like exporting, importing, manufacturing in different countries. MNCs operate in a global environment unfamiliar in political, economic, social, cultural, technological, and legal aspects (Martin, 2012). Today, there are thousands of MNCs which operate in many parts of the globe and should familiarise with the languages, cultures and the business environments of host countries (John et al, 2013).

The MNCs in the banking sector are called multinational banks (MNBs). These banks establish operations in more than one country and are also sometimes referred to as foreign banks or are comprised in the general category of foreign direct investment (FDI) in the financial services. MNB operations can come in different forms and their regulatory treatment may differ from those of domestic banks. The market segments served by MNBs are areas where the MNBs have a clear competitive advantage. One of the main reasons for MNBs to enter a new economy is to provide services to MNCs which are already their customers in other parts of the world. Further, MNBs provide services that other banks are either less familiar with or that they cannot provide. Such services include foreign currency loans, acceptances and guarantees related to international trade, or syndicated loans (Brainard, 1990; Euh and Baker, 1990). Examples of these banks in Kenya are Standard Chartered Bank and Barclays Bank. Every company doing business abroad faces numerous legal issues. The MNC faces issues raised by the home country laws, host country laws, regional regulations or directives, bilateral and multilateral treaties and international standards and certifications. It is against this background that the study on the legal and regulatory environment in which MNBs operate and the influence of this environment on their operations will be undertaken. The study will focus on the foreign multinational banks in Kenya.

### **1.1.1 International Business Environment**

International business means the buying and selling of goods across the border. These business activities may be of government or private enterprises, here the national boarder is crossed by activities like manufacturing, construction, agriculture, banking, insurance, health, education, transportation, communication, and mining etcetera. The international business environment is defined as the environment in different sovereign countries, with factors exogenous to the home environment of the organisation, influencing decision making on resource use of capabilities. This includes the social, political, economic, regulatory, tax, cultural, legal, technological, ecological and historical environments (John et al 2013). Further, the international environment consists of the interactions between the domestic environmental forces and the foreign environmental forces, and between the foreign environmental forces of two countries when an affiliate in one country does business with customers in another (Geringer, 2012).

A business enterprise which goes for international business has to go for a very wide and long view before making any decision. It has to refer to social, political, historical, cultural, physical, geographical, ecological and economic aspects of the country where it is doing business. To function effectively and efficiently, countries operating internationally must understand the social environment of the host country they are operating in. Today there are thousands of MNCs which operate in many parts of the globe. Such companies must familiarize themselves with the language, culture and the business environments in the countries in which they are operating.

The political environment in a country influences the legislations and government rules and regulations under which a foreign firm operates. The economic environment relates to all the factors that contribute to a country's attractiveness for foreign businesses.

Every country in the world follows its own system of law. A foreign company operating in that particular country has to abide with its system of law as long as it is operating in that country. This is because different legal systems are operated by different countries and they all widely differ from each other.

The existence of different legal systems makes the task of MNCs more difficult as they have to follow legal provisions of the two countries as regards their business operations. The technological environment comprises factors related to the materials and machines used in manufacturing goods and services. Receptivity of organisations to new technology and adoption of new technology by consumers influence decisions made in an organisation. As firms have no control over the external environment, their success depends on how well they adapt to the external environment. A firm's ability to design and adjust its internal variables to take advantage of opportunities offered by the external environment and its ability to control threats posed by the same environment, determine its success.

MNCs follow three general procedures to access markets: merger with or direct acquisition of existing concerns; sequential market entry and joint ventures. Merger or direct acquisition of existing companies known as foreign direct investment allows MNCs especially larger ones to take full advantage of their size and economies of scale (Rhoda, 2012). Sequential market entry often includes foreign direct investment and involves establishment or acquisition of concerns operating in niche markets related to the parent company's product lines in the new country of operation (Rhoda, 2012).

### **1.1.2 Legal and Regulatory Environment of foreign firms**

As earlier noted, the political environment in a country influences the legislation and government rules and regulations under which a foreign firm operates. Every country in the world follows its own system of law and a foreign company operating within it has to abide by these laws for as long as it continues to operate there. According to Geringer, 2012, the legal environment constitutes the many foreign and domestic laws governing how international firms must operate. The legal environment is further categorised as home, host and global environments. The home environment stipulates that a company must follow the laws in its home country. These include laws regarding exportation of products including those forbidding certain goods to certain countries (Gactaern, 2010). The first area falls under the heading administrative law. This is the law pertaining to rules set down by any of the numerous agencies and departments created to administer federal or local law.

The other area comprises statutory law. This is the law enacted by the legislative branches of government (Karen, 2010). The host environment stipulates that the Company must also abide by the laws governing business in the host country including employment practices, taxation and environmental protection. The global environment is governed by agreements that countries make to regulate the flow of goods and services across national borders. These agreements include; Investment Treaties which regulate direct investments across borders, Trade Agreements, these are rules of trade between countries and Multilateral Trade Agreements which are rules of trade between several countries (Gactaern, 2010). Countries competing with each other, pursuing their own self-interest, would presumably arrive at a set of policies (regulations) which are globally efficient. These policies would provide the optimal degree of property rights protection (Joseph, 2007).

Sound business regulations are important for a thriving private sector and a thriving private sector is important for overall development. A key premise of MNCs is that economic activity requires good rules. These include rules that establish and clarify property rights, reduce the cost of resolving disputes, increase the predictability of economic interactions and provide contractual partners with core protections against abuse. The objective is to have regulations designed to be efficient, accessible to all who use them and simple in their implementation. These regulations are considered SMART if they are Streamlined, that is, regulations that accomplish the desired outcome in the most efficient way; Meaningful, that is, regulations that have a measurable positive impact in facilitating interactions at the market place; Adaptable, that is regulations that adapt to changes in the environment; Relevant, that is, regulations that are proportionate to the problem they are designed to solve and Transparent, that is, regulations that are clear and accessible to anyone who needs to use them ( World Bank Group, 2014).

Laws and regulations that protect investors help them quickly resolve issues related to their businesses can be crucial for business creation and survival because they encourage investment, facilitate smooth business operations and help viable firms recover if they become insolvent (John, L., & Y., 2008).

The relationship between laws and regulations protecting investors, risk taking and economic growth is measured by variables including the rule of law, disclosure standards and shareholder rights that include minority shareholders. An assessment of how much a good business regulatory environment is, as measured by aggregate, matters for economic growth, higher productivity and innovation revealed that economies with good business regulatory environments grow faster and that output growth is 2.3% higher for the best quartile in the sample than for the worst (World Bank Group, 2014).

On the international level no effective regulation of MNCs has yet been established. In 1974, the United Nations established the programme on Transnational Corporations. This consisted of two bodies; a Commission and Centre for Transnational Corporations. Between 1974 and 1992, the Programme was carried out by the United Nations on Transnational Corporations (UNCTC). In 1993, after a brief period in the United Nations Department of Economic and Social Development (1992-1993), the Programme on Transnational Corporations was transferred to the United Nations Conference on Trade and Development (UNCTAD) in Geneva and is now being implemented by UNCTAD's division on investment, Technology and Enterprise Development. The aim is to produce a UN code of conduct of multinational enterprises. In July, 2000 "Guidelines for cooperation between the United Nations and the business community" were issued by the Secretary-General of the United Nations. These are intended to serve as a common framework for all entities of the United Nations Secretariat. Many other UN organisations and agencies and regional groupings have also made proposals or published codes in this area.

The Organisation for Economic Cooperation and Development (OECD) first published Guidelines for Multinational Corporations in 1976. The guidelines and their review are part of the 1976 Declaration by the Governments of OECD member countries on International Investment and Multinational Enterprises. The Guidelines are reviewed every seven years and provide voluntary principles and standards for responsible business conduct in a variety of areas including employment and industrial relations, human rights, environment, information disclosure, combating bribery, competition, and taxation. The current Guidelines were adopted on June 27, 2000.

### **1.1.3 Multinational Corporations**

There are over 40,000 MNCs currently operating in the global economy, in addition to approximately 250,000 overseas affiliates running cross continental businesses. Top MNCs are headquartered in United States, Western Europe and Japan and have the capacity to shape global trade, production and financial transactions. MNCs are viewed to favor their home operations when making difficult economic decisions though the tendency is declining as companies are forced to respond to increasing global competition. The World Trade Organisation (WTO), the International Monetary Fund (IMF) and the World Bank are the institutions that underwrite the basic rules of economic, monetary and trade relations between countries. Many developing nations have loosened trade rules under pressure from the IMF and the World Bank.

There is a total population of 213 MNCs in Kenya. The MNCs in Kenya have adopted a number of business strategies including: better quality, excellent customer service, innovation, differentiation, diversification, cost cutting measures, strategic alliances, joint ventures, excellent customer service mergers and acquisitions, as well as lower prices to weather competitive challenges. The most popular business strategies adopted by the MNCs in Kenya are mixed ownership, better quality, lower price, franchising and licensing. These MNCs have played a major role in the Country's economy. They engage in very useful and productive activities such as creating employment opportunities, contributing to Kenya's gross national product and making available a wider range of better quality products. They also contribute to the critical financial infrastructure and enormous resources for economic and social development of the Country. Kenya has been chosen as the base camp for what is likely to turn into a sub-regional business (Newsprint, 2011).

### **1.1.4 Foreign Multinational Banks in Kenya**

Multinational Banks are banks which establish operations in more than one Country. Hence MNBs are also sometimes referred to as foreign banks or are comprised in the general category of foreign direct investment (FDI) in financial services.



MNB operations can come in different forms, namely as branch offices, as subsidiaries, as joint ventures, or as strategic partnerships.

Branch offices for instance are an integral part of the mother company, that is, they have no capital of their own. Subsidiaries, however, are their own corporate entities, which are fully owned by the mother company, but chartered in the host economy. Similarly, joint ventures are separate corporate entities owned jointly by more than one Mother Company.

As at 31<sup>st</sup> December, 2013, the banking sector in Kenya comprised of the Central Bank of Kenya, as the regulatory authority, 44 banking institutions comprising 43 commercial banks and 1 Mortgage Finance Company (MFC), 7 representative offices of foreign banks, 9 Microfinance Banks (MFBs), 2 credit reference bureaus (CRBs) and 101 forex bureaus. Out of the 44 banking institutions, 30 locally owned banks comprise 3 with public shareholding and 27 privately owned while 14 are foreign owned. The foreign owned financial institutions comprise of 10 locally incorporated foreign banks and 4 branches of foreign incorporated banks.

For purposes of regulation, The Bank Supervision Department (BSD) department plays a critical mandate as stipulated in section 4(2) of the Central Bank of Kenya Act, which is to foster liquidity, solvency and proper functioning of a stable based financial system, with one of its key functions being the development of legal and regulatory frameworks to foster stability, efficiency and access to financial services. The Central Bank has adopted the Capital Adequacy, Asset Quality, Management Quality, Earnings and Liquidity (CAMEL) rating system in assessing the soundness of commercial banks. The banking sector was rated strong in 2013, a similar rating attained in 2012. The institutions rated strong, satisfactory and fair in December, 2013 were 18, 20 and 5 respectively. As at 31<sup>st</sup> December, 2013, four banks were in violation of the Banking Act and CBK Prudential Guidelines. This translated into six incidences of non-compliance affecting five sections of the Banking Act and Prudential Guidelines. In the previous year, 2012, six banks were not compliant with ten sections of the Banking Act. Appropriate remedial action was taken on the concerned institutions by the Central Bank in respect of these violations.

Foreign Multinational Banks are required to observe compliance with the home country laws over and above the regulations formulated by CBK which are considered as laws formulated by the host country. These Banks include multinational banks like Citi Bank, Standard Chartered Bank, Barclays Bank of Kenya, CFC Stanbic Bank, Bank of Africa, Bank of India, Bank of Baroda, Habib Bank Limited, Habib Zurich, United Bank of Africa, Eco Bank.

The Kenyan banking sector has continued to attract the attention of global banking sector players, which indicates the existence of unexploited business opportunities in the sector. The entry of international players into the Kenya's banking sector, contributes towards the sector's vision under Vision 2030 of *creating a vibrant and globally competitive financial sector*. The variety of financial products on offer and the resultant competition envisaged to promote efficiency and accessibility of the. The Central Bank will continue to provide an enabling legal and regulatory environment to spur the growth and stability of the banking sector.

## **1.2 Research Problem**

All states regulate. From rules and laws governing trade, banking, and education to hazardous material, health standards, and the state rules on what will be produced, how it will be produced and often who will be the beneficiary of what. The focus on the linkage between regulatory issues and economic growth is relatively new. The globalization of the world economy, associated with the transnational revolution in information, technology and trade in the past two decades, has ushered in a strong emphasis on models of sustainable economic development based on free-market enterprise. The importance of competitiveness and competition on global markets place has led to a need for establishing the incentive and regulatory framework which would provide the enabling environment for the market forces to thrive.

The legal and regulatory environment imposes on multinational corporations (MNCs) numerous regulations raised by the home country laws, host country laws, regional regulations or treaties, bilateral or multilateral treaties and international standards and certifications. Although these numerous regulations pose a challenge for the operation of MNCs, compliance with these set of laws is important.

Foreign MNBs are therefore bound to operate in a regulatory environment characterised by these complex set of laws and ensure legal consistency and legal completeness with these laws. Legal consistency is a property that declares enterprise policies to be free of contradictions with the applicable laws, regulations and business rules. Legal completeness on the other hand is a property that declares enterprise policies to cover all scenarios included or suggested by law. Completeness suggests that there are no scenarios covered by the law that cannot be implemented in an enterprise. In addition it implies that all scenarios not allowed by the law are not allowed by the enterprise. An issue however arises as to the influence of this regulatory environment on the business operations of the foreign MNBs and this therefore calls for a review of this environment on the business operations of MNBs in Kenya with a view to determining the associated challenges and making necessary recommendations to foster their business.

The global regulatory regime is currently undergoing a fundamental change, in response to the recent financial crisis, regulators across the globe are focusing on a programme of more robust supervision of financial services firms whilst also introducing a raft on new regulatory initiatives to bolster the regulatory framework. Changes in the UK regulatory architecture, with the moves towards ‘twin peak’ regulation and the Financial Services Authority (FSA) committing to a more intensive and intrusive supervisory approach focusing on both prudential and conduct risk, show that profound changes to the regulation of the global financial services industry are unlikely to let up any time soon. A strong focus on improving transparency in markets and products, providing greater investor and consumer protection are central to the new regulation and updates to existing rules that are bearing down on the industry. Recent experience has shown that even those banks that appeared well capitalized and risk aware have been subject to regulatory censure. No firm is exempt from the need for constant change and renewal. Failure to adapt to the changing regulatory requirements could have serious impacts for firms, both in their relationship with the regulator and potential sanctions imposed by the regulator.

The foreign MNBs in Kenya have to ensure that they do not contravene the home country laws while at the same time enforcing compliance with the host country laws. They should observe prudential guidelines formulated by the parent country as well as

prudential guidelines formulated by the central bank of Kenya. The study will unveil the differences in these regulations, areas of conflict, similarities in the same and the influence that such a regulatory environment has on the business operations of the foreign MNBs.

A lot of research conducted locally has mainly focused on the influence of the Political and Technological environment on operations of banks in general. Further research has focused on marketing, innovation and growth strategies on business operations of firms including banks. For example, it was established that there was a significant relationship between the strategies adopted by Postbank in Kenya and their respective performances with respect to total revenue growth, total asset growth, net income growth, market share growth and overall performance or growth (Ofunya, 2013). It has also been found that Rationalization and automation results in more efficient use of resources (Muchiri, 2012). Several challenges were encountered in the pursuit of growth some of which included high cost of advertising, challenges faced when venturing into jurisdictions i.e. legal and regulatory requirements (Ofunya, 2013). There has also been a lot of research in the banking area but with a major focus on strategy. It was established that outsourcing is a strategy of competitive advantage at Barclays Bank of Kenya Limited (Otieno, 2013). Research has also been done to establish the various strategies that are adopted by Commercial Banks in Kenya to manage services (Chege, 2013). The regulatory environment has been identified as one of the challenges that commercial banks face when entering international markets (Mugira, 2009). On the issue of regulation of multinational banks, there has been little research. Research closely relating to regulation was done for purposes of evaluating the preparedness of Kenyan commercial banks towards basel II implementation (Ghati, 2009).

At the international level, research has been done on the impact of multinational banks on development finance institutions and it indicated that increased international financial competition, early credit crunches and later credit growth can have real implications in the form of lowered business investment or financial instabilities unless adequate regulatory and supervisory structures are installed. Proponents of more financial competition assert that MNB entry increases market discipline, the efficiency of domestic banks, and thereby financial intermediation, and the supply of

credit (Fry, 1995; BIS, 1988). Others however, argue that a growing MNB presence may indeed induce domestic banks to lend more, but for riskier projects as they become less prudent in their activities under mounting competitive pressures (Demirguk-Kunt and Detragiache, 1998). On the regulation aspect, research has been done on the efficacy of regulation in developing countries in general (Hafeez, 2003).

There is a gap in regard to research on the impact of the legal and regulatory environment on the business operations of foreign multinational banks. This environment is complex and is characterised by regulations by the home country laws and the host country laws. This study will therefore explore the influence of the legal and regulatory environment on the business operations of multinational banks. This was noted as a gap in as far as local research studies are concerned. This therefore leads to the question; what is the influence of the legal and regulatory environment on the business operations of multinational banks in Kenya?

### **1.3 Research Objective**

The objective of the study was to determine the influence of the legal and regulatory environment on the business operations of foreign Multinational Banks in Kenya.

### **1.4 Value of the Study**

This study will be beneficial to various stakeholders.

The study will provide the management teams of foreign MNBs with important information on the influence of the legal and regulatory environment on their operations. It will also highlight areas of improvement within the regulatory environment which the management can thereafter review with a view to enhancing the competitiveness of their business activities. The Government, through the central bank plays a key role in the regulation of foreign MNBs. The study will provide information that will be used by the Government for purposes of determining policies for review with a view to promoting the business operations of foreign MNBs in Kenya.

The study will be of particular importance to CBK which is charged with the role of regulating banks.

The study will further assist scholars in finding areas for further research in compliance management and will help in giving more information to facilitate research on techniques for effective compliance management.

## **CHAPTER TWO: LITERATURE REVIEW**

### **2.1 Introduction**

Literature review is the process of reading, analysing, evaluating and summarizing scholarly material about a specific topic. The results of a literature review may serve as part of a research article, thesis, or grant proposal. It is an evaluative report of information found in the literature related to a selected area of study. It gives a theoretical base for the research and helps the author to determine the nature of his research. This chapter therefore examines the theoretical basis of regulation, regulation of multinational banks and operations of multinational banks.

### **2.2 Theoretical Foundation**

In legal and economic literature, there is no fixed definition of the term regulation. Some researchers devoted considerable attention to the various definitions and attempt through systemisation to make the term amenable to further analysis (Mitnick, 1980). In this chapter regulation will be taken to mean the employment of legal instruments for the implementation social-economic objectives. A characteristic of legal instruments is that individuals or organisations can be compelled by government to comply with prescribed behavior under penalty of sanctions. Corporations can be forced, for example to observe certain prices, to supply certain goods, to stay out of certain markets, to apply particular techniques in the production process or to pay the legal minimum wage. Sanctions can include fines, the publicising of violations, imprisonment, an order to make specific arrangements, an injunction against withholding certain actions, or closing down the business.

A distinction is often made between economic and social regulation. Economic regulation consists of two types of regulations: structural regulation and conduct regulation (Kay and Vickers, 1990). Structural regulation is used for regulating market structure. Examples are restrictions on entry and exit rules and rules against individuals supplying professional regulations in the absence of recognised qualifications. Conduct regulation is used for regulating behavior in the market. Examples are price control, rules against advertising and minimum quality standards.

Economic regulation is mainly exercised on natural monopolies and market structures with limited or excessive competition.

Social regulation comprises regulation in the area of environment, labor conditions and consumer protection. Theories directed to the economic explanation of regulation will be discussed. These theories are divided into public interest and private interest theories of regulation.

### **2.2.1 Public Interest Theory of Regulation.**

The first group of regulation theories account for regulation from the point of view of aiming for public interest. This public interest can further be described as the best possible allocation of scarce resources for individual and collective goods. According to public interest theory, government regulation is the instrument for overcoming the disadvantages of imperfect competition, unbalanced market operation, missing markets and undesirable market results. In the first place, regulation can improve the allocation by facilitating, maintaining, or imitating market operation. The exchange of goods and production factors in markets assumes the definition, allocation and assertion of individual property rights and freedom to contract (Pejovich, 1979). The guarantee of property rights and any necessary enforcement of contract compliance can be more efficiently organised collectively than individually. In the second place, regulation is capable of contributing to the stabilization of market operation and the earlier achievement of market equilibrium. Imbalances within an economy occur at the level of separate markets and on a macro level.

Public interest theory explains regulation from viewpoints not restricted to imperfect competition and unbalanced market operation. For a number of reasons markets may not exist for some goods for some goods for which utility or the willingness to pay exceeds the production costs. Markets may not exist as a result of information problems and transaction costs in the case of external effects and public goods. In these cases, regulation can improve the allocative efficiency of the economy. Missing markets can be accounted for by hidden information or an asymmetric distribution of information with respect to prices, quantities or quality of goods (Hirshleifer and Riley, 1979). In addition to information failures, prohibitively high transaction costs



can also result in missing markets. Transaction costs can impede, for example, the coming into existence of a market for efficient use of the environment.

In a market economy, resources are efficiently used when the production of goods is increased until the marginal cost is equal to the marginal benefits of production.

### **2.2.2 Naïve Public Interest Theory**

Criticism of the public interest theory has led to a more serious public interest theory (Noll, 1983, 1989a). According to the Naïve public interest theory, regulation can be accounted for by market failure under conformance to the conditions of the Coase theorem. This implies the assumption of absence of transaction costs and freely available, conveniently processed information in the political process. By letting go of these assumptions, a more sophisticated version of the public interest theory comes about. In the presence of transaction costs, regulation can form a more efficient solution to market failure than private negotiations between the parties involved. Costs of organisation can also be avoided when for example in the case of environmental pollution, politicians bundle the preferences of those negatively affected. In the case of flawed information, political entrepreneurs can detect the causes of market failure and report them to those involved. Regulation can be more efficient in this way because the government can obtain information less expensively. This sophisticated version of public interest theory does not therefore require regulation to be perfect. It does however assume that market failures exist, that regulation is the most effective means of combating it and that regulation does not continue to exist once the costs exceed the benefits. This theory also assumes that politicians support open decision-making process and spread information widely about the effects of market results and regulation. According to this theory, then, regulation can be accounted for as efficient solution to market failure.

### **2.2.3 Capture Theory- Private Interest Theory**

After the public interest theory had fallen into disrepute through empirical and theoretical research, the capture theory was developed mainly by political scientists. This theory assumes that in the course of time, regulation will come to serve the interests of the branch of industry involved. For example, it is assumed that legislators subject the branch to additional regulation by an agency if misuse of the economic

position of power is detected. In the course of time, other political priorities arrive on the agenda and the monitoring of the regulatory agency by the legislators is relaxed. The agency will tend to avoid conflicts with the regulated company because it is dependent on this company for its information. Furthermore, there are career opportunities. Furthermore, there are career opportunities for regulators in the regulated companies. This leads in time to the regulatory agency coming to represent the interests of the branch involved.

#### **2.2.4 The Chicago Theory of Regulation**

In 1971 a start was made on the development of a theory of regulation called by some the economic theory of regulation (Posner, 1974) and by others the Chicago theory of government (Noll, 1989). The Theory of Economic Regulation by George Stigler (1971) appeared that year. His central proposition was that as a rule, regulation is acquired by the industry and is designed and operated primarily for its benefit. The benefits of regulation for a branch of industry are obvious. The government can grant subsidies or ban the entry of competitors to the branch directly so that the levels of prices rise. In the second place, the government can maintain minimum prices more easily than a cartel. In the third place, the government can suppress the use of substitutes and support complements. An example of support to complements is the subsidizing airports for the benefit of airlines. A demand will therefore arise on the one hand for government regulation. The political decision-making process on the other hand makes it possible for branches of industry to exploit politics for its own ends. The political decision-making process on the other hand makes it possible for branches of industry to exploit politics for its own ends.

In the political decision-making process, interest groups will exercise political influence, as opposed to individuals. Individuals will not participate because forming an opinion about political questions is expensive in terms of time, energy and money, while the benefits in terms of political influence will be negligible. A representative democracy would more readily honor the strongly felt preferences of majorities and minorities than the less passionately expressed preferences. This is related to the costs of organisation of such minority and majority groups. Some groups can organise themselves less expensively than others.

Politicians will honor the demand for regulation by branches because it is not worth the while of the majority of opponents to gather the information and organise.

The conclusion is that regulation is not directed at the correction of market failures, but at setting up income transfers in favor of the industries in exchange for political support.

### **2.3 Regulation and Foreign Multinational Banks**

Most developing countries have adopted liberalization and privatization as the cornerstone of the strategy for private sector development. Issues of regulatory reform in the developing countries have ranged widely from deregulation or re-regulation (to improve existing regulation) in some, to establishing new regulatory structures and mechanisms, in others. Most deregulation and regulatory reform has taken place at the sectoral level. In many countries electricity, telecommunications, transportation, agriculture and banking have been subject to economic deregulation in the form of reducing or dismantling barriers to entry or exit, streamlining licensing and tariff laws, and price and wage controls. In the decade of the 1990s, issues of trade and investment, access to World Trade Organisation (especially as they related to reducing tariff and non-tariff barriers) diversification of the economic base, and of sustaining and promoting exports led most countries around the world to reduce the burden sectoral economic regulation and strengthen free market regimes. Whereas effective economic and social regulation aims at improving economic efficiency and promoting social welfare, nevertheless all regulation imposes costs. These take the form of management of the regulatory compliance and are termed process or administrative regulation.

Historically financial institutions especially banks have been one of the most heavily regulated companies in the world thus the most safest and conservative businesses. Even though they were considered safe some regulations hindered bank growth, regulation took many forms i.e. maximum interest rates paid on deposits and charged on loans, limited geographic markets for full service banking and they were also constrained on the type of investments permitted and restrictions on the range of activities, products, and services offered (Olum, 2010). Regulatory set-up need to be

strengthened, in line with the requirements of a market-led integrated financial system as this highly affect the functionality and productivity of banks (Rao, 2013).

A country's financial system is largely an intangible asset that can facilitate economic growth, it may fail to do so without an appropriate legal, regulatory, enforcement, and accounting environment (James, Gan, & Nolle, 2004).

In a study focused on the strategies applied by commercial banks in Kenya in anti-money laundering compliance programs concluded the need for implementation of strict adherence procedures and standards to ensure that money laundering is contained in Kenya (Ofunya, 2013). The legal and regulatory environment in which multinational banks survive has called for a clear definition on the nature and changing role of banks in promoting economic growth, development and stability; restrictions on the scope of banking activities and allowable ownership arrangements in which to conduct them; the structure and scope of bank regulatory and supervisory schemes; supervisory practices to promote safe and sound banks; market discipline and corporate governance in banking; international cooperation in regulation and supervision; offshore banking; potential disputes in banking arising from World Trade Organization membership; and deposit insurance schemes. This development has contributed to increased competitive pressures on banks, particularly in the economically more advanced countries, which has resulted in consolidation in the banking industry and expansion in the range of products and services banks offer.

The globalization of trade and services has also increased banks' efforts to service customers internationally resulting to more multinational banks. At the same time that the role of banking has been changing, the way in which banks are regulated and supervised has also been changing. A growing number of countries have recently taken responsibility for bank regulation and supervision away from the central bank and instead placed it in a separate regulatory authority, in some cases one which encompasses securities firms or insurance companies as well as banks. Countries in which banks have been heavily government owned have also been increasingly privatizing many of them, which in some cases has resulted in mergers and acquisitions involving foreign banks. This too has spurred the internationalization or globalization of banking. These developments raise issues about who should regulate and supervise big international banking and financial conglomerates operating across

many national borders, and how such regulation and supervision should be conducted (James, Gan, & Nolle, 2004).

The presence of foreign owned banks can be a two-edged sword. A large foreign banking presence may provide host country supervisors with additional challenges in terms of developing a comprehensive understanding of foreign banks' operations, and jurisdictional tensions may arise; but foreign banks may also "import" effective supervision, in that they may be supervised by the home country supervisor, which may adhere to best practices in supervision in the host country. For those countries with government ownership of banks, the percentage of bank assets owned by government range from a high of 98 percent in China to a low of 1 percent in Kenya. (James, Gan, & Nolle, 2004).

## **2.4 Operations of Foreign Multinational Banks**

The operations that foreign MNBs engage in follow from some of the determinants of their presence. Weller and Scher (1999) analysed the determinants of foreign MNBs presence and their results indicated that host country characteristics, such as real per capita GDP, growth population, size of the banking sector or current account balances are not significant in determining the MNB presence, but that lower asset prices, a ready market and competition with other MNBs may matter more than economic fundamentals in attracting foreign MNBs. Generally, their activities are more limited in their scope than those of local banks, and they tend to remain more restricted. In the early stages of multinational bank operations in a host economy, their operations are limited by a few factors, such as small capital base, insufficient physical and human capital, and unfamiliarity with the host economy.

Over time, all these hurdles may be overcome but in most cases, this leads foreign MNBs to only expand in market segments where they are already active, with the possible exception of strategic partnerships. One of the main reasons for these MNBs to enter a new economy is to provide services to MNCs which are already their customers in other parts of the world. Further, foreign MNBs provide services that other banks are either less familiar with or that they cannot provide. Such services

include currency loans, acceptances and guarantees related to international trade or syndicated loans (Brainard, 1990; Euh and Baker, 1990).

Due to the nature of these services, large domestic corporations become MNB clients, whereas Small and Medium Enterprises (SMEs) are less likely to require these services. Foreign MNBs also offer their services to high net worth individuals to attract new deposits and to provide consumer finances. Such retail banking services include brokerage services, savings products, mortgages, credit cards or consumer loans (Brainard, 1990).

The evidence suggests that in most cases, MNBs have rarely expanded their activities beyond these market segments. For instance, when competition in traditional MNB market segments increased in Korea in the 1980's, Some MNBs shut down their operations while others expanded their activities where competition were not as fierce, in this case services to high net worth individuals, customized financing packages for corporate clients, or foreign currency loans (Brainard, 1990; Euh and Baker, 1990). Market segments which have so far been largely ignored by MNBs are only getting a second look lately. This evidence on MNB activities confirms some of the findings on determinants of foreign MNB presence. In particular, these MNBs appear to serve mainly three market segments, namely MNCs, large domestic corporations and high net worth individuals, thus supporting the finding that foreign direct investment (FDI) flows are a significant determinant of MNB presence.

## **CHAPTER THREE: RESEARCH METHODOLOGY**

### **3.1 Introduction**

This chapter sets out the outline of methods of collection, measurement and data analysis. The chapter describes the methods that will be employed in providing answers to the research objectives as stated in chapter one. The following aspects of research methodology are discussed; research design, population, sample data, collection and data analysis.

### **3.2 Research Design**

This study adopted a cross-sectional descriptive research design. Cross sectional studies are also known as cross-sectional analyses. That was appropriate for this study because all the banks forming part of the population to be studied were studied at the same time to enable comparison. The study aimed at collecting information about the foreign MNBs in Kenya. The subject of discussion was not manipulated in any way.

### **3.3 Target Population**

The target population for a survey is the entire set of units for which the survey data are able to make inferences. Thus the target population defines those units for which the findings of the survey are meant to generalise. It is the group about which the researcher wishes to draw conclusions. As at 31<sup>st</sup> December, 2013, there were 14 foreign MNBs in Kenya (CBK Supervisory Report December, 2013). These were the target population for this study.

### **3.4 Data Collection**

Data collection is the process of gathering and measuring information on variables of interest, in an established systematic manner that enables one to answer stated research questions, test hypotheses, and evaluate outcomes. The goal for the data collection is to capture quality evidence that then translates to rich data analysis and allows the building of a convincing and credible answer to questions that have been posed. Since the population targeted was a small one, the study covered all the fourteen banks. The study was therefore a census one. Data for the study was collected from specific officers of the banks.

For each of the banks, the officers targeted for information were the Company Secretary or Legal Managers and in their absence the Risk and Compliance Managers or the Audit Managers. Information was collected mainly through secondary sources. Secondary data is the data that has already been collected from other sources and is readily available. Secondary sources of data are usually publicly available. The secondary sources included published reports and papers as well as the media. In cases where secondary data was not available, primary data was used and was collected using a structured questionnaire (appendix II). The structured questionnaire was administered through the drop and pick later method. The option of secondary data was selected because it is cheaper and readily available in instances where primary data cannot be obtained at all.

### **3.5 Data Analysis**

Data analysis is the process of inspecting, cleaning, transforming and modeling data with the aim of discovering useful information, suggesting conclusions, and supporting decision making.

The collected data was edited for consistency and completeness and statistical methods were used in analysis. Quantitative classification of data was done and use of graphs, charts and tables was adopted in data presentation. Qualitative data was also analysed. That was done through the development of a thematic framework from key issues, concepts and themes. Descriptive statistics was used in analyzing data. All the collected data was interpreted, explained and recommendations derived therefrom.



## **CHAPTER FOUR: DATA ANALYSIS, RESULTS AND DISCUSSION**

### **4.1 Introduction**

This chapter contains the findings of the study based on the data collected from the field. The study sought to find out the influence of the legal and regulatory environment on the business operations of multinational banks in Kenya. The data was analysed and information presented in form of, pie charts, bar graphs and cross tables.

### **4.2 Response Rate**

The study targeted a sample of 14 foreign multinational banks in Kenya. However out of the 14 questionnaires distributed only 9 were returned. This represented a 64% response rate making it a good response rate for analyzing and reporting. Secondary data comprising of published reports, media publications on the foreign multinational banks, articles and information on the respective websites for the multinational banks was also utilized as a source of data.

### **4.3 Demographic Information**

The study focused on 14 foreign multinational banks and descriptive analysis was done to represent some of the information. This was on the basis of the Nature of Regulatory Environment, Effectiveness of the Regulatory Environment and Governance of the foreign multinational Banks.

#### **4.3.1 Nature of the Regulatory Environment**

The 14 foreign multinational banks home countries are as illustrated in table 4.1.

The study sought to establish whether the home country regulations on banking and finance affected the business operations of the foreign MNBs located in Kenya and according to the findings of the study; those regulations affect the business operations of the foreign multinational banks in Kenya.

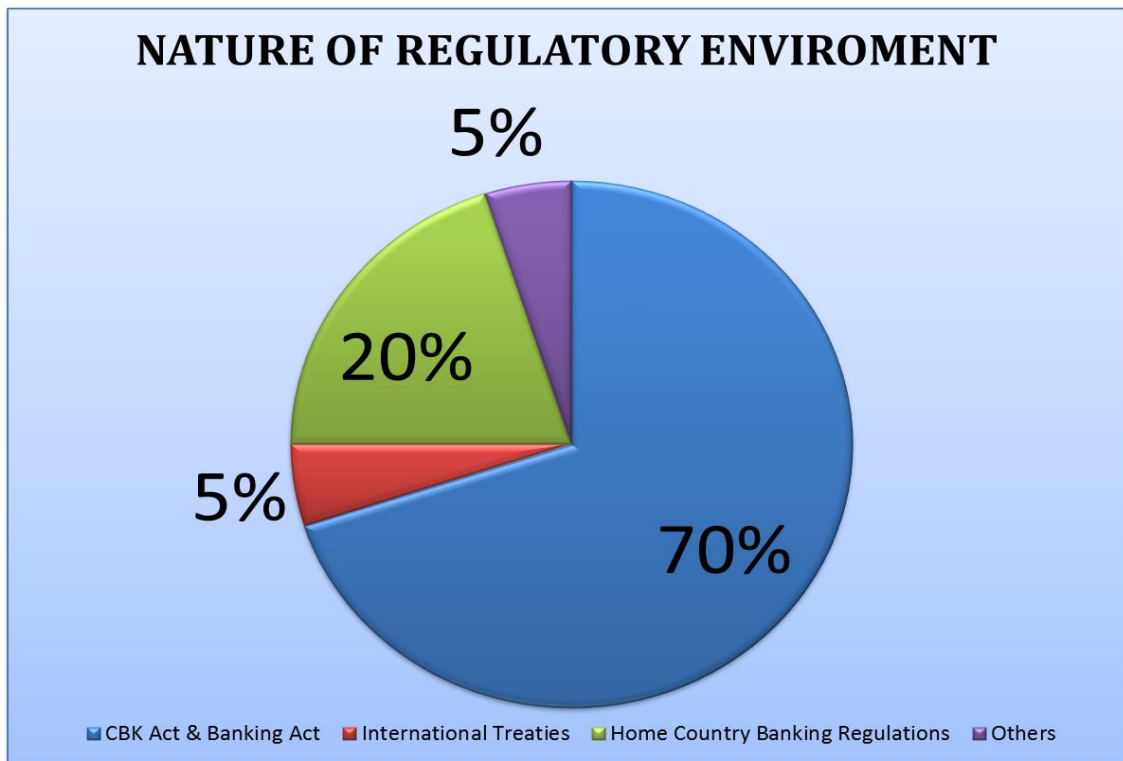
**Table 4.1 Home country of each foreign multinational bank.**

<b>Bank</b>	<b>Home Country</b>	<b>Headquarters</b>
Bank of Africa	Mali	Bamako
Bank of Baroda	India	Vadodara
Bank of India	India	Mumbai
Barclays Bank	UK	London
CFC Stanbic Bank	South Africa	Johannesburg
Citi Bank	USA	New York City
Eco Bank	Lome`	Togo
Guaranty Trust Bank	Nigeria	Lagos
Habib Bank A.G Zurich	Switzerland	Zurich
Habib Bank Limited	Pakistan	Multan
Standard Chartered Bank	UK	London
United Bank of Africa Kenya	Nigeria	Lagos
African Banking Corporation	South Africa	Johannesburg
Chase Bank	USA	Chicago

**Source: Research data 2014.**

These banks do not only comply with the Banking Act, Cap 488 Laws of Kenya and the CBK Act, but they have to pay due regard to the home country banking guidelines with a view to ensuring that their operations and policies do not contravene these regulations. Compliance with the home country banking regulations is however only to a limited extent.

**Figure 4.1 Various laws that govern the operations of Foreign Multinational Banks**



**Source: Research data 2014.**

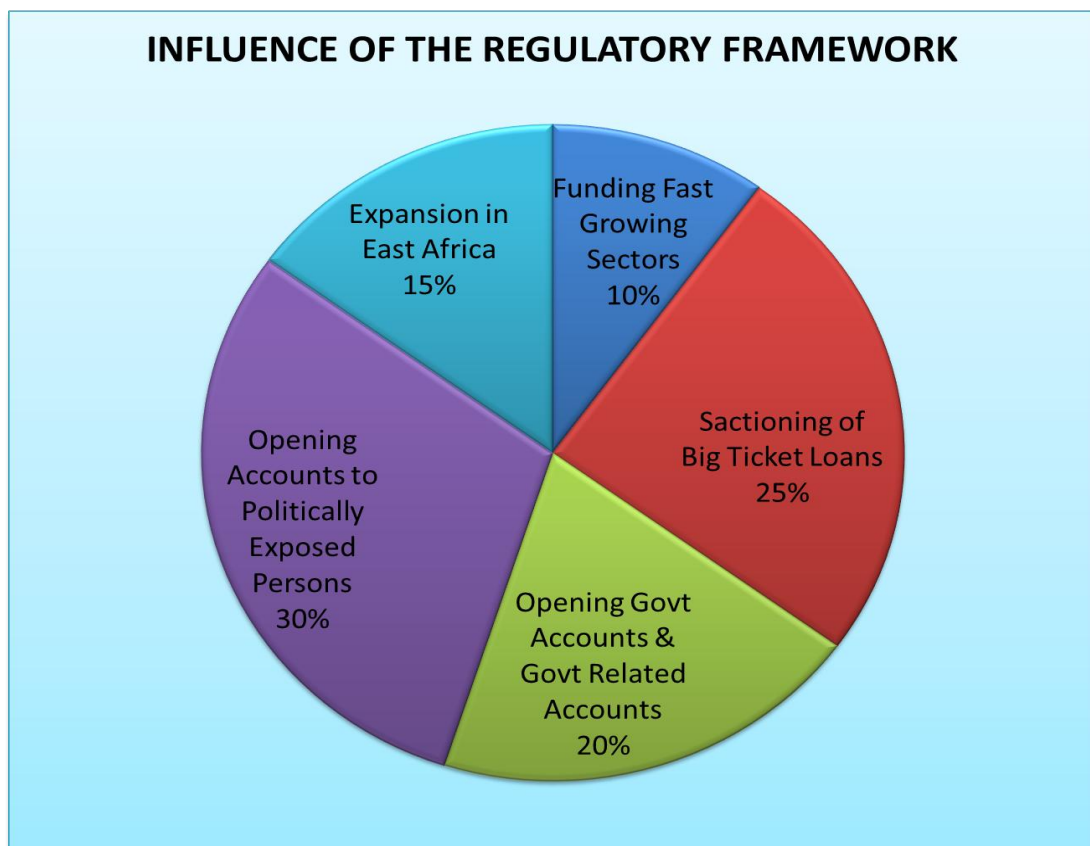
From Figure 4.1 all the foreign multinational banks however comply with all the host country regulations. Compliance with the home country banking regulations is over and above the host country regulations and it is done through the development of in-house policies. In regulating banks in Kenya, including the foreign MNBs, the CBK is in various ways guided by the Constitution of Kenya 2010, the Central bank of Kenya Act Chapter 491 Laws of Kenya, Banking Act Chapter 488 Laws of Kenya, and Microfinance Act (2006) and the National Payment System Act and The Kenya Deposit Insurance Act, 2012.

#### **4.3.2 Influence of the Regulatory Framework**

The study sought to establish the nature of the regulatory environment for the foreign MNBs and it was established that the regulatory environment for the foreign MNBs is complex. These banks have to comply with home country and host country regulations on banking.

This environment therefore influences their competitiveness, flexibility of the banks in terms of product development and innovation when compared to the homegrown banks. The pie chart below illustrates some of the areas where the MNBs face restrictions in their business operations because of the nature of their regulatory environment.

**Figure 4.2 Areas where Foreign Multinational Banks face restrictions in business**



**Source: Research data 2014.**

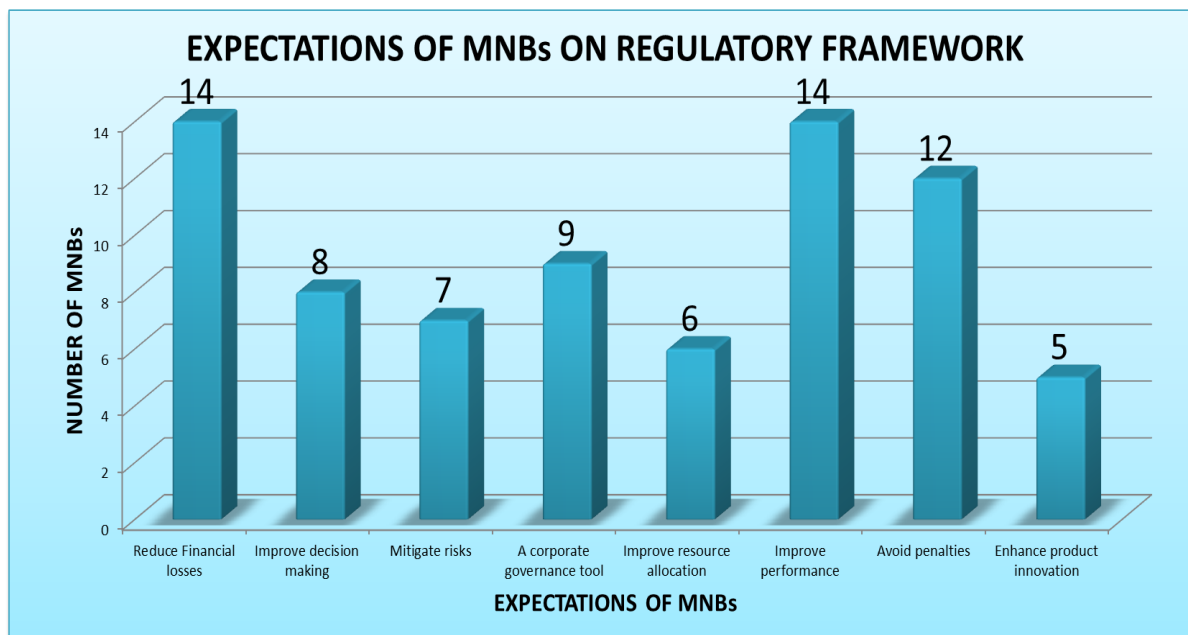
The research noted that the regulatory environment influences the financial performance of the foreign MNBs, their decision making process, how they allocate resources, product innovation and their corporate governance. These MNBs therefore expect the regulations to act as a corporate governance tool, improve performance, mitigate risks, avoid penalties, reduce financial losses, and improve decision making and resource allocation. These are in line with the CBK objectives for regulating the banking sector especially in regard to the regulations and guidelines issued pursuant to the Banking Act.

Regulations and Guidelines issued by the Central bank of Kenya Subject banks certain requirements, restrictions and guidelines. That regulatory structure creates transparency between banking institutions and the individuals and corporations with whom they conduct business among other things given the interconnectedness of the banking industry and the reliance that the national (and global) economy holds on banks.

According to CBK, the objectives of these regulations are classified as prudential, that is, to reduce the level of risk to which the bank creditors are exposed to; systematic risk reduction, that is to reduce the risk of disruption resulting from adverse trading conditions for banks causing multiple or major bank failures; avoid misuse of banks, that is, to reduce the risk of banks being used for criminal purposes like laundering proceeds of crime and to protect banking confidentiality credit allocation, that is, to direct credit to favored sectors to provide the best customer service.

The research also sought to establish the expectations of the foreign Multinational banks from the regulatory environment. The findings indicated that the expectations vary from one bank to the other but they revolved around the expectation to reduce losses mitigate risks, enhance corporate governance and innovation and avoiding penalties. Figure 4.3 illustrates these results.

**Figure 4.3 : Expectations of the Foreign Multinational Banks from the Regulatory Environment**



**Source: Research data 2014.**

The research further established that effective January, 2013, Basel I, II and III were adopted as global standards for all banks to adopt. The United States of America which is considered the global superpower has encouraged banks to comply with the Foreign Account Tax Compliance to facilitate the collection of taxes from American citizens in foreign countries.

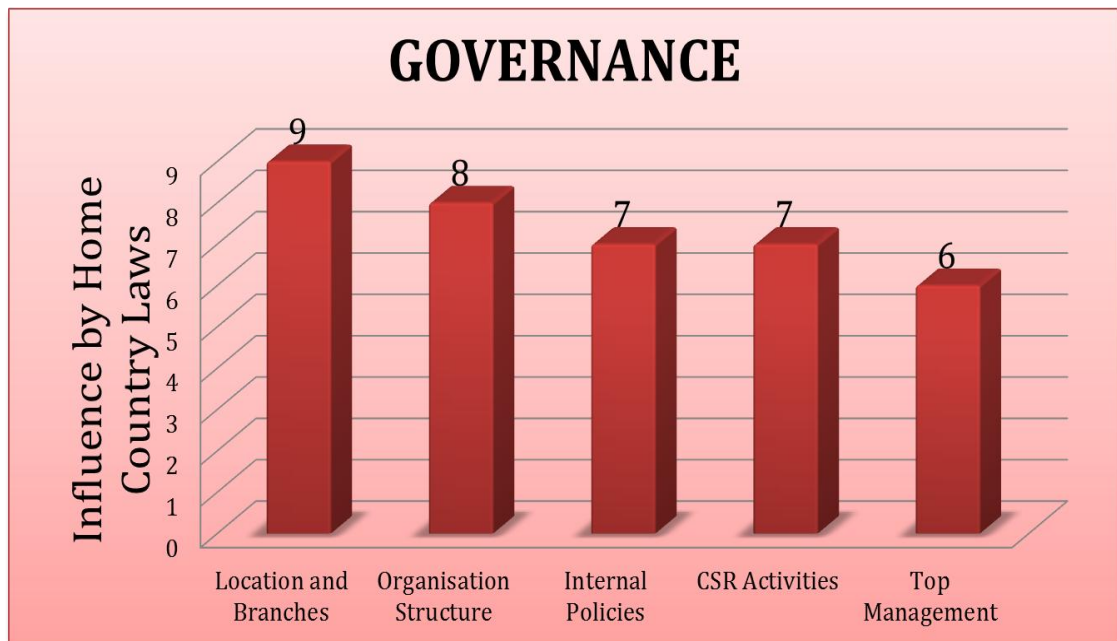
The regulatory environment was therefore noted as being fairly effective in as far as it enables the foreign MNBs to achieve their objectives; however the environment limits the competitiveness of the banks in some of the areas illustrated in Figure 4.2 above.

### **4.3.3 Governance of the Foreign Multinational Banks**

The research also aimed at establishing the influence of the regulatory environment on the governance structure of the foreign MNBs in Kenya and the findings indicated that the governance of the foreign multinational banks is influenced by the home country regulations although modified to suit the requirements of the host country regulations in terms of governance. The findings also indicated that major decisions affecting these banks are made by the parent companies or parent banks.

The findings are illustrated in the figure below.

**Figure 4.4: The influence of the home country laws on the governance of Foreign Multinational Banks.**

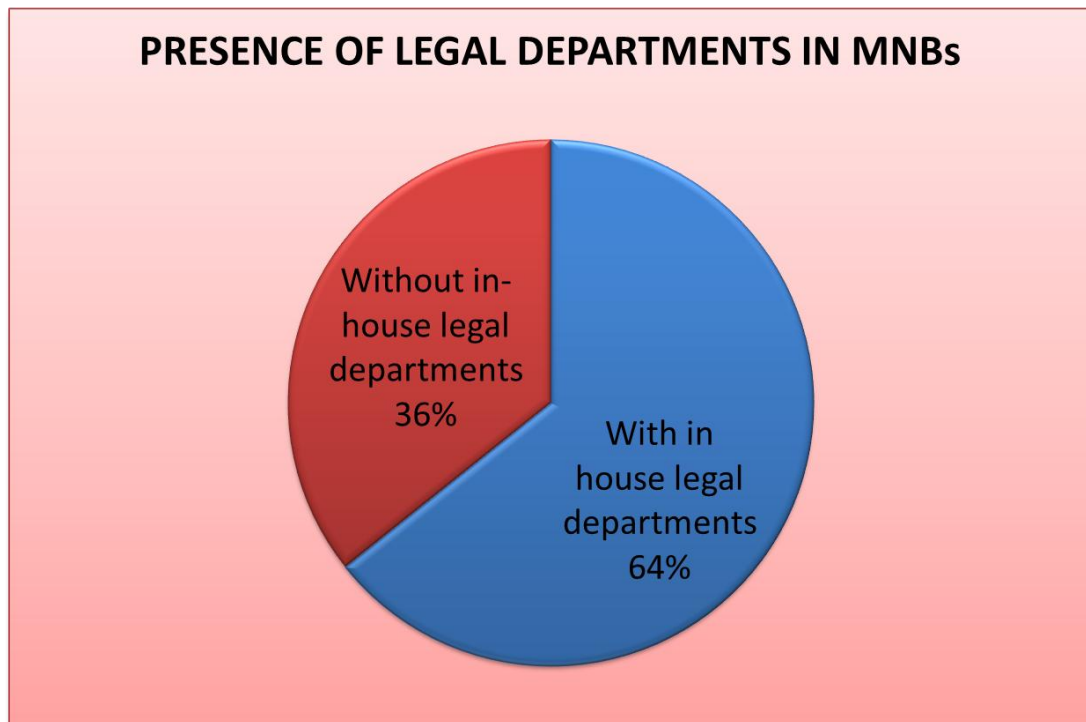


**Source: Research data 2014.**

Research was also conducted to establish whether all the foreign MNBs had in-house legal departments. The findings indicated that some of the foreign MNBs do not have in-house legal department that addresses legal matters that arise in the ordinary course of business. Instead, legal issues are outsourced to their external lawyers and departments like operations and finance are assigned the responsibility of ensuring compliance with the relevant laws.

Figure 4.5 illustrates the findings in relation to MNBs with and without legal departments.

**Figure 4.5 The presence of legal departments in the Foreign Multinational Banks.**



**Source: Research data 2014.**



## **CHAPTER FIVE: SUMMARY, CONCLUSION AND RECOMMENDATIONS**

### **5.1 Introduction**

This chapter provides a summary of findings on the research, the conclusion, and recommendations of the study which sought to establish the influence of the legal and regulatory environment on the business operations of foreign multinational banks in Kenya.

### **5.2 Summary**

The study mainly sought to establish the influence of the legal and regulatory environment on the business operations of foreign multinational banks in Kenya. According to the findings of the study, the MNBs operate in a complex regulatory environment when compared to their homegrown rivals. The complex regulatory environment is characterised by the Banking regulations for the home country, banking regulations for the host country in this case CBK and international treaties which mostly form part of the home country banking regulations following their adoption by the home country. There are also other regulations including circulars and policies formulated by the Bankers association which govern the operations of the banks. This complex regulatory environment differs with that of homegrown banks and affects various areas of their business operations.

The research findings indicated that the foreign MNBs face restrictions in various areas of their business operations including lending and operation of bank accounts. It was established that some of these banks are for example restricted in terms of opening bank accounts for politically exposed persons and operating bank accounts for Government entities because these persons are likely to be appointed as signatories. This is the case despite the fact that the Government controls about 60% to 70% of the National Expenditure. This in essence implies that there are products that homegrown rivals can develop targeting the Government and PEPs that some of the foreign multinationals may not be in a position to develop and offer.

This explains the reason why some of the foreign MNBs have resolved to open fresh turf war with the local rivals as was established during the research. Kenya's highly competitive banking market is headed for a major shift as local units of foreign multinational lenders stage a major comeback to claw back the huge market share they have ceded to homegrown rivals in the past three years. The latest half-year financial results indicated that Barclays and StanChart were pursuing a rapid growth strategy that is hinged on increased lending and introduction of new services for an edge over their homegrown rivals. Barclays' bigger risk appetite has been drawn from Johannesburg-based Barclays Africa to which it now reports following a reorganization of African subsidiaries in the year 2013. The Kenya subsidiary previously reported to London-based Barclays Plc, which had to sanction big-ticket loans, making its credit approval processes more stringent compared to its homegrown rivals. The bank also shunned fast-growing sectors such as real estate and SMEs in pursuit of a conservative lending strategy that led to the contraction of its loan book that has largely focused on large corporate borrowers. CFC Stanbic, a local subsidiary of South Africa's Standard Bank has also stepped up its growth momentum as it races to break into the top five group after staying in the sixth position for years.

Findings of this study also indicated that the governance of the foreign multinational banks is also affected by the home country banking regulations. It was noted that the parent company plays a key role in making major decisions that affect the foreign MNBs in Kenya. It was further noted that there is a conflict in terms of regulatory compliance when it comes to statutory reporting. Whereas the local banks report to the CBK the foreign MNBs are required to report to CBK and their parent Companies or banks. The research established that the foreign MNBs have numerous compliance responsibilities imposed by the nature of their regulatory environment but they nevertheless ensure consistency and completeness with both the home country and host country regulations on banking. This poses more challenges to those foreign MNBs that do not have an in-house legal or compliance department and the responsibility of monitoring regulatory compliance has been assigned to the Manager in charge of operations or the finance department.

### **5.3 Conclusion**

The study established that foreign MNBs operate in a complex legal environment which influences their business operations in terms of competitiveness in some metrics and their governance. The Complex regulatory environment is characterised by a combination of home country regulations on banking, host country regulations on banking and international treaties which the home countries are party to and which have been reduced into key governing policies in banking. Despite this kind of influence on their business operations, the foreign MNBs constantly review their business strategies to ensure good performance in key metrics such as profitability and loan book size. This was supported by the study findings which indicated that three foreign MNBs were among the top five banks in the country which posted the highest net profits.

The foreign MNBs are also answerable to regulators in banking at the home country as well as the host country making them organisations with numerous compliance requirements when compared to their homegrown rivals. The study further established that the MNBs have taken the necessary measures with a view to ensuring compliance with the regulatory framework and to that end these banks ensure consistency and completeness with both the home country and host country regulations in relation to banking business.

### **5.4 Limitations of the Study**

The study's key objective was to determine the influence of the legal and regulatory environment on the business operations of foreign multinational banks. The legal departments or the compliance departments were therefore identified as key respondents when it came to collection of data. It was however noted during the collection of data that some of the foreign MNBs do not have these departments and matters legal and those that relate to compliance are assigned to the operations department, the credit department or the finance department. This was a major limitation because the nature of the research topic requires persons who are trained in law to enable them comprehend the legal issues raised and give adequate responses.

Some of the responses given revealed a capacity challenge in comprehending legal matters. Some of the respondents, though willing to provide data, declined to complete the questionnaire citing poor grasp of the legal matters relating to the research topic.

There was also resistance to release data relevant to the study by some of the foreign MNBs. This is attributed to the fact that the banking industry is highly competitive and some of these banks have developed in house policies that bar the receipt of questionnaires on ground that the data may be used against them by their rivals. That attitude subsisted despite production of an introduction letter indicating that the report would be used solely for academic purposes and a copy of the same would be availed upon request.

## **5.5 Recommendations**

The study recommends reforms in the banking sector in as far as the foreign MNBs organisation structure is concerned for purposes of ensuring that all banks including foreign MNBs have a full-fledged legal department and a risk and compliance department. This follows the finding by the study that some of the MNBs did not have an in-house legal framework comprising of the legal department. This should be strictly enforced by the Central Bank and provisions to that effect must be provided for in the Banking Act. The engagement of in-house legal professionals is very important for the day to day running of these banks due to the complex legal environment that they operate in. The legal professionals will play a key role in the interpretation of these laws and offer legal advice that departments require in the ordinary course of business from time to time. The legal department will also assist the bank by attending to complex legal issues from external parties and serve as a link between the bank and external advocates that the bank may be required to engage from time to time.

The study established that the foreign MNBs have domesticated their home country regulations in banking with a view to ensuring a reliable financial sector for sustained economic growth. That objective was found to be consistent with that of CBK in relation to its Risk Based Supervisory Role (RBS).

The RBS framework is designed to allow CBK deliver consistent, high-quality supervision as the financial sector develops and as risk profiles of institutions change in reaction to competitive forces. The enhanced supervisory regime seeks to promote competition, safety and soundness of the financial sector. That approach benefits institutions as regulatory effort is more focused on high-risk areas and provides for more efficient supervision. Risk based supervision is an approach that places strong emphasis on understanding and assessing the adequacy of each institution's risk management systems which are expected to identify, measure, monitor and control risk in an appropriate and timely manner.

Some of their home country laws are worth considering for adoption. Examples of these laws include Foreign Account Tax Compliance Act. This is important for collection of taxes from American citizens living abroad. Indeed, the USA which is considered a global superpower has encouraged all countries to comply with that law. The other law found to be worth consideration by CBK is the US Patriotic Act and the Foreign Corrupt Practices Act. Domestication of some of these laws will play a key role in supporting the CBK's role of supervision of the banking sector by bringing the required discipline in the sector.

In recent decades, a large number of countries have experienced financial distress of varying degrees of severity, and some have suffered repeated bouts of distress (Hardy, 1998). Pazarbasioglu (1999) believes that the best warning signs of financial crises are proxies for the vulnerability of the banking and corporate sector. He showed that full-blown banking crises are associated more with external developments, and domestic variables are the main leading indicators of severe but contained banking distress. He adds that the most obvious indicators that can be used to predict banking crises are those that relate directly to the soundness of the banking system. In the 1980's and early 1990's, several countries in developed, developing and transition economies experienced several banking crises requiring a major overhaul of their banking systems (IMF, 1998). Kenya has experienced banking problems since 1986 culminating in major bank failures (37 failed banks as at 1998) following the crises of; 1986 - 1989, 1993/1994 and 1998 (Kithinji and Waweru, 2007; Ngugi, 2001).

Presently, several developed countries including the USA are experiencing a banking crisis. For example the Citibank group alone, has written off more than \$39 billion in losses (Elliot, 2008). Despite the problems facing the global financial market, Canadian banks have remained relatively stable. Eliot (2008) attributes this to a combination of regulatory discipline and cultural mindset among Canadian banks.

It is against this background that the recommendation to consider the said laws and domesticating them by the CBK has been made.

## **5.6 Suggestions for further research**

This study focused on the influence of the legal and regulatory environment of the business operations of foreign Multinational Banks in Kenya. During the study, various questions arose which require further research to provide the necessary answers. There is need to conduct further research on the compliance strategies employed by the foreign MNBs to ensure consistency and completeness with both the home country and host country laws on banking regulations, this study having established that their legal environment is complex compared to that of their local rivals. Further research should also be carried out to determine the effectiveness of the compliance strategies adopted by the foreign MNBs.

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## APPENDICES

### Appendix I: Introduction Letter



UNIVERSITY OF NAIROBI  
SCHOOL OF BUSINESS  
MBA PROGRAMME

Telephone: 020-2059162  
Telegrams: "Varsity", Nairobi  
Telex: 22095 Varsity

P.O. Box 30197  
Nairobi, Kenya

DATE 22/9/14

#### TO WHOM IT MAY CONCERN

The bearer of this letter ..... EDNA ADALA .....

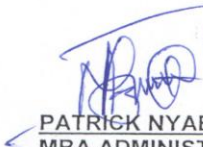
Registration No. .... D61/75802/2012 .....

is a bona fide continuing student in the Master of Business Administration (MBA) degree program in this University.

He/she is required to submit as part of his/her coursework assessment a research project report on a management problem. We would like the students to do their projects on real problems affecting firms in Kenya. We would, therefore, appreciate your assistance to enable him/her collect data in your organization.

The results of the report will be used solely for academic purposes and a copy of the same will be availed to the interviewed organizations on request.

Thank you.

  
PATRICK NYABUTO  
MBA ADMINISTRATOR  
SCHOOL OF BUSINESS



**APPENDIX II: QUESTIONNAIRE**

**SECTION A: GENERAL INFORMATION**

1. Indicate the name of the bank.....

2. Kindly, indicate the department you are working in.

Legal [ ] Risk Management [ ]

Compliance [ ] Internal Audit [ ]

Finance [ ]

Any other (specify).....

3. Indicate the position that you hold in the department.

Manager [ ] Unit Head officer [ ] Supervisor [ ]

Departmental Head [ ] Assistant Manager [ ]

Technical personnel [ ]

Any other (specify).....

4. For how long have you worked in the Bank?

1- 5 years [ ] 6 - 10 [ ] 11 – 15 years [ ] Above 16 years [ ]

5. Does the bank have an in-house legal framework?

Yes [ ] No [ ]

**SECTION B:**

**PART I: The Nature of the Regulatory Environment of Foreign Multinational banks in Kenya.**

1. Indicate the home country/ or the country where the headquarters of the parent bank or parent company are located.....

2. List the local laws/ host country laws and regulations that influence the business operations of the Bank.

.....  
.....  
.....

.....  
.....  
.....  
.....  
.....  
.....  
.....

Which authorities in Kenya are charged with the responsibility of formulating these laws and enforcing compliance?

.....  
.....  
.....  
.....

3. List the home country laws that affect the business operations of the Bank.

.....  
.....  
.....  
.....  
.....  
.....  
.....  
.....  
.....

4. Which authorities in the home country are charged with the responsibility of formulating these laws and enforcing compliance?

.....  
.....  
.....  
.....  
.....

5. Are there international treaties that affect the business operations of the Bank?

If yes, list them.

.....  
.....  
.....  
.....  
.....

6. Is there a similarity between the host/local laws and the home country laws that influence the business operations of the Bank?

.....  
.....

Briefly explain.

.....  
.....  
.....  
.....  
.....

8. Is there a conflict between the host/local laws and the home country laws that influence the business operations of the Bank?

.....  
.....

Briefly explain.

.....  
.....  
.....  
.....  
.....

9. Indicate your level of agreement to the statement below relating to the nature of the regulatory environment of foreign multinational banks. Use a scale of 1-5, where 1- strongly disagree, 2- disagree, 3- neutral, 4- agree, 5- strongly agree.

	1	2	3	4	5
The bank has numerous regulatory responsibilities compared to other local banks					
Are there products offered by other local banks which the bank cannot offer because of the home country regulations or restrictions ( Give examples if any)					
.....					
.....					
.....					

10. Indicate your level of agreement to the statements below relating to enforcement of governing regulations. Use a scale of 1-5, where 1- strongly disagree, 2- disagree, 3- neutral, 4- agree, 5- strongly agree.

	1	2	3	4	5
The regulatory environment is a standing agenda item in senior management and board meetings at the bank.					
The regulatory function is independent from the business of the bank.					
Accountability for compliance with regulations runs throughout the bank.					
The head of compliance/ or the equivalent routinely and regularly provides compliance updates for both the home country and host country prudential guidelines					
The bank has clearly split responsibilities for the ownership of prudential compliance					
There is a system of monitoring prudential compliance with home country laws and host country prudential guidelines					

11. What are the expectations of your bank from the regulatory framework?

(Indicate all that apply)

Reduce financial losses [ ]      Improve resources allocation [ ]

- |                             |     |                            |     |
|-----------------------------|-----|----------------------------|-----|
| Improve decision making     | [ ] | Improve performance        | [ ] |
| Mitigate risks              | [ ] | Avoid penalties            | [ ] |
| A Corporate governance tool | [ ] | Enhance product innovation | [ ] |

**PART II: Effectiveness of the Regulatory Framework of Multinational Banks in Kenya**

1. How the laws do indicated in part I above affect the profitability goals of the Bank?

Host Country laws

.....  
 .....  
 .....  
 .....

Home Country Laws

.....  
 .....  
 .....  
 .....

2. Comment on the influence of these laws on the flexibility of the bank in regard to product development and innovation when compared to the purely local banks.

.....  
 .....  
 .....  
 .....  
 .....

3. Comment on the influence of these laws on the competitiveness of the bank when compared to the purely local banks.

.....  
 .....  
 .....  
 .....

4. Which department(s) is/are responsible for ensuring regulatory compliance?

.....  
.....

5. Would you propose any changes to the legal and regulatory environment of the bank? If yes, indicate your proposals.

.....  
.....  
.....  
.....  
.....

**PART III: Governance Structure of the Bank**

1. Do the home country laws affect the Governance structure of the Bank? Briefly explain.

.....  
.....  
.....  
.....

2. Do the host country/ local laws affect the Governance structure of the Bank? Briefly explain.

.....  
.....  
.....  
.....  
.....

3. Does the Governance structure of the Bank differ with that of purely local banks by virtue of it being a foreign multinational? Briefly explain.

.....  
.....  
.....



4. Which compliance function structure has your bank adopted?

Centralized [ ]                      Decentralised [ ]

**PART III: Compliance with the Regulatory Framework**

1. Indicate your level of agreement to the statement provided below. Where 1- strongly disagree, 2- disagree, 3- neutral, 4- agree and 5- strongly agree.

	<b>1</b>	<b>2</b>	<b>3</b>	<b>4</b>	<b>5</b>
1. The banks ensures consistency with both home country and host country prudential guidelines					
2. The bank ensures completeness with both the home country and host country prudential guidelines					
3. There is adequate communication of the key elements of the regulatory environment to the staff					

**THANK YOU FOR YOUR PARTICIPATION**

## **APPENDIX III**

### **LIST OF FOREIGN MULTINATIONAL BANKS**

African Banking Corporation

Bank of Africa

Bank of Baroda

Bank of India

Barclays Bank

CFC Stanbic Bank

Chase Bank

Citi Bank

Eco Bank

Guaranty Trust Bank

Habib Bank A.G Zurich

Habib Bank Limited

Standard Chartered Bank

United Bank of Africa