A COMPARATIVE STUDY ON FINANCIAL PERFORMANCE OF FOREIGN BANKS AND DOMESTIC BANKS IN KENYA.

BY

NOTI WILLIAM MGHANGA

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Declaration

This research proposal is my original work and has not been presented for a degree in any other university.

Signed: …………………….......................   Date: ………………………………

NOTI WILLIAM MGHANGA

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This research proposal has been submitted for examination with my approval as the University Supervisor.

Signed: ………………………………….   Date: ………………………………

MR. LUTHER OTIENO
SCHOOL OF BUSINESS
DEPARTMENT OF ACCOUNTING AND FINANCE
UNIVERSITY OF NAIROBI

Dedication

This Project is dedicated to my late parents Nathaniel andNaomiNoti and my dear wife Carolyne for their encouragement and support during the time of my studies.

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Abstract

This study is to ascertain whether the performance of foreign banks is different from their domestic counterparts over the period 2006 to 2010.The units of analysis are all commercial banks in Kenya. The data used in this study is from Central bank of Kenya and web sites and from the annual financial statements for 43 licensed commercial banks in Kenya for a period of five years. This allows for use of annual data that is largely secondary data.

This study is an investigation into the discrimination between domestic and foreign banks, by the use of five performance and risk discriminating variables. The statistical data was gathered for their five characteristics, return on assets (ROA), return on equity (ROE), liquidity, capital adequacy and credit risk for each bank that represent independent variables. The dependent variable is categorical, foreign bank or local bank. These are examined for the capability to discriminate significantly between foreign and domestic banks. Therefore, the appropriate tool for analysis used is the discriminant technique. The test to be done under discriminant analysis depends on the number of groups and number of variables. In this study are two groups and several (5) variables and the relevant test is Hotel ling's T^2.

Significant mean differences were observed for the predictors, except on capital adequacy. The log determinants were quite similar, and Box's M indicated that the assumption of equality of covariance matrices was not violated. The discriminate function revealed a significant association between groups and predictors variables, accounting for 27.9% of between group variability. Three ROA, ROE and credit risk are significant predictors. The cross validated classification showed that overall 73.6% were correctly classified confirming significant differences in risk and return characteristics between foreign and commercial banks in Kenya. The descriptive statistics confirm that foreign banks earn superior returns when compared to domestic banks and also exhibit low credit risk.

The credit risk management approaches of domestic banks and foreign commercial banks are different, and one can argue that, this is the source of difference in performance across the commercial banks. It might be that foreign banks deploy superior management techniques. Liquidity and capital adequacy is not useful in discriminating foreign and domestic banks. This is attributed to monitoring of capital adequacy levels set by Central Bank of Kenya.

The commercial banking sector is dominated by foreign banks in terms of performance and there is a need to address this issue by encouraging domestic banks to adopt better credit risk management approaches.

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ROA : Return on Assets

ROE : Return on Equity

CDF: Cumulative distribution function