BANK FINANCIAL PERFORMANCE AND CUSTOMER SATISFACTION IN KENYA

BY:

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DECLARATION

I declare that this research paper is my original work and has not been exhibited or published in any way and has never been presented for any awards in any institution. Where other sources of information have been used they have been acknowledged.

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DEDICATION

I dedicate this paper to my beloved husband Patrick Cherugong, my parents Mr. and Mrs. David Ronoh, my siblings Joyce, Beatrice, Janet, Caroline, Isaac, Eric and Gloria for unwavering support in every step of the way.

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LIST OF ABBREVIATIONS

ATM : Automated Teller Machine

CBK : Central Bank of Kenya

CSR : Corporate Social Responsibility

GDP : Gross Domestic Product

NPM : Net Profit Margin

ROA : Return On Assets

ROE : Return On Equity

ROI : Return On Investment

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ABSTRACT

The study intended to establish the relationship between financial performance and customer satisfaction in Kenyan banks. Financial performance was measured by use of Return on Asset that is net profit after tab divided by total current asset obtained from audited statements of comprehensive income while Customer satisfaction was measured by numbers of customers. For uniformity purposes, net profits before taxes was chosen since some commercial banks had treated expenses on CSR as tax exempt while others had not. Commercial institutions that did not participate in customer satisfaction activities or that had not kept data pertaining to financial performance were excluded. Secondary data from the year 2010 to 2014 was used for analysis. Using descriptive research design, the study tested for linear relationship between financial performance and customer satisfaction. The study used regression analysis and the five years secondary data to analyze the relationship between financial performance and customer satisfaction. Financial performance was the independent variable while customer satisfaction was the dependent variables in the linear regression. The study revealed that not all commercial banks report their customer satisfaction involvement. Out of the 44 commercial banks studied, only five provided the necessary and complete data that was appropriate for the study. The study finding implies that change in customer satisfaction is negatively attributable to financial performance. of commercial banks in Kenya. The independent variables studied explain only (10.2%) on the relationship between of financial performance and customer satisfaction in commercial banks in Kenya as represented by R^2. This means that the other variables not studied in this research contributed (89.8%) and thus further research should be conducted to investigate these other factors affecting financial performance in commercial banks in Kenya.

CHAPTER ONE

INTRODUCTION

1.1 Background of the Study

Banks have a key role in meeting customer satisfaction in Kenya and this can be achieved through offering quality and reliable banking services. A bank is financial institution and a financial intermediary that accepts deposits and channels those deposits into lending activities, either directly by loaning or indirectly through capital markets. A bank is the connection between customers that have capital deficits and customers with capital surpluses. The Kenyan banking industry is one of the broadest and most developed in sub-Saharan Africa with 49 financial institutions, comprising 43 commercial banks, 1 mortgage finance company and five deposit-taking microfinance institutions (CBK 2011). These institutions, along with the Kenya Post Office Savings Bank, make up Kenya's formal banking sector and serve 22.6 percent of Kenya's adult population, according to Fin Access household survey (Beck et al., 2010).

The Banking industry in Kenya is governed by the Companies Act, the Banking Act, the Central Bank of Kenya Act and the various prudential guidelines issued by the Central Bank of Kenya (CBK). According to central bank of Kenya the Kenyan Banking Sector continued to register improved performance with the size of assets standing at Ksh. 2.3 trillion, loans and advances worth Ksh. 1.32 trillion, while the deposit base was Ksh. 1.72 trillion and profit before tax of Ksh. 80.8 billion as at 30th September 2012. During the same period, the number of bank customer deposit and loan accounts stood at 15,072,922 and 2,055,574 respectively (Ndome, 2012).

1.1.1 Bank Financial Performance

Financial performance is a subjective measure of how well an organization can use assets from its primary mode of business and generate revenues (Greenwood and Jovanovic, 1990). This term is also used as a general measure of a firm's overall financial health over a given period of time, and can be used to compare similar firms across the same industry or to compare industries or sectors in aggregation. There are many different ways to measure financial performance, but all measures should be taken in aggregation. Line items such as revenue from operations, operating income or cash flow from operations can be used, as well as total unit sales (Jayawardhera and Foley, 2000).

Profit is the ultimate goal of firm. To measure the profitability, there are varieties of ratios used of which Return on Asset, Return on Equity and Net Interest Margin are the major ones (Murthy and Sree, 2003). ROA is a major ratio that indicates the profitability of a bank. It is a ratio of Income to its total asset (Khrawish, 2011). It measures the ability of an organization’s management to generate income by utilizing company assets at their disposal. Net Interest Margin (NIM) is a measure of the difference between the interest income generated by banks and the amount of interest paid out to their lenders, relative to the amount of their assets. It is usually expressed as a percentage of what the financial institution earns on loans in a specific time period and other assets minus the interest paid on borrowed funds divided by the average amount of the assets on which it earned income in that time period (the average earning assets). ROE is a financial ratio that refers to how much profit a company earned compared to the total amount of shareholder equity invested or found on the balance sheet. ROE is what the shareholders look in return for their investment.

1.1.2 Customer Satisfaction

Customer satisfaction refers to the degree to which customers' expectation of a product or services are met (Paul and Abauma, 1989). It can as well be defined as a state of mind that customers have about a company when their expectations have been met or exceeded over the lifetime of the product or service (Kevin, 2009). Customers are satisfied if they are loyal to the product, customer retention rate and switching behavior, customer willingness to use new or existing services put by the organization, give nice comments about the product or services offered continue consuming the product and low levels of complaints about the product or services offered.

Customers are the most important factor to any organization. It is therefore important for organizations to ensure that their customers are satisfied with the organizations products and services. Statistics are bandied around that suggest that the cost of keeping a customer is only one tenth of winning a new one. Therefore, when they win a customer, they should hang on to them. Once an organization has set its goals to satisfy customers in all aspects it has to ensure that the customers' expectations and needs are met according to their specifications. Banks need to identify the various techniques and methods that can be used to satisfy customers and to understand how to apply them

1.1.3 Bank Financial Performance and Customer Satisfaction

Bank financial performance does not meet customers need. Customers while using the Direct Banking system spends a lot of time lining up for services, banks' products and services are expensive for the customers in form of bank charges, mathematical problems, though not so common; take place, which take a lot of time for customers reconciling their accounts with the bank. While using electronic banking, customers have experienced problems like unauthorized access and redirection of websites or emails, credit card fraud or theft, network problems and they need computers connected to the internet of which they must have the knowledge of using the internet. When using Automated Teller Machines, there is a maximum and minimum amount of money one can withdraw at ago, theft of customer money and capturing of the cards especially when a mistake is made. This has partly led to the reduction in profits by 2% by the year 2014, deposits reduced and there was an increase in loan default rates (Annual General Meeting report, 2014).

The studies revealed that the bank customers' expectations had not been met. Bank financial performance and assurance had the largest influence on customer satisfaction in both areas and resulted in positive word of mouth about the bank. Ndubisi and Wah (2005) evaluated customer satisfaction in Malaysian banks. Results indicated that strong customer-bank relationships depend on the banks' competence, commitment, communication, conflict handling financial skills and trust. Banks exhibiting the five qualities had quality relationships with their customers while those lacking in those dimensions created poor quality relationships with customers.

Once banks understand the factors affecting customer satisfaction with the banking products, they can design their financial strategies to cope with the increased competition in the market place with the customer in mind. The more satisfied the customers are, the greater is their retention (Ranaweera & Prabhu, 2003; Trasorras, Weinstein & Abratt, 2009).

Due to emerging trends mentioned above, Kenyan banks have witnessed increased competition and they have tried to establish the cause of customer dissatisfaction leading to attrition. A study by Mburu (2012) established bank financial related factors as having a high impact on customer satisfaction in the Kenyan banking industry. However many commercial banks in Kenya have opened up new branches to match with the increasing number of customers. They have also increased on the number of ATMs and agents especially in towns to reduce on the queues in the banks. To reduce on the problem of theft which is now growing while using ATMs, they have a provision where one can change his/her pin number any time he or she feels like.

1.1.4 Commercial Banks in Kenya

As at 31st December 2014, the banking sector comprised of the Central Bank of Kenya, as the regulatory authority, forty four banking institutions (forty three commercial banks and one mortgage finance company - MFC), four representative offices of foreign banks, six Deposit-Taking Microfinance Institutions (DTMs), one hundred and eighteen Forex Bureaus and two Credit Reference Bureaus (CRBs) (CBK, 2012). Out of the forty four banking institutions, thirty one locally owned banks comprise three with public shareholding and twenty eight privately owned while thirteen are foreign owned. The six DTMs, two CRBs and one hundred and eighteen forex bureaus are privately owned. The foreign owned financial institutions comprised of nine locally incorporated foreign banks and four branches of foreign incorporated banks.

According to Central Bank of Kenya (2014) Out of the forty four banking institutions, thirty one are locally owned and thirteen are foreign owned. The locally owned financial institutions comprise three banks with significant shareholding by the Government and

State Corporations, twenty seven commercial banks and one mortgage finance institution. In terms of asset holding, foreign banks accounted for about 35% of the banking assets as of 2014. In Kenya the commercial banks dominate the financial sector. In a country where the financial sector is dominated by commercial banks, any failure in the sector has an immense implication on the economic growth of the country. This is due to the fact that any bankruptcy that could happen in the sector has a contagion effect that can lead to bank runs, crises and bring overall financial crisis and economic tribulations.

1.2 Problem Statement

Most commercial banks customers are not satisfied with their respective bank services. They spend a lot of time lining up for services, transaction costs are high and Automatic Teller Machines fraud is high when using Automatic Teller Machines. This has led to a reduction in the number of customers by over 2% (CBK, 2014). In an attempt to solve the problem, most commercial banks have improved on the coverage of its Automatic Teller Machines; have installed more ATM machines in different areas in Kenya. They have also introduced a provision where customers can change PIN numbers for those who use ATMs any time they feel insecure.

Most commercial banks have introduced agency banking and use of mobile banking as a new mobile payment and banking platform for its customers –that officially brings to the fore the convergence between mobile and banking services in Kenya. However customer's complaints still continue. Customers still waste a lot of time in lines and fraud on ATM is still available.

Customer satisfaction is a much sought after phenomenon in today's highly competitive and globalized market place. Today's consumers seek more than price bargains and want useful purchasing information, high quality, reliable and safe products, dependable servicing and fair sales practices. A bank's failure to fulfill these expectations can breed dissatisfaction and antipathy, unless that business helps resolve resulting consumer complaints fairly and promptly. Satisfied customers are less sensitive, buy additional products, are less influenced by competitors and stay loyal longer (Zineldin, 2000). Bejou et.al, (1998) propose that customer satisfaction can be enhanced through relationships provided they are developed and managed to customers' satisfaction. Banks are adopting financial-driven strategies guided by the logic that all business strategy decisions should start with a clear understanding of markets, customers, and competitors.

Research done on the role of the different information technology enabled business functions in large enterprises indicated that information technology improves business performance and enhances productivity in firms. It also revealed that improved bank financial performance are crucial in driving business growth (Lansity&Favaloro,2006). Over the past few years information banking systems has replaced the conventional modes of banking with innovative technological tools. In addition to the increased output and efficiency, banking systems has introduced new concepts such as e-banking (Carr, 2005). Studies on information technology challenges facing leaders of Homeland security in the 21st century indicate that electronic banking is still in its infancy, but has great potential (Alexander, 2004). Few companies are engaged in on-line transaction. In addition, the number of the secure transaction sites is still low. This may well be a barrier to the visitor considering buying products or services over the Internet.

Cravens (2003) noted that firms that support their banking system investments with investments in complimentary assets such as new banking models, new banking processes management behavior , organization culture, or training , receive superior returns whereas those banks failing to make complimentary investment receive less or no returns on their investment. According to Cravens & Piercy (2003), Banks can be market-oriented only if it completely understands its markets and the people, and that complaint resolution strategies are important particularly in managing customer relationships in service business.

Customer satisfaction remains one of the biggest challenges for the Kenyan banking industry. Empirical studies that attempt to explore how various bank financial performance affect customer satisfaction are few. Customer attrition in the Kenyan banking industry is still high and the causes have not been exhausted. This gap presented the motivation for this study. The study sought to establish the correlation between bank financial performance and customer satisfaction in Kenya. The question that pegged for answers is what is the relationship between bank financial performance and customer satisfaction in Kenya?

1.3. Research Objective

The objective of this study is to establish the relationship between financial performance and customer satisfaction in Kenyan banks.

1.4. Value Of The Study

The study will enhance understanding of the relationship between bank financial performance and customer satisfaction, investors will determine how to allocate their portfolio so as to maximize returns and thereafter change their assessment of companies' performance and will be making decisions based on criteria that will include ethical concerns (Carroll, 1991).

Furthermore, this study will add knowledge to previous studies on bank financial performance. The results of the study can be important to the managers of other commercial banks both in Nairobi and other parts of the country by contributing to the existing body of knowledge in the area of bank financial management and its impact on customer satisfaction. Academicians would use findings for further research.

The study can be a source of reference material for future researchers on other related topics. It will also help other academicians who undertake the same topic in their studies. The study would also highlight other important relationships that require further research; this may be the areas of relationships between intelligence and the banks' performance. The research findings and their recommendations can be used by the bank managers to improve the quality of their services.

CHAPTER TWO

LITERATURE REVIEW

2.1. Introduction

The chapter represents the existing literature about bank financial performance and customer satisfaction that have been explored and studied both theoretically and empirically by a number of scholars. The secondary data is obtained from journals, text books, pamphlets and from the internet.

2.2. Theoretical Literature Review

It is appropriate to lay out the theoretical underpinnings of this study. This is henceforth undertaken in the sections hereunder.

2.2.1. Stakeholder Theory

In stakeholder theory, the purpose of the firm is to create wealth or value for its stakeholders by converting their stakes into goods and services (Clarkson, 1995) or to serve as a vehicle for coordinating stakeholder interests (Evan and Freeman, 1988). Stakeholder theory was first presented as managerial theory. Accordingly, the corporation ought to be managed for the benefit of its stakeholders: its customers, suppliers, owners, employees and local communities, and to maintaining the survival of the firm (Evan and Freeman, 1988). The decision making structure is based on the discretion of the top management and corporate governance, and frequently it is stated such governance should incorporate stakeholder representatives. Stakeholder theory of CSR is related to the belief that corporations have an obligation to constituent groups in society other than stockholders and beyond that prescribed by law or union contact (Jones, 1980). Thus, stakeholder theory takes into account individuals or groups with a stake in the company including shareholders, employees, customers, supplier and local community.

According to Freeman (1984) the stakeholder concept provides a new way of thinking about strategic management. By paying attention to strategic management, executives can begin to put a corporation back on the road to success. However, it is also a normative theory which requires management to have a moral duty in order to protect the corporation as a whole and, connected with this aim, the legitimate interests of all stakeholders (Friedman, 1970). Evan and Freeman (1988) stated that management, especially top management, must look after the health of the corporation, which involves balancing the multiple claims of conflicting stakeholders. The term stakeholder was meant by Friedman (1970) to generalize the notion of stockholder as the only group to whom management need to be responsible. ‘Stakeholder’ can be taken in two senses. In a narrow sense, the term stockholder includes those groups who are vital to the survival and success of the corporation (Freeman and Reed, 1983). In a wide sense, it includes any group or individual who can affect or is affected by the corporation (Freeman, 1984). Thus, stakeholders are identified by their interests in the affairs of the corporation and it is assumed that the interests of all stakeholders have intrinsic value (Donaldson and Preston, 1995).

The base legitimacy of the stakeholder theory is on two ethical principles; principle of corporate rights and principle of corporate effects (Freeman and Reed, 1983). Both principles take into account the Kant’s dictum respect for persons. The former establishes that the corporation and its managers may not violate the legitimate rights of others to determine their future. The latter focused on the responsibility for consequences by stating that the corporation and its managers are responsible for the effects of their actions on others. There is the problem of solving conflicting interests between stakeholders. Several authors, accepting the basic stakeholder framework, have used different ethical theories to elaborate different approaches to the stakeholder theory, and specifically to solve conflicting stakeholder demands. It has been proposed, among others, the following theories: Feminist Ethics (Burton and Dunn, 1996), the Common Good Theory (Argandoña, 1998), the Integrative Social Contracts Theory (Donaldson and Dunfee, 1999) and the Doctrine of the fair Contracts (Freeman, 1994). Freeman accepted these pluralistic ethical approaches by presenting stakeholder model as a metaphor where different ethical theories find room.

2.2.2. Relational Theory

Relational theory has its root from the complex firm-environment relationships. Corporate citizenship of the relational theory strongly depends on the type of community to which it is referred. It is a path that a corporation may take to behave responsibly. Fundamentally, it is about the relationship that a corporation develops with its stakeholders, and therefore, the former has to continuously search for engagement and commitment with the latter. Corporate citizenship, according to Garriga and Mele (2004), is an approach used under the integrative and political theories and this is supported by Swanson (1995) and Wood and Lodgson (2002). This theory is sub-divided into four categories namely business and society, stakeholder approach, corporate citizenship and the social contract.

Business and society implies business in society where bank financial performance is the interacting factor between the two. It is necessary that the Social responsibility of the business need to reflect social power that the business possesses. The approach is both within the interactive and ethical theories, where the former emphasizes the integration of social demands and the later focuses on the right thing to achieve a good society (Garriga and Mele, 2004). Corporations are proactive in publishing reports on economic, social and environmental performance following the idea of triple-bottom line (Elkington, 1998).

Stakeholder approach is one of the strategies of improving the management of the firm. Corporate relationship of relational theory depends on the type of community it refers to while the social contract theory explains the fundamental issue of justifying the morality of economic activities in order to have a theoretical basis of analyzing social relations between the corporation and the society. In the stakeholder approach, the purpose of the firm is to create wealth or value for its stakeholders by converting their stakes into goods and services (Clarkson, 1995), or "to serve as a vehicle for coordinating stakeholder interests" (Evan and Freeman, 1988). Stakeholder approach has been developed as one of the strategies in improving the management of the firm. It is a way to understand the reality in order to manage socially responsible behavior of a firm.

The term 'corporate citizenship' was introduced into the business and society relationship mainly through practitioners (Vidaver-Cohen and Altman, 2000). Since the concept of corporate or business citizenship is increasingly associated with a global sense of business and with a notion of citizenship which go beyond national boundaries, Wood and Logsdon (2002) suggested using the expression ‘business citizenship’ and ‘global business citizenship’ instead of ‘corporate citizenship’ to make clear that this term is not limited to corporate involvement and philanthropy and to present a global sense for citizenship. A firm is not socially responsible if it merely complies with the minimum required of the law (Eilbert and Parket, 1973). Meade (1973) argues that a society is a series of social contacts between members of society and society itself. He states that the business does not act in a responsible manner because it is in its commercial interest but because it is part of how society implicitly expects business to operate.

2.2.3. Agency Theory

Generally, ‘shareholder value-oriented’ goes along with the agency theory, which has been dominant in many business schools in the last decades (Ross, 1973). In this theory, owners are the principals and managers are their agents. The manager bears fiduciary duty towards the owners and is generally subject to strong incentives in order to alienate their economic interests with those of the owners, and with the maximization of shareholder value. Today, it is commonly accepted that under certain conditions the satisfaction of social interests contribute to maximizing the shareholder value and most large companies pay attention to customer satisfaction particularly in considering the interests of people with a stake in the firm. In this respect, Jensen (2000) has proposed what he calls ‘enlightened value maximization’. This concept specifies long-term value maximization or value-seeking as the firm’s objective which permits some trade-offs with relevant constituencies of the firm.

Corporate social responsibility has been a key element aimed towards satisfying customers interests. Burke and Logsdon, (1996) proposed the concept of SCSR to refer to policies, programs and processes which yield substantial business related benefits to the firm, in particular by supporting core business activities, and thus contributing to the firm's effectiveness in accomplishing its mission. From this perspective, there is an ideal level of customer satisfaction determinable by cost-benefit analysis and depending on several factors (McWilliams and Siegel, 2001). This requires a careful calculation of the optimal level of social output in each situation for maximizing shareholder value.

2.3. Customer Satisfaction and Financial Performance Indicators

Customer satisfaction can be measure by considering their emotional and behavioral reactions towards a brand. According to Fornell (1992), customers loyalty towards a brand can be used to measure their satisfaction towards that brand. A satisfied customer will always use same brand frequently. Satisfied customers have a perceived reliability towards a brand and tend to like it more than other brands. Customers who consistently complain of a brand are usually not satisfied with it.

The determinants of commercial bank's financial performance can be categorized into two namely those that management can control and those that are beyond management control (Linyiru, 2006). The factors that management can control are classified as internal determinants while those that are beyond their control are referred to as external determinants. According to Williams, Molyneux and Thornton (1994), the internal determinants basically reflect on the differences in bank management policies and decisions in regard to sources and uses of funds management, capital and liquidity management and expenses management. The management induced effects on profitability can be analyzed by examining the comprehensive income statement and statement of financial position of these institutions. Statement of financial position items would illustrate the bank's management policies and decisions in relation to the sources, composition and use of funds (Bourke, 1989). Profit generation is the ultimate goal of commercial banks hence all the strategies designed and activities performed thereof are meant to realize this grand objective. To measure the profitability of commercial banks, there are variety of ratios used of which Return on Asset, Return on Equity and Net Interest Margin are the major ones (Murthy and Sree, 2003).

According to Molyneux and Thornton (1992), management efficiency in generating revenues and controlling costs would be reflected in the statement of comprehensive income. Management controllable internal determinants include capital ratios, liquidity ratios, asset and liability portfolio mix and overhead expenses. On the other hand, external determinants of commercial bank profitability can be sub-classified as either environment related factors or firm related factors. Environment related factors considered by Short (1979), Bourke (1989) and Molyneux and Thornton (1992), include market structure, regulation, inflation, interest rate and market growth. Firm specific factors include firm size and ownership. Alkhatib (2012) studying the financial performance of Palestinian commercial banks listed on Palestine securities exchange (PEX) measured financial performance using three indicators; Internal–based performance measured by Return on Assets (ROA), Market based performance measured by Tobin's Q model (Price / Book value of Equity) and Economic–based performance measured by Economic Value add.

2.4. Empirical Literature Review

Molina et al. (2007) investigated customer satisfaction in Spain. Trust and exemplary customer service emerged as the key factors contributing to good long-term relationship between the bank and the customers. Manraj and Manraj (2007) investigated dimensions of customer service that influenced customer satisfaction in the American banks. The study identified the following dimensions of customer service having the greatest influence on customer satisfaction: Personnel related considerations, financial considerations, (interest earning and interest payments), environmental related considerations (atmospherics) and convenience related considerations (ATM presence and bank opening hours).

Ahmad, Bashir and Humayoun (2010) examined the impact of customer satisfaction on performance of conventional banks in Pakistan. The findings established a relationship between customer satisfaction and bank performance. Studies recommended that banks improve their products and introduce new, diversified and marketable products to meet the requirements of various market segments. A study by Ghazizadeh, Besheli and Talebi (2010) in state owned banks in Tehran found that customer satisfaction and demographic factors like age and level of education had influenced customers' propensity to stay with their current banks. Lastly, a study in Iranian state owned banks by Ghazizadeh, Besheli and Talebi (2010) revealed that bank service operation such as assurance, responsiveness and empathy, bank employees friendliness, care, helpfulness and courtesy were important in explaining customer satisfaction.

Ojung'a (2005) investigated e-commerce services in commercial Banks in Kenya. His study gave various outputs and some of them included extend to which bank to bank ecommerce service utilization, extend to bank to customer electronic payment methods and extend of usage of electronic payment methods. Magutu et al.,(2009) modeled the effects of E-Commerce adoption on Business Process Management: Case Study of Commercial Banks in Kenya. According to Ochieng, (1998) and Otieno, (2006) the new banking systems is becoming an important factor in the future development of Kenya financial services industry, and especially Kenyan banking industry. Banks are faced with a number of important questions, for examples how to take full advantage of new technology opportunities, how e-developments change the ways customers interact with the financial services provider. Kenya has achieved significant success in the implementation of electronic banking; it is on the top of the emerging markets in this area and even outpaces the achievements of some developed countries. This progress is not coincidence; it has external and also subjective reasons. It is upon this premise that this study is designed to fill this gap in the body of knowledge.

2.5. Summary of Literature Review

Banking systems has produced changes in the structure of bank income. As a result of increased competition that has lowered margins in lending operations (the banks' traditional business) banks have diversified their sources of income and rely increasingly on income from fees services rather than interest rate spreads. Fees charged for services include typical banking activities like payment transactions, safe custody and account administration (Hallam-Baker,(1996).These activities are, in general, less volatile than fees and commissions charged on activities which are affected by economic and cyclical developments (e.g. underwriting activities, brokerage services, treasury management, transactions on derivatives, private banking, credit card business). This change is also reflected in the increasing size of off-balance sheet items in the banks' financial accounts.

Despite the potential benefits of bank financial performance, there is debate about whether and how their adoption improves customer satisfactions. Use of and investment in banking systems requires complementary investments in skills, organization and innovation and investment and change entails risks and costs as well as bringing potential benefits. The impact of banking systems on customer satisfactions are positive overall, but that bank financial performance are not a panacea in themselves. There seems to be no study conducted in Kenya to establish the relationship between bank financial performance and customer satisfaction. This study intends to establish the relationship of the two variables by posing the question: “Does customer satisfaction affect bank financial performance?

CHAPTER THREE

METHODOLOGY

3.0 Introduction

This chapter describes the research design adopted and identifies the target population from which the sample will be selected and the sampling techniques to be used in identifying the firms to be subjected to the study. The chapter ends by describing the data analysis techniques to be used in analyzing the data and the models to be applied in data analysis.

3.1 Research Design

Research design used in this study was descriptive design. The descriptive design leads to the discovery of associations among the different variables. An explanatory case study was used to explore causation in order to find out underlying principles. The design was appropriate for carrying out a holistic, in depth and comprehensive investigation where much emphasis was placed on the analysis of the relationship between bank financial performance and customer satisfaction in Kenya. The study employed regression analysis of bank's profits against customer base from 2010-2014. The design was appropriate for carrying out a holistic, in depth and comprehensive investigation where much emphasis was placed on the full analysis of the effect of customer movements on financial performance of Kenyan commercial banks.

3.2 Target Population

The target population for this study was all 44 commercial banks of Kenya.

3.3 Sampling

The data utilized in this study was obtained from annual financial reports from the banks from the year 2010 to 2014 and confirmations from senior bank staff. In this case a non probabilistic sampling design was used because the data included in the study was only from those firms that have incorporated customer satisfaction measures in their core activities from 2010 to 2014. The study used data from all commercial banks. Their financial performance was tested against their customer numbers for the same period.

3.4 Data Collection

The study used secondary data for analysis which included data from the company's annual reports to shareholders. The nature of data used included statement of financial position, statement of comprehensive income and annual reports to stakeholders. The study covered a period of five years from 2010 to 2014.

3.5 Data Analysis

The study used Statistical Package for Social Sciences to determine the relationship between bank financial performance and customer satisfaction. The strength of the relationship between bank financial performance and customer satisfaction was then tested using covariance correlation coefficient. Regression analysis was used to determine the relationship between bank financial performance and customer satisfaction 5% level of significance. The regression equation was of the following form;

$Y = \beta_0 + \beta_1 X_1 + e$

Where;Y-financial performance (measured by Return on assets-Net profits after tax/total assets),

X_1- customer satisfaction (measured by number of customers)

β_0 and β_0 are constants, e is the error term.

CHAPTER FOUR

DATA ANALYSIS AND PRESENTATION OF FINDINGS

4.1. Introduction

This chapter presents data collected, data analysis, results from regression analysis and a conclusion from the analysis.

4.2 Response rate

The study seeks to find the effect of customer satisfaction on financial performance of commercial banks in Kenya. Data was obtained from audited financial statements, company websites and publications and annual reports from all commercial banks. Out of the 44 commercial banks studied, only five provided the necessary and complete data appropriate for this study. This study reveals that all commercial banks are interested in satisfying their customers in one way or the other. Commercial institutions that did not provide their data or that did not keep data pertaining to customer care activities were excluded from this study. The study also revealed that activities relating to customer satisfaction were also used to entice customers and build their loyalty towards the particular banks.

Real investment includes investment in government securities, investment in subsidiary, securities held for trading purposes and investment in foreign currency. Customer satisfaction was purely measured by changes in account numbers held in a bank. The notion was that if a customer is satisfied, he will market the bank brand name and in return bring in more customers and save more in their accounts. ROA is the net profits after tax as reported in the institutions audited statements of comprehensive income. The data was analyzed using Excel to determine values for each of the firm's return on investment and Net Profits before Tax. The Statistical package for social Sciences (SPSS) version 16 was then used to find the statistical relationship between financial performance and customer satisfaction at 5% significance level. The results from SPSS were as follows:

4.3 Descriptive Analysis

In this analysis we describe the basic features of the data in a study by simple summaries about the sample and the measures

Table 4.1 Descriptive Statistics

	N	Range	Minimum	Maximum	Mean	Std. Deviation	Variance	Skewness	
	Statistic	Statistic	Statistic	Statistic	Statistic	Statistic	Statistic	Statistic	Std. Error
Return on asset	25	.33	.01	.34	.0508	.06118	.004	4.579	.464
number of customer	25	5.75E6	2.37E6	8.12E6	4.9975E6	1.40085E6	1.962E12	.529	.464
Valid N (listwise)	25								

The total numbers of samples were five banks in a period of five years totaling to 25 samples. Minimum score for financial performance (ROA) and customer satisfaction (number of customers) are 0.01 and 2.37 million respectively while financial performance (ROA) and customer satisfaction (number of customers) maximum score are 0.34 and 8.12 million respectively. Average mean score for financial performance was 0.0508 and 4.9975 million for number of customers. Standard deviation was 0.06118 and 1.962E12 for ROA and number of customers respectively.

4.4 Correlation Analysis

In this analysis we determine the extent to which changes in customer satisfaction is associated with changes in financial performance. To quantify the strength of the relationship between the variables, the study used Karl Pearson's coefficient of correlation. The Pearson product-moment correlation coefficient (or Pearson correlation coefficient for short) is a measure of the strength of a linear association between two variables and is denoted by *r*. The Pearson correlation coefficient, *r*, can take a range of values from +1 to -1. A value of 0 indicates that there is no association between the two variables. A value greater than 0 indicates a positive association, that is, as the value of one variable increases so does the value of the other variable. A value less than 0 indicates a negative association, that is, as the value of one variable increases the value of the other variable decreases. The Pearson's coefficient was used to verify the existence or non-existence of linear correlation between and among the variables. The findings are presented as follows;

Table 4.2 Correlations

		Return on asset	number of customers
Return on asset	Pearson Correlation	1	-.319
	Sig. (2-tailed)		.120
	N	25	25
number of customers	Pearson Correlation	-.319	1
	Sig. (2-tailed)	.120	
	N	25	25

Results from table 4.2 above reveal that there is a negative relationship between financial performance and customer satisfaction (r = -0.319). In this finding the correlation between number of customer and ROA is insignificant. This implies that change in customer satisfaction is negatively attributable to financial performance. Further, since the r value is so small (less than 0.5) there is consequently no evidence of multi-co linearity and hence the following regression analysis.

4.2.2 Regression Analysis

Regression analysis is the statistical technique that identifies the relationship between two or more quantitative variables: a dependent variable, whose value is to be predicted, and an independent or explanatory variable (or variables), about which knowledge is available. The technique is used to find the equation that represents the relationship between the variables. Multiple regressions provide an equation that predicts one variable from two or more independent variables.

Regression analysis is used to understand the statistical dependence of one variable on other variables. The technique can show what proportion of variance between variables is due to the dependent variable, and what proportion is due to the independent variables. The relation between the variables can be illustrated graphically, or more usually using an equation. The study adopted simple regression guided by the following model:

$Y= \beta_0 + \beta_1 X_1 + e$

Where;Y- financial performance (measured by Return on assets-Net profits after tax/total assets),

X_1- customer satisfaction (measured by number of customers)

β_0 and β_0 are constants, e is the error term.

Table 4.3 Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Change Statistics				
					R Square Change	F Change	df1	df2	Sig. F Change
1	.319[a]	.102	.063	.05923	.102	2.613	1	23	.120

a. Predictors: (Constant), number of customers

Table 4.3 provides R and R^2.The R value is 0.319 which represents the simple correlation. It indicates a lower degree of correlation. The R^2 value how much of the dependent variable (financial performance) can be explained by the independent variable (customer satisfaction). In this findings 10.2% can be explained which is small. The independent variables studied explain only (10.2%) on the relationship between of financial performance and customer satisfaction in commercial banks in Kenya as represented by R^2. This means that the other variables not studied in this research contributed (89.8%) and thus further research should be conducted to investigate these other factors affecting financial performance in commercial banks in Kenya.

Table 4,4 Coefficients[a]

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	.121	.045		2.695	.013
	number of customers	-1.395E-8	.000	-.319	-1.616	.120

a. Dependent Variable: Return on asset

Table 4.4 present results of the simple linear regression of relationship between financial performance and customer satisfaction. We can see that both the constant and financial performance contribute significantly to the model by looking at the Sig. column. We can derive a simple regression analysis equation from column B as Y=0.121 – 1.395E-8X (customer satisfaction)

4.3. Conclusion

The study seeks to find the relationship between customer satisfaction and financial performance of commercial banks in Kenya. Out of the 44 commercial banks studied, only 5 provided complete data necessary and appropriate for this study. Most of the commercial banks that did not provide data either did not keep data on their customer relations activities or were not willing to share data in their records. From the results, there seems to be no relationship between number of customers and financial performance of Kenyan commercial banks.

The study revealed that all commercial banks studied realized increases in their profits for the years 2010, 2011, 2012 , 2013 and 2014 respectively. Commercial institutions with huge capital base invested significantly huge amounts on building good customer relations as compared to those that had low capital base. The study also revealed that commercial banks that invested the largest amounts of money on their customer relations activities realized the highest percentage increase in their financial performance.

CHAPTER 5

DISCUSSION AND CONCLUSION

5.1 Introduction

This chapter presents the discussion of key data findings, conclusion drawn from the findings and makes appropriate recommendations. The conclusions and recommendations drawn were focused on addressing the objectives which was to evaluate the relationship between customer satisfaction and financial performance of Kenyan commercial banks.

5.2 Summary of Findings and Interpretations

The main objective of this study was to examine the relationship[between financial performance and customer satisfaction in commercial banks of Kenya. From a sample size of 44 samples, five samples successfully provided data that is useful for this study. Data collected for commercial banks of Kenya were net profit after tax, total assets and number of customers for five years for the period since 2010 to 2014.

Formulation of customer satisfaction strategy as radical paradigm shifts across operations, financial measures, sales and marketing in the bank. From the findings and conclusions this study recommends that Kenyan commercial banks should develop a data-driven, customer-focused bank pricing strategy. Facilities at the exposure of the customers such as ATM' machines, banking agents, queue management systems and mobile banking need to be enhanced for customers to access money more easily and faster without a lot of struggle. This would enable the bank to position itself to use pricing as a competitive advantage across market and customer segments, as well as the entire portfolio of deposit, lending and transaction products and services.

. It indicates a lower degree of correlation. The R^2 value how much of the dependent variable (financial performance) can be explained by the independent variable (customer satisfaction). In this findings 10.2% can be explained which is small. The independent variables studied explain only (10.2%) on the relationship between of financial performance and customer satisfaction in commercial banks in Kenya as represented by R^2. This means that the other variables not studied in this research contributed (89.8%) and thus further research should be conducted to investigate these other factors affecting financial performance in commercial banks in Kenya.

From the findings, the study recommends that measures aimed at customers satisfaction strategies should be designed so as to mitigate problems faced during adoption of customer satisfaction strategies. Support for banks in difficulty has hitherto had the effect of protecting the customer satisfaction strategy implementation and managers of banks need to apply the measures to achieve positive consequences. The determinant factors; perceived quality of services, customer expectations, image of the Bank, trustworthiness of the organization and customer service relationship have been found to have a statistically positive effect on customer satisfaction hence there is need for Kenyan banks to improve on these determinant factors.

The research has revealed that indeed majority of commercial banks in Kenya have invested in service delivery design practices in effort to enhance customer satisfaction. This relationship may be majorly due to the benefits accrued by both the banks and the customers. Service innovation benefits both the service producer and customers and it improves its developer's competitive edge (Hall et al, 2006).

5.3 Theoretical Implications of the Research

Design to service delivery practice was shown to be the weakest dimension of satisfaction. Though the outcome was attributed by the wide gap between the minimum rating and maximum rating as a result of some of the upcoming banks lagging behind in adoption of this practice, bank management should improve in adoption of this practice in order to ensure that the commercial banks are not lagging behind compared to other sectors in service industry and financial industry in other countries.

Therefore, bank management should maintain the attributes of tangible service quality at the bank. Many previous studies have examined customer satisfaction with internet banking service quality in many industry contexts (Cristobal, 2007; Joseph et al., 1999; Zeithaml, 2001). This study contributes to the global body of knowledge in the area of customer evaluation of service quality by examining the phenomenon in the context of a bank in an emerging economy, Kenya. Notably, the study found that customer satisfaction is the most important banking service item. The provision of superior customer service and the giving of preferential rates for online services are the two most important factors that could influence user satisfaction with internet banking service quality in emerging economies like Kenya.

This calls for further research agenda for scholars and practitioners, particularly, in examining the impact of these two most important predictors of user satisfaction in similar industry context in other emerging economies. This study, again, increases knowledge on the value addition that customer satisfaction brings towards banks achieving their targets. Furthermore, the study highlights the significant demographic variables such as income that are likely to influence customer satisfaction regarding internet banking service quality in developing countries.

5.3 Study Limitation

There was a limitation on the time and monetary resources. The resources available were not enough to cover the entire 44 commercial banks of Kenya. A detailed review of all the issues is beyond the scope of this study. This was mainly due to the constraints of time. The sample studied was restricted to the population of commercial banks of Kenya alone. Perhaps a broader pool of financial providers and customers would have given more insights into the financial performance and customer satisfaction.

Secondly, many respondents were not willing to provide quantitative information requested. This study was limited by some respondents not willing to disclose their financial information in terms of net profit after tax and current assets. Many banks especially those that have a no or decreasing profits in subsequent years were unwilling to declare.

Some financial institutions considered their data as confidential despite the researcher's effort to convince them. This study only focused on results from the group which was only available. Information from individual branches was not available. Results of the study could significantly change if individual bank branches were considered.

5.4 Recommendation for Future Research

Further study should be undertaken to apply the results of this study. It would be valuable to conduct further research concerning the perception by the bank branches of the different banks and comparison of the outcome with other service industries. Further research in these areas would further contribute to overall improvement of service standards of Commercial Banks in Kenya.

5.5 Conclusions

In any business-to-customer (B2C) type of environment, satisfying a customer is the ultimate goal and objective. More often than not, it can be quite an issue. This is perhaps due to the fact that organizations sometimes do not really understand of what actually goes on in a customer's mind. As such, this predicament has provided as a challenging task to most business corporations that places strong emphasis on customer relations. Although many researches and studies were conducted on the actual working of the customer's mind, till today it is a still a mystery.

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APPENDIX 1: DATA USED IN STUDY

Year	Bank	Net Profit	Total Assets	Customers	Current Assets	Net Interest Income
2010	KCB	7177973	251356200	4356212	216583320	19645325
2011	KCB	10981046	330663959	5321750	126665648	23286406
2012	KCB	12203531	368018785	5897231	150436544	30636232
2013	KCB	14341382	390851579	6235721	679875280	32984287
2014	KCB	‘20927709	390976356	6360498	679842736	54317744
2010	Equity	7132000	143018000	3568977	22348000	11713000
2011	Equity	10325000	196294000	4832125	25303000	16223000
2012	Equity	12080000	243170000	5476235	24978000	23966000
2013	Equity	13278000	277729000	7982365	12641000	26491000

2014	Equity	15736772	277976000	8120314	25129777	38968751
2010	Coop Bank	4379230	153983533	3985632	31944384	94919560
2011	Coop Bank	5186343	124012039	4123562	29517849	12352888
2012	Coop Bank	7718784	222140660	5122014	40850831	13581079
2013	Coop Bank	9108186	207131690	6012358	29578941	15869248
2014	Coop Bank	11243763	208379446	6601884	29703528	15055914
2010	Barclays	10599000	172415000	3258412	33400000	15674000
2011	Barclays	8113000	167029000	3685326	21358000	16336000
2012	Barclays	8741000	184825000	4123659	29427000	18145000
2014	Barclays	7623000	206739000	5125552	28955000	18860000
2013	Barclays	7963466	228286778	5251338	31490888	19518954
2010	National	2021919	6002694	2369568	26247865	54307610

2011	National	1546113	68664516	3569820	26931788	50811100
2012	National	729752	67154805	3986327	25829766	55191425
2013	National	1112805	92555717	4356982	35670822	56381140
2014	National	1395650	93424951	5213666	35924159	56970011

APPENDIX 2: Commercial Banks in Kenya

African Banking Cooperation (Kenya)

Bank of Africa

Bank of Baroda

Bank of India

Barclays Bank (Kenya)

CFC Stanbic Bank

Chase Bank (Kenya)

Citibank

Commercial Bank of Africa

Consolidated Bank of Kenya

Cooperative Bank of Kenya

Credit Bank

Development Bank of Kenya

Diamond Trust Bank

Ecobank

Equatorial Commercial Bank

Equity Bank

Family Bank

Fidelity Commercial Bank Limited

First Community Bank

Giro Commercial Bank

Guaranty Trust Bank / Fina Bank

Guardian Bank

Gulf African Bank

Habib Bank

Habib Bank AG Zurich

I&M Bank

Imperial Bank Kenya

Jamii Bora Bank

Kenya Commercial Bank

K-Rep Bank

Middle East Bank Kenya

National Bank of Kenya

NIC Bank

Oriental Commercial Bank

Paramount Universal Bank

Prime Bank Limited

Stanbic Bank

Standard Chartered Bank Kenya

Trans National Bank

United Bank for Africa

Victoria Commercial Bank

APPENDIX 3: Representative Offices of Foreign Banks

Bank of China

Bank of Kigali

Central Bank of India

FirstRand Bank

HDFC Bank Limited

Hong Kong and Shanghai Banking Corporation

Nedbank