THE ROLE OF ISLAMIC BANKING ON ECONOMIC GROWTH IN KENYA

BY

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DECLARATION

This research project is my original work and has not been presented for a degree at any other university for examination.

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ABBREVIATIONS

CBK	Central Bank of Kenya
FDI	Foreign Direct Investment
GDP	Gross Domestic Product
GFCF	Gross Fixed Capital Formation
IBs	Islamic Banks
MENA	Middle East and North Africa
UAE	United Arab Emirates

ABSTRACT

Islamic Banking has become ever popular in the last three decades, not only in Arab and Islamic world but also in other parts of the World. However, despite over four decades of experience of Islamic banking and finance, the industry has its critics, both Muslim and non-Muslims. Islamic finance products and services are often accused of mimicking those of the conventional financial system, while some criticisms consider the Islamic financial system as window dressing. Thus, this study sought to examine the role of Islamic banking on economic growth in Kenya. The study adopted a quantitative research design. The population of interest comprised of two fully-fledged Islamic banks in Kenya and four other banks that offer Islamic banking services in Kenya. The study utilized secondary data from financial statements of the Islamic for a period of six years from 2008-2014. The data collected was analyzed using the Karl Pearson correlation and multiple linear regression using the statistical package for social studies. The study findings established that the level total savings had a positive relationship with economic growth while total advances have a negative relationship with economic growth. The study conclude that an increase in savings in Islamic banks stirs economic growth while a decrease in lending inversely affects economic growth while increase in lending by Islamic banks stirs economic growth. The study recommended that Islamic banks should develop effective policies on deposit mobilization as this would increase their total deposit hence more funds which they can advance inform of credit.

CHAPTER ONE
INTRODUCTION

1.1 Background of the Study

The development of the banking industry is favorable to the economic growth because the activity of the banks increases the mobilization of the saving, improve the efficiency of the resources allowance, and stimulate the technological innovation (Goaied, 2015). The role and functions of the banking system in a contemporary economy is of great significance to the development process and thus, it is often considered as the heart of every prosperous economy (Usman, 2003). The banking industry plays an important role in economic activities in all countries, especially with regard to those activities related to economic development (Rajaei-Baghsiyaei, 2011). According to Zeineb and Mensi (2014), banks occur as a crucial and major role in economic growth. Thus, a healthy and sound banking sector is a key ingredient for growth, economic prosperity and general welfare. Ahmad (2006) also posits that banking institutions act as financial intermediaries between savers and investors hence they can be of significant help in assisting the process of capital formation and development.

In the last two decades, the banking sector has witnessed the emergence and the development of a new financial industry: the Islamic banking (Goaied, 2015). The Islamic banking system emerged as a competitive and a viable substitute for the conventional banking system. Islamic Banking has grown substantially and has become one of the well and truly established as one of the world's fastest-growing economic sectors. This industry is characterized by banking operations excluding the use of the interest rate and it is based on the underlying fundamental concept of justice as well as sharing of risk (Benhayoun et al., 2014). Islamic banking emanated from Islam which discourages concentration of wealth in a few hands thus the importance of Islamic banking system is to bridge the gap between the rich and the poor by modifying the distribution of wealth and economic resources in favor of the less fortunate (Ismail, 2010).

Financial intermediation is the major function of the modern banking system and is probably the main reasons of existence of commercial banks. Islamic banks are also financial intermediaries since they collect savings from income earners who have surplus and distribute them to entrepreneurs and consumers who need them to finance their purchases of goods and services (Kahf, 2005). Islamic financial institutions take the form of commercial banks, investment banks, investment and finance companies, insurance companies, and financial service companies (El-Galfy and Khiyar, 2012). However, Islamic banks make their financial intermediation based on several contracts that do not include lending and borrowing because interest in prohibited in the Islamic law (Kahf, 2005). Islamic finance essentially promotes financial transactions with links to the real economy and abstains from financing activities that are detrimental to society. Islamic financing supports financial inclusion by offering instruments suited to different socioeconomic groups (Tabash and Dhankar, 2014a).

According to PWC (2013), the demand for Islamic finance services has been increasing due to growing Muslim populations in countries especially in Asia and Africa, which currently account for over 95% of the world's Islamic population and which are projected to grow 35% by 2030. Most countries in Asia and Africa also contain large unbanked populations, which can be harnessed by Islamic banking models. Mohieldin (2012) as cited in Gheeraert and Weill (2013) points out that Islamic banking represents the vast majority of these assets with total banking assets for a total value of $939 billion in 2010, with Islamic banks particularly active in Middle East countries and in Southeast Asia. Recently, Islamic Banking had grown substantially with financial shocks and volatility providing a good opportunity for the sector as non-Muslim bank customers opts for the relative safety of institutions based on the principles of Islam (Tabash and Dhankar, 2014b).

1.1.1 Islamic Banking

An Islamic bank is a financial institution that operates with the objective to implement and materialize the economic and financial principles of Islam in the banking arena. It is defined as a financial and social institution whose objectives and operations as well as principles and practices must conform to the principles of Islamic Shariah (Jurisprudence), and which must avoid the interest in any of its operations (Islamic Development Bank, 2007). The Islamic bank is an institution which it main activity, likely to conventional bank, is the mobilization of funds from the savers and the offer of these funds to the agents having a deficit (companies, business men) and lead all banking activities without the use of interest rate (Goaied, 2015). Islamic banks provide a variety of products, including Murabaha, Ijara, Mudaraba, Musharaka, Al Salam and Istitsna'a, restricted and unrestricted investment accounts, syndications and other structures (Tabash and Dhankar, 2014a).

An Islamic banking and financial system exists to provide a variety of religiously acceptable financial services to the Muslim communities. In addition to this special function, the banking and financial institutions, like all other aspects of Islamic society, are expected to contribute richly to the achievement of the major socio-economic goals of Islam (Hassan and Lewis, 2007). Islamic banking is a financial system whose main objective is to achieve the teachings of the Koran. Islamic law reflects the commandments of God, organizes all aspects of Muslim life, and therefore directly involved in Islamic finance, spirituality and social justice (Sarwer et al., 2014). The basic principles of Islamic banking are derived from the axioms of justice and harmony with reality on one hand and the human nature on the other hand. Islamic banking has established itself as an emerging alternative to interest based banking and has grown rapidly over the last two decades both in Muslim and non- Muslim countries (Nedal, 2011). In addition, Islamic banking has witnessed remarkable growth in terms of numbers of new Islamic banks being established all over the world (Waemustafa, 2013).

The main characteristics of Islamic banking include the prohibition of interest “USURY”, unethical investment, Al-Gharar, Al-Darar, and impulse. Islamic banks are also characterized by the emphasis of productivity, equitable contracts and profit sharing. Islamic banks have developed many financial techniques that adopt the above characteristics and comply with Islamic sharia principles (El-Galfy and Khiyar, 2012). The essential characteristic of Islamic modes of financing is their direct and undetectable link to the real economy or physical transactions. Sharing modes are only possible for productive enterprises that involve real-life businesses that increase quantity, improve quality, or enhance usability of real goods and services. According to Alio and Aburime (2009) the prohibition of interest, low consumer lending, profit and loss sharing and high real sector investing are primary characteristics of Islamic banks.

Islamic bank is slightly different from the conventional banks because the Islamic banks shares profit and loss with its depositors but the conventional bank provides fixed rate of return on the investment deposited by the depositors (Ashraf, 2013). In Islamic banks, there are account holders that deposit their funds on a profit-and-loss sharing basis (Musharakah), or on a profit-sharing and loss-bearing basis (Mudarabah). Maintenance of these accounts in Islamic banks qualifies them to be described as profit and loss sharing banks (Fatai, 2012). In addition, conventional banks finance more the operations in short-term and personal loans while the Islamic financial system, which depends crucially upon the financial instruments, is superior to the conventional financial system in terms of equity stability and efficiency. Islamic financial services are characterized by a prohibition against the payment and receipt of interest at a fixed or predetermined rate (Ashraf, 2013).

1.1.2 Economic Growth

Economic is 'a rise in the total output produced by a country'. Economic growth can be measured in nominal terms including inflation, or in real terms, which are adjusted for inflation like by the percent rate of increase in the economic growth (Ayres and Warr, 2006). Economic growth measures growth in monetary terms and looks at no other aspects of development (Illyas and Siddiqi, 2010). The United Nations' Human Development Report (1996) defines economic growth as simply as increase in a nation's total wealth. However, this definition ignores the effect of the population on the wealth.

Economic growth can be either positive or negative. Negative growth is referred to as a shrink in economy. Negative growth is associated with economic recession and economic depression (King and Levine, 1993). Islamic banking propels economic growth when bank customers, employees, and the governments transact through banks. Remittances in cash, cheques, money transfer and other services raise revenue and commissions for the banks which in turn create employment, propelling development and thus economic growth.

1.1.3 Role of Islamic banking on Economic growth

There are several empirical studies regarding the role of Islamic banking in economic growth and development. Studies have established that Islamic finance allows a closer link between real economic activity that creates value and financial activity to be forged (Nedal, 2011). For instance, Hassan, Kayed and Oseni, (2013) pointed out that Islamic banking and finance one of the most significant aspects of the modern global financial system. Kammer et al., (2015) also argued that Islamic finance has the potential to contribute to higher and more inclusive economic growth. In addition, Adeola (2007) noted that Islamic banking enhances economy growth through better integration of the real and financial sectors of the economy, better business ethics since banks will only entertain economically viable financing requests, instead of being lenders and Islamic banks will stay away from financing prohibited activities e.g. producing alcohol among others.

Additionally, Tabash and Dhankar, (2014b) explored empirically the relationship between the development of Islamic finance and economic growth in the Middle East and established that Islamic banks' financing has contributed to the increase of investment and in attracting FDI in the long term and in a positive way. The results obtained from Granger causality test revealed a positive and statistically significant relationship between economic growth and Islamic bank's financing in the long run. Adedeji and Abdulazeez (2014) explored the importance of Islamic banking system towards economic development in Malaysia. The study established that Islamic banking system is characterized by the ability of attracting huge deposits from both Muslims and Non-Muslims customers through sharia-compliance retail banking, wholesale banking and investment banking services, which serves as a tool that furnishes enabling business environment that could foster economic development.

A study by Asif, Ather and Isma (2014) on the impact of Islamic investment trend on economic growth of Pakistan found that revealed that deposits of Islamic Banks at four different lags significantly play role in predicting the economic growth. Ismail (2010) also established that Islamic banks play a valuable and integral part in the development of the national economy since Islamic banks can economically empower employees, shareholders and business partners, and can contribute to the sustainability of state treasuries and a diverse spectrum of important social development projects. Aurangzeb (2012) also emphasized that there is a significant and strong link between the financial sector of a nation and the performance of overall country economy hence nations that have good financial system have a tendency to develop its economic growth more quickly.

1.1.4 Economic Growth in Kenya

Economic growth is defined as an increase in Gross National Product (GNP) or increase in Economic growth (Rajaei-Baghsiyaei, 2011). Kenya is the largest economy in Sub Saharan Africa and has been hailed as the regional financial hub. Based on the Kenya economic survey (2014), Kenya's Gross Domestic Product (GDP) was estimated to have expanded by 4.7 per cent compared to a growth of 4.6 per cent in 2012. Accordingly, the financial sector registered a growth of 7.2 per cent in 2013 up from an increase of 6.5 per cent recorded in 2012. During the review period, monetary policy was geared towards achieving stability in inflation and exchange rates. According to Kenya economic report (2013), the recent growth has largely been driven by growth in domestic household consumption and investment.

In Kenya, the banking sector plays a critical role in the development process. In the vision, 2030 the financial sector is one of the pillars that is expected to drive high levels of savings and financing of Kenya's investment needs (Kenya economic report, 2013). As at 2014, the banking sector comprised 43 commercial banks two of which are fully pledged Islamic Banks. Statistics indicate that the banking sector in Kenya has been experiencing a momentous growth in assets in recent years. For example, in 2007, the total assets of the banking industry were KES951 billion which is equivalent to US$10.78

billion (Laving, 2013). According to the African Economic Outlook (2012) total assets of the banking sector in Kenya rose by 21% from KES 1 548.4 billion in June 2010 to KES 1 873.8 billion as at the end of June 2011. In addition, growth in asset base was due to growth in deposits, retained profits and capital injections. This signifies the importance of the financial sector to the Kenyan economy.

Islamic finance is a powerful tool for pro poor and inclusive financial system in Africa regardless the fact that they are Muslim country or not (Nguena, 2014). As such, Kenya has demonstrated considerable promise in the area of Islamic finance; and in its Vision 2030, aims to develop into an international financial center as well as a hub for eastern and central Africa for Islamic finance (Laving, 2013). Kenya was the first country in the East and Central African region to introduce Islamic banking. Currently there are two Islamic banks operating in Kenya: Gulf African and First Community bank, which had a loan portfolio of 4.9-billion shillings, deposits totaling 7.5billion shillings and 27270 deposit accounts. These indicators point to the tremendous potential of this market niche, which has been previously untapped, largely comprising Muslims estimated to make up at least 15% of Kenya's population of 36-million (Issak & Kwasira, 2012).

Islamic banking is not related to Muslims only it is related to all and it is not related to any particular religion thus it can operate and expand their network in the country along with traditional banks as the focus of it is on social well being and wealth generation activities in the society (Khan, 2014). According to El-Ghazali (1994) as cited in Nedal (2011) the concept of the Islamic economic system as described in all its aspects focuses on the worship of the creator, which includes man’s duty to develop life on earth, thus securing a decent standard of living for the individual. Islamic finance is an increasingly important means for the financing of physical and social infrastructure that supports economic development and job creation in an expanding group of emerging economies (Islamic Financial Services Board, 2014). El-Galfy and Khiyar, (2012) also point out that Islamic banking positively contributes to macroeconomic stability for both developing and developed countries.

1.2 Statement of the Problem

There has been much debate over whether the growth of financial intermediation facilitates economic development or if banks expand because of economic development (African development Bank, 2011). Islamic Banking has become ever popular in the last three decades, not only in Arab and Islamic world but also in other parts of the World (Fatai, 2012). However, despite over four decades of experience of Islamic banking and finance, the industry has its critics, both Muslim and non-Muslims (African development Bank, 2011). According to Nguena, (2014) Islamic finance products and services are often accused of mimicking those of the conventional financial system, while some criticisms consider the Islamic financial system as window dressing. Kammer et al. (2015) points out that to date Islamic finance face a number of other constraints that may be impeding its development and in some countries, the concept of Islamic finance is yet to be fully embraced.

In their short period of existence, Islamic banking in Kenya has shown very commendable performance commanding combined market share of the banking sector in terms of gross assets. Kenya has had two authorized Islamic banks since 2008 i.e. Gulf Arab Bank and First Community Bank which were established following the introduction of an Islamic banking law (Global Islamic Finance Report, 2010). Ever since the inauguration of Islamic financing in Kenya in 2008 or thereabouts, Islamic banking has seen a speedy intensification in a comparatively small period. Therefore, the growing recognition of Islamic banking in Kenya as a viable alternative to the conventional banking necessitates the need to examine its role on the economic development in Kenya.

In addition, there exists lots of literature on Islamic banking, for example, Tabash and Dhankar, (2014) carried several studies on the role of Islamic banking on Economic growth of several countries including Qatar, Bahrain and other Middle East and Northern African countries. However, the studies were carried in countries that have embraced Islamic banking for years making it impossible to generalize the results to the Kenyan Context which adopted Islamic banking six years ago. In Kenya, most studies have examined different aspects of Islamic banking. For instance, Kinyanjui (2013) investigated the challenges facing the development of Islamic banking in Kenya. Talam (2014) also investigated the effect of Islamic banking on financial performance of commercial banks in Kenya. Abubakar (2014) examined the effect of Islamic banking on investment financing in Islamic banks in Kenya. Mustafa (2013) explored the effects of Islamic banks on financial deepening amongst Kenyan Muslims. However, this studies and many more on the Kenyan context have investigated the role of Islamic banking on the economic growth in Kenya.

Most of the Islamic banks are concentrated in the Middle East, North Africa and Southeast Asia and most of the studies on the role of Islamic banking on economic growth have been carried out in those countries. Moreover, most previous studies have concentrated on the impact of financial sector on economic growth. In Kenya, no study has been carried out on the role of Islamic banking on economic growth. This opens up a gap in literature which this study intents to seal, by answering the question, what role does Islamic banking play towards the economic growth in Kenya?

1.3 Objective of the study

To examine the role of Islamic banking on economic growth in Kenya

1.4 Significance of the study

Research provides the basis for nearly all government policies in our economic system like the government, Therefore, this study will be of significance to policy makers including the government of Kenya, the Central Bank of Kenya and the ministry of finance whom develop policies regarding the financial system. In addition, this study will be of importance to all financial institutions including commercial banks, microfinance institutions and cooperative societies since it provide an insight on the role of financial institutions towards economic growth.

The study will also be of significance to Islamic banks since it will establish whether they play any role in economic growth and its recommendations will provide further insights on how Islamic banks can enhance economic growth. Further, the study will be of benefit to both the Muslims and non-Muslims, as it will provide additional information on Islamic banking, their guiding principles and their role towards economic growth. Lastly, the study will be of benefit to prospective researchers, institutions since it will add on to the existing knowledge, and it may open up additional gaps in literature, which may require further investigation.

CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

This chapter examines the literature and investigates theories related to Islamic Banking, the determinants of economic growth, a review of past studies by different authors on the study topic and finally the conclusion from literature review.

2.2 Theoretical Review

This study will examine the profit and loss sharing theory, theory of Islamic banking, trust-financing theory and mark up financing theory to understand the principles of Islamic banking.

2.2.1 Profit and Loss Sharing Theory

The originality of Islamic banks consists of the principle of Profits and Losses Sharing (PLS) between the provider and the user of funds. This notion of equitable sharing is a key element in the concept of Islamic finance as it is supposed to reflect the values of Islam. Under the rules of Shariah, no one can claim any compensation without incurring some of ex ante investment risks (Jedidia & Hamza, 2014). The Profit and loss sharing concept used by the Islamic banks according to the Islamic Shariah laws and according to this rule in Islamic banks, investment depositors are customers with some rights of ownership in the bank. Profit and loss sharing difference introduces a mutuality concept in Islamic banking. The main factor, which contributes to the emergence of the PLS-banking system, is the prohibition of Interest (Riba) in the Holy Quran (Ashraf, 2013). The underlying principles of Shari'ah that govern Islamic banking is to promote a profit and loss sharing framework as an ideal mode of financing to achieve justice and socioeconomic objectives (Zamil, 2014).

PLS is a contractual arrangement between two or more transacting parties, which allows them to pool their resources to invest in a project to share in profit and loss. PLS is based on two major modes of financing, namely Mudaraba and Musharaka, which are desirable in an Islamic context wherein reward sharing is related to risk-sharing between transacting parties (Farooq, 2006). In these lending arrangements, profits are shared between the investors and the bank on a predetermined basis. In sharing of profit and loss the borrower and the lender share, the profits as well as losses arising from the venture with the finances obtained from the lender. The basic view is that the general community should benefit from such activities (Khan, 2014).

The Islamic profit sharing concept helps to foster economic development by encouraging equal income distribution and which results in greater benefits for social justice and long-term growth. In addition, profit-loss sharing scheme improves capital allocation efficiency as a return on capital depends on productivity and the allocation of funds is based on the success of the project (Nedal, 2011). The profit and loss sharing may lead to a more efficient and optimal allocation of resources than does the interest-based system (Siddiqui 2001). Accordingly, pust studies have emphasized that the profit-and-loss sharing contracts promote greater stability in financial markets In addition, the PLS framework is expected to reduce significantly the inequitable distribution of income and wealth and is likely to control inflation to some extent (Zamil, 2014).

2.2.2 Theory of Islamic banking

The earliest writings on the subject of Islamic banking and finance date back to the forties of the twentieth century by Siddiqi. The theory of Islamic banking is based on the idea that interest is strictly forbidden in Islam, and that Islamic teachings provide the required guidance on which to base the working of banks (Hassan and Lewis, 2007). According to Ahmad (2006), the theory of Islamic banking is based essentially on the premise that interest, which is strictly forbidden in Islam, is neither a necessary nor a desirable basis for the conduct of banking operations, and that Islamic teachings provide a better foundation for organizing the working of banks. The basic postulate that has guided all theoretical work on Islamic banking is that while interest is forbidden in Islam, trade and profit is permissible. The basic principle in Islamic law is that exploitative contracts or unfair contracts that involve risk or speculation are impermissible (Hassan and Lewis, 2007).

Theoretical work on Islamic banking encompasses several aspects related to both the operating procedures of Islamic banks and the possible socioeconomic consequences of the adoption of the new system (Ahmad, 2006). Islam seeks to establish a society based upon fairness and justice (Holy Qur'an 2:239). Thus, the concept of Islamic banking has proceeded on the basis that guidance for all institutionalized developments in an Islamic society should be derived from the principles of Shari'ah .The form and content of Islamic banking practices have, therefore, to be derived from the teachings of Islam (Ahmad, 2006). For instance, if a loan provides the lender with a fixed return irrespective of the outcome of the borrower's venture. It is much fairer to have a sharing of the profits and losses. Fairness in this context has two dimensions: the supplier of capital possesses a right to reward, but this reward should be commensurate with the risk and effort involved and thus be governed by the return on the individual project for which funds are supplied (Hassan and Lewis, 2007).

2.2.3 Trust Financing Theory

The trust financing theory is referred to Mudaraba in Islam (finance by way of trust). According to Mirakhor and Zaidi (2007) Mudaraba is a form of partnership in which one partner (rabb al-mal) finances the project, while the other party (mudarib) manages it. This mode of financing does not require that a company be created; the financial institution provides all of the capital and the customer is responsible for the management of the project. Thus, profits from the investment are distributed according to a fixed, predetermined ratio. The partner has possession of the assets, but the other party has the option to buy out the partner's investment. Mudaraba may be concluded between an Islamic bank, as provider of funds, on behalf of itself or on behalf of its depositors as a trustee of their funds, and its business - owner clients (Mirakhor and Zaidi, 2007).

2.3.4 Mark Up Financing Theory (Murabaha)

In mark up financing also referred to as cost plus financing or Murahaba an Islamic bank does a transaction where the institutions buys a product on a client's behalf and then resells this with a mark-up to a client, the borrower (Khan, 2014). In a murabaha agreement, the bank agrees to buy an asset or goods from a third party, and then resells the goods to its client with a mark-up. The client purchases the goods against either immediate or deferred payment (Mirakhor and Zaidi, 2007). This mode of Islamic finance is said to be very close to a conventional interest-based lending operation since there is a mark up. However, a major difference between murabaha and interest-based lending is that the mark-up in murabaha is for the services the bank and the mark-up is not stipulated in terms of a period like interest. Thus, if the client fails to make a deferred payment on time, the mark-up does not increase from the agreed price owing to delay (Mirakhor and Zaidi, 2007).

2.3 Determinants of Economic Growth

The determinants of economic growth can be classified is various categories including – interest rates, political stability, foreign direct investment, employment and government expenditure. Various literatures have evidence the determinants economic growth by different researchers as illustrated below.

2.3.1 Interest Rates

Interest rate is the amount charged on the principal amount borrowed normally expressed as a percentage either on a monthly or annual basis. Nathalie Hilmi and Alain Safa (2010) stated that bank lending where the interest rates are favorable and causes economic growth. That means that when bank rates are relatively low, customers find it favorable to borrow since the periodic repayments are low. The result is increased spending thus enhanced GDP and economic growth. Most Islamic banks charge a lower interest rate than other conventional banks due to religious beliefs. Owing to the fact that borrowing encourages investment from both the local and international level, economic growth is realized.

2.3.2 Political Stability

Political stability is a major economy driver and enhances the GDP of a country. Mina (2002) Stated that political stability in a country intensifies the GDP of an economy this increases foreign investor confidence and thus economic growth. Islamic banking has a positive correlation with economic growth as it enhances local and foreign direct investment boosting the economy. Most Islamic/ Arab countries have constant political unrest due to leadership or oil resource disputes. The realization of political stability in these nations would yield economic growth as the business environment will be conducive to both local and international investors.

2.3.3 Foreign Direct Investment

Tavokoli (2002) stated that direct foreign investment plays a significant role in the growth of the economy. The macroeconomic policy classifications include economic and policy determinants classification and domestic and outsourcing factors are applied to compare Iran's potential FDI attraction with seven other nations, Egypt, Indonesia, Malaysia, Pakistan, the Philippines, Thailand, and Turkey. The neo-classical production function including foreign capital stock and imports as inputs in addition to labor and domestic capital stock is applied to analyze the effect of FDI inflows on the economic growths of Iran and Pakistan Islamic banks over time. Ayachi Fethi and Claude Berthomieu (2002) in Mediterranean countries stated that the size of the market, the infrastructure, the distance, the investment climate (governance) and the agglomeration economies are key factors explaining European foreign investment decisions. The paper also highlights the role of other factors, such political and civilian freedoms, in explaining total FDI flows to the Mediterranean economies. Massoud N. (*2005)* stated that increasing amounts of FDI is its potential direct and indirect effects on increasing demand for labour. Almasaied (2004) investigated the how investments like banks enhance the growth rate of gross domestic product and exports are significant in stimulating domestic investment which leads to more foreign direct investment.

2.3.4 Employment

Islamic banks have intensified employment levels directly and indirectly. Direct employment relates to the banks employees while indirect employment relates to suppliers, professionals among others. Bilgin and Kilicarslan (2010) stated that the relationship between growth and employment are highly correlated. Islamic banking has brought about high employment opportunities thus propelling economic growth. Belarbi, Zouache and Boureille (2002) Regional employment growth is significant to the country’s economic growth in that the country will experience a balance of trade and eventually a balance or surplus in payment due to increased import levels.

2.3.5 Government Expenditure

Government expenditure is a major determinant of economic growth. Abdallah and Adair (2009) Government spending is a critical economic driver in that when the level of expenditure is high, money supply is also high in the economy thus driving economic growth. The amount and nature of government expenditure has a strong bearing on the economic growth of any country. When the government spends more, it stimulates demand which in returns sparks investment and the production o f more goods and services (Behrman, 1990).

The manner in which the government spends funds can resolve how strong the growth rate will be realized. If a government spends too much money on unproductive ventures, then the expenditure may not affect economic growth at all. However, if the expenditure is in productive investment, the economy grows at a high rate (Behrman, 1990). Islamic banks also benefit from government spending as either its customers or the bank supplies materials or services to the government. Alternatively, when the government spends more, the suppliers come to borrow from the bank or deposit more money due to increased money supply thus the economy thrives.

2.4 Empirical Review

Ackermann & Jacobs (2008) analyzed and described the banking needs of South African Muslim corporate clients for Shari'ah-compliant banking products. The research tested five hypotheses to establish the need for cost-effective, Shari'ah-compliant asset-based finance products. It applied the market-driven element of the target cost model to analyze client requirements in terms of the costs associated with the product offering. The research findings indicated that South African Muslim corporate clients would buy Islamic banking products for religious reasons. It was found that price would be a determinant in evaluating a purchasing decision. The research further found that it is tenable that Muslim corporate clients would require asset-based finance products to possibly finance their capital investment strategies. This article highlights that it is vitally important for financial institutions to understand the needs of South African Muslim corporate clients for Shari'ah compliant banking products.

Kadubo (2010) investigated the factors influencing the development of Islamic banking in Kenya. The study adopted a case study approach focusing on four Islamic compliant banks in Kenya, which included the First Community Bank; Gulf African Bank; Dubai Bank; Kenya commercial Bank Ltd and Barclays Bank Ltd. A sample of 33 customers, who were the holders of accounts in the respective banks and 11 managers were involved. Data was collected by use of questionnaires. The study revealed Islamic banking compliant was driven by religious compliance and customers need being met. It also revealed that continuous review and improvement of Shari’ah compliant products together with diversifying market niche would lead to drastic development and marketing of Islamic banking products. The study concluded that the factors that influence development of Islamic banking products in Kenya are purely religious compliance and customers need being met.

Daud, Yussof and Abideen (2011) examined the perceptions of Nigerian Muslim Youths in Malaysia on the perceived role expected of the Central Bank of Nigeria in the establishment and operation of IBs in Nigeria. The study focused on the perceptions of students in three Malaysian universities i.e. Kolej Universiti Insaniah, Universiti Utara Malaysia and International Islamic University Malaysia. The sample of the study was made up of 100 questionnaires of which 85 percent were returned and usable. The data collected were subjected to statistical analysis using the SPSS version 18. One-Sample and Independent-Samples t-Tests were used for analyses. The finding revealed that the role of the Central Bank of Nigeria in the establishment and operation of IBs in Nigeria is of no significance. Other findings hold that the Central Bank of Nigeria should seriously promote adequate research in IBs, the legal framework of IBs should be further strengthened and that the Central Bank of Nigeria should collaborate with the Judiciary for the establishment of Shari’ah courts to adjudicate cases on IBs.

Yusuf and Mobolaji (2012) explored the Nigerian experience of Islamic micro insurance in poverty alleviation objective of the Central Bank. The study adopted a case study approach in assessing the performance and contribution of the Al-Baraka microfinance Bank based in Lagos since its inception. The concern was whether the Shariah-compliance could be a positive element towards the realization of the poverty alleviation objective of the government. In order to gain an in-depth understanding of the potential of Islamic micro-insurance in Nigeria qualitative research in the form of an explorative study was used. The study utilized both primary and secondary data to explore the performance of Al-Baraka microfinance house to see whether it was providing its services for all those living below the poverty line including the extreme poor. The study findings established that Islamic Micro Insurance Company was doing better than its conventional counterparts were.

Abduh and Chowdhury (2012) investigated the long run and dynamic relationship between Islamic banking development and economic growth in the case of Bangladesh. The quarterly time-series data of economic growth, total financing and total deposit of Islamic banking from 2004 to 2011 are used in this study. Using cointegration and Granger's causality method, Islamic bank financing was found to have a positive and significant relationship with economic growth both in the long and short run. This implied that the development of Islamic banking is one of the policies, which should be considered by the government to improve their income.

Johnson (2013) examined the role of Islamic banking in economic growth. Using an exogenous instrument in 2SLS regressions, results show that Islamic bank is not significantly correlated with economic growth. Most notably, including the Islamic banking instrument affects the strength of beta-convergence. The study found that Basic Solovian specifications show that convergence occurs; countries with higher initial GDP per capita grow more slowly. After accounting for the intensity of Islamic banking, this effect becomes much less statistically significant, suggesting that some of the effect of convergence may operate through the propensity to adopt Islamic banking. Empirical analysis disaffirms the hypothesis that Islamic banks minimize the explanatory power of legal origin on economic growth due to their independent implementation of Shariah law; the results show that accounting for Islamic banks has no effect on the determinative power of legal origin. In addition, the study established that the correlation of Islamic banking and financial deepening is largely dependent on legal origin, resulting in negative effects for countries with British legal origin and positive for those with French legal origin.

Sarwer, Ramzan and Ahmad (2013) examined the dynamic interactions between Islamic banking and economic growth in Pakistan, to see if the financial system affects and growth, transformation and growth of the financial system. The aim of the paper was to consider the opinions of the interviewees regarding the role of Islamic banking in Pakistan in economic development. Six interviewees were asked about the types of effects of Islamic banking on economic development in the Pakistan. They were asked about eight different types of effects. The study established that most respondents believe that Islamic banking in Pakistan had positive impact on economic development. The study also established that some scholars around the world consider the use of Islamic banking more convenient for economic development. Further, the findings also established that improving the infrastructure of Islamic finance in Pakistan could benefit economic development.

Ahmednoor (2013) evaluated the effects of Islamic banking products on the profitability of Islamic banks in Kenya. Annual financial statements of two Kenyan fully-fledged Islamic banks from 2008 to 2011 were obtained from the CBK and Banks annual report. The data was analyzed using linear regressions method to measure the performance of key financial performance variables and financing contracts. The study made use of secondary data, which was obtained basically from published annual reports of the selected banks and data collection form for individual product data for items not appearing on the financial statements. The study findings established a strong positive relationship between product size amount and financial performance of Islamic bank in Kenya.

Siat (2013) evaluated and compared financial performance of Islamic banks and conventional banks in Kenya during year 2010 to 2012 to establish whether there are significant differences between the financial performances of the two banking category. Data for the study were mainly extracted from financial statements of the sampled banks where Gulf African Bank and First Community represented the Islamic Banks while Giro Bank and K-Rep Bank represented the conventional Banks. CAMEL model, a financial ratio based model, representing Capital Adequacy, Asset quality, Management quality, Earnings and Liquidity was employed in analysis of the financial performances and mean ratios of each category were compared through inter-bank analysis. Finally, T-test was carried out to establish whether there are significant differences between the financial performances of the two banking category. Ms-Excel was mainly used in carrying out the data analysis. The study revealed that Conventional banks outperformed Islamic banks in overall financial performances during the study period though there was no significant difference between the financial performances of the two banking categories.

Mustafa (2013) explored the effects of Islamic banks on financial deepening amongst Kenyan Muslims. The research adopted a descriptive research design and a sample of 384 Muslims was used. Questionnaires were used to collect data. The regression model was used to establish the relationship between the variables. The study established that lack of access to financial information service affected the growth of Islamic banking. In addition, the study established that government policies, regulations, and technological changes affected the growth of the financial institutions. Further, the study found out that customers encounter problems of raising capital, accessing finance and accessing credit and recommended that there should be increased support for learning visits to improve the information flow, the government should come up with policies on training of business owners.

Gheeraert and Weill (2013) evaluated if the development of Islamic banking influences macroeconomic efficiency. The study analyzed the relation between Islamic finance and economic growth by applying the stochastic frontier approach to estimate technical efficiency at the country level for a sample of 70 countries. Unique hand collected database, which covers Islamic banks worldwide over the period 2000-2005 was used. The study found that Islamic banking development favors macroeconomic efficiency. The study also established a support for a non-linear relation with efficiency for Islamic banking development, measured by credit or by deposits. The study concluded that increasing Islamic banking development enhances efficiency until a certain point beyond which expansion of Islamic banking becomes detrimental for efficiency.

Tabash and Dhankar, (2014c) assessed the contribution of Islamic finance in the growth of the economy of United Arab Emirates. To establish the relationship between development of Islamic finance and economic growth, time series data from 1990 to 2010 was used. The unit root test, cointegration test and Granger Causality tests were done. The study findings established that there is a strong positive association between Islamic banks' financing and economic growth in the UAE, which reinforces the idea that a well-functioning banking system promotes economic growth. However, the results established that a causal relationship happens only in one direction, i.e., from Islamic banks' financing to economic growth, which supports Schumpeter's supply-leading theory. Further, the study established that Islamic banks' financing has contributed to the increase of investment and in attracting Foreign Direct Investment inflow (FDI) in the long term and in a positive way in UAE. The results also showed that there is a bidirectional relationship between Islamic Banks' financing and FDI. It means that FDI reinforces Islamic finance and Islamic finance attracts foreign direct investment.

Tabash and Dhankar, (2014d) explored empirically the relationship between the development of Islamic finance system and economic growth and its direction in Qatar. Using econometric analysis, annually time-series data of economic growth and Islamic banks' financing from 1990 to 2008. The study used Islamic banks' financing funds given by Islamic banks as a proxy for the development of Islamic finance system and Gross Domestic Product (GDP), and Gross Fixed Capital Formation (GFCF) as proxies' for real economic growth. For the analysis, the unit root test, cointegration test and Granger causality tests were done. The study findings established that in the long run, Islamic banks' financing is positive and significantly correlated with economic growth in

Qatar which reinforces the idea that a well-functioning banking system promotes economic growth. Further, the findings established that Islamic banks' financing has contributed to the increase of investment in the long term and in a positive way in Qatar.

Seyed-Javadin et al., (2014) identified and explained the important challenges associated with IB implementation in Islamic Republic of Iran. To achieve this goal, based on the qualitative method after a detailed study of the theoretical foundation and literature review, using data obtained from interviews with experts and the convenient questionnaire, the final identified factors have been analyzed and presented in form of a conceptual research model. Experts of the research included both academicians and practitioners in the field of banking and financial system. The findings established that significant challenges exist to establish a comprehensive system of Islamic banking; accordingly, policy makers and mangers in order to succeed in this system should consider them. The convenient programs should be settled so that the problems and challenges eliminated and the road to success implementation will be paved.

Saida (2014) investigated the factors that influence utilization of Islamic banking and financial services in Kenya. A descriptive survey design was used. One hundred and twenty five respondents were randomly sampled from four Islamic and Conventional Banks operating in Nairobi-Kenya. The study found that majority of those surveyed knew about Islamic banking and financial products with some of them being very knowledgeable about them. Religious affiliation was found to be the major reason for choice of Islamic banking and financial services for Islamic users. Other reasons given were that: it offers cheap products; banks are conveniently located and other ethical reasons. The convenience of banking with an institution followed by the level of interest it offers ranked highest among respondents in terms of differentiating services offered by different banks. The consumers also preferred banking institutions with; high levels of confidentiality, that could provide financial advice, that offered fast and efficient transactions and they were least concerned with whether the institution provided Islamic banking or financial services.

Wako et al (2014) investigated the challenges affecting the performance of Islamic banks in Kenya. The study used a descriptive survey design and it involved gathering of facts opinions and views of staffs on the challenge that affect the performance of Islamic banks. The target population for this research study included 250 Islamic banking staff in Nairobi County. Primary data was used and was collected through the use of questionnaires. The study findings indicated that institutional framework, information technology and global economy influenced the performance of Islamic banking in Kenya. Additionally, the study found that bad loans, substitute products and supplier IT systems were factors influencing the performance of Islamic banks, under bank specific challenges risk asset management, weak corporate governance and poor human resource practices were also identified as challenges influencing the performance of Islamic banks.

2.5 Conclusion from Literature Review

A review of the theoretical literatures has established that Islamic financing is based on several principles which emanate from the teachings of Islam. The profit sharing theory, Islamic banking theory, cost plus theory and the trust financing theory form the basis of Islamic banking and they aim to promote justice and fairness which in turn enhances economic growth. In addition, a review of the empirical literature has established that Islamic Banking leads to economic growth. However, Most of the studies on the role on Islamic banking were carried out in Islamic dominated countries mostly in the Middle East and Northern African Regions, which include countries like Qatar, U.A.E, Bangladesh, Tunisia, Bahrain, Pakistan and the Islamic republic of Iran.

In Africa, few studies have been carried out in Nigeria including those of Daud et al (2011), and Yusuf and Mobolaji (2012) and by Ackermann & Jacobs (2008) in South Africa. In Kenya, there ase several studies on Islamic banking including Ahmednoor (2013), Mustafa (2013), Saida (2014) and Wako et al (2014). However, the studies carried in Nigeria, South Africa and in Kenya in particular investigate other aspects of Islamic banking like the challenges, performance and profitability. None of the reviewed studies investigated the role of Islamic banking and its role on economic growth. This it can be concluded that Islamic banking is a still a new concept in most African countries Kenya included hence its impact on economic growth is yet to be quantified.

CHAPTER THREE
RESEARCH METHODOLOGY

3.1 Introduction

This chapter includes the research design, the population of the study, data collection procedure and finally the data analysis technique.

3.2 Research Design

A research design is the general plan of how one goes about answering the research questions. A research design is the blue print of a study that provides the outline and direction of a research (Orodho, 2008). This study adopted a quantitative research design. A quantitative research involves the generation of data in quantitative form, which can be subjected to rigorous quantitative analysis in a formal and rigid fashion. The aim of this study was to establish the role of Islamic banking on economic growth in Kenya thus a quantitative design helped in the generation of data, which was subjected to rigorous quantitative analysis.

3.3 Population of the Study

A population is a complete set of individuals, cases or objects with some common observable characteristics (Mugenda & Mugenda, 2003). The population of interest comprised of two fully-fledged Islamic banks in Kenya i.e. the Gulf African bank and First Community bank, and four other banks that offer Islamic banking services including - Chase Iman, National Amanah, Saadiq (Standard Chartered bank) and Lariba (Barclays Bank of Kenya Limited).

3.4 Data Collection

This study utilized secondary data from financial statements of the Islamic banks indicated above. In addition, secondary data on economic development was obtained from Central Bank of Kenya. Islamic banking was introduced in Kenya in 2008 thus, the Islamic banking and economic growth data covered a period of six years from 2008-2014.

3.5 Data Analysis

Data analysis entails examining the data collected and making deductions and inferences. The data collected was analyzed using the Karl Pearson correlation and multiple linear regression using the statistical package for social studies (SPSS).

3.5.1 Analytical Model

The regression equation took the following form

$Y = \beta_\circ + \beta_1 X_1 + \beta_2 X_2 + \varepsilon$

Where

Y= Gross Domestic Product

X_1 = Total Savings

X_2 = Total Financing

$\beta_\circ$ = Constant

β_1& β_2 = Beta Coefficients

ε = Error term

3.5.2 Variables Description

Category	Variable	Description	Measure
Dependent variable	Economic growth	Economic growth is defined as an increase in Gross National Product or increase in Gross Domestic Product	Gross Domestic Product (GDP)
Independent variables	Total Financing	This is a proxy for credit and advances by Islamic banks	Total loans and advances to Islamic Customers
	Total Savings	This is a proxy for savings and investments by Islamic bank customers.	Total customer savings by Islamic customers

3.5.3 Test of Significance

To test the statistical significance the F test was used to test the overall significance of the whole model while the t – test was used to test the significance of the coefficients at 5% level of significance level.

CHAPTER FOUR
DATA ANALYSIS, FINDINGS AND INTERPRETATION

4.1 Introduction

This chapter presents analysis, the study findings and interpretation of the findings as pet the study objectives. The results are shown in terms of the descriptive analysis, correlation analysis and regression analysis.

4.2 Descriptive Statistics

This section presents the response rate and the summary descriptive statistics.

4.2.1 Response Rate

Data was sought from 6 commercial banks in Kenya which offer Islamic banking services for a period of 6 years from 2008-2014. However, complete data was only obtained from 2 banks which started offering the services since 2008 while data for the other banks was obtained for the years they have been offering the Islamic banking services hence a total of 23 observations.

4.2.2 Summary Descriptive Statistics

Table 4.1 shows the descriptive summary statistics obtained from the study. The table presents N (the number of observations), maximum and minimum values, mean and the standard deviation.

Table 4.1 Summary Statistics

	N	Minimum	Maximum	Mean	Std. Deviation
GDP	23	1.700	5.700	4.447	1.193
Total savings	23	3.40E6	1.6E8	3.973E7	5.2640E7
Total Advances	23	1.9E6	1.3E8	2.947E7	4.0281E7

Source: Research Findings

The results on table 4.1 indicate that GDP had a mean value of 4.447 with a standard deviation of 1.193 and minimum and maximum values of 1.7 and 5.7 respectively. Total savings by Islamic customers had a mean of 39.7M and standard deviation of 52.6M with minimum and maximum values of 34M and 160M in that order. Total advances had a mean value of 29.47M and standard deviation of 40.28M with minimum values 19M and 1388M respectively.

4.3 Correlation Analysis

The Karl Pearson correlation was used to establish the nature and the degree of the relationship between the study variables. Table 4.2 shows the results obtained

Table 4.2 Correlation Matrix

		GDP	**Total savings**	**Total Advances**
GDP	Pearson Correlation	1		
	Sig. (2-tailed)			
Total savings	Pearson Correlation	.344	1	
	Sig. (2-tailed)	.108		
Total Advances	Pearson Correlation	.336	.996**	1
	Sig. (2-tailed)	.117	.000	

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

Source: Research Findings

The results on table 4.2 indicate that GDP had a weak positive correlation with total savings as indicated by a correlation coefficient of 0.344. The results also show that GDP has weak positive correlation with total advances as indicated by a correlation coefficient of 0.336. This indicates that GDP has weak positive correlation with total savings and advances.

4.4 Regression Analysis

This section presents the model summary, the analysis of variance and the regression coefficients

4.4.1 Model summary

Table 4.3 presents the model summary which entails the R value, R square value, the adjusted R and the std. error of the estimate.

Table 4.3 Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.350[a]	.123	.035	1.1723927

a. Predictors: (Constant), Total Advances, Total savings

Source: Research Findings

The results on table 4.3 show that the coefficient of determination value is 0.123 which indicates that 12.3% of the variation in the dependent variable (GDP) is explained by the independent variables which include total savings and advances while 87.7% of the variation is explained by other factors and the error term.

4.4.2 ANOVA

Table 4.4 show the analysis of variance (ANOVA) as per the study findings

Table 4.4 ANOVA

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	3.847	2	1.924	1.400	.270[a]
	Residual	27.490	20	1.375		
	Total	31.337	22			

a. Predictors: (Constant), Total Advances, Total savings

b. Dependent Variable: GDP

Source: Research Findings

The results on table 4.4 indicate that the F-statistics value of 1.400 is insignificant since the p value of 0.270 > 0.05 the level of significance. This indicates that our model is a poor predictor of the role of Islamic banking on economic growth in Kenya.

4.4.3 Regression Coefficients

The study variables were examined to establish whether they were significant of insignificant. Table 4.5 shows the study results

Table 4.5 Regression Coefficients

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	4.120	.314		13.128	.000
	Total savings	2.508	.000	1.106	.473	.642
	Total Advances	-2.269	.000	-.766	-.327	.747

a. Dependent Variable: GDP

Source: Research Findings

According to the results on table 4.5, total savings has a positive and insignificant relationship with economic growth measured using GDP. The results also show that total advances have a negative insignificant relationship with total advances. This indicates that at 95% confidence level total advances positively influence economic growth while total advances negatively influence economic growth.

4.5Summary and Interpretation of the Findings

This study examined the role of Islamic banking on economic growth in Kenya. The research was to find, specifically, the relationship between economic growth and the variation in the amounts of total customer deposits and loans granted. Data was sought from 6 commercial banks in Kenya which offer Islamic banking services for a period of 6 years. However, complete data was only obtained from 2 banks which started offering the services since 2008 while data for the other banks was obtained for the years they have been offering the Islamic banking services hence a total of 23 observations. GDP had a mean value of 4.447 with a standard deviation of 1.193 whereas Total savings by Islamic customers had a mean of 39.7M and standard deviation of 52.6M while Total advances had a mean value of 29.47M and standard deviation of 40.28M respectively.

Correlation results established that GDP had a weak positive correlation with total savings and total advances. The coefficient of determination (R square) value was 0.123 which indicated that 12.3% of the variation in the dependent variable (GDP) is explained by the independent variables which include total savings and advances while 87.7% of the variation is explained by other factors and the error term. In addition, the ANOVA results established that the F-statistics value of 1.400 was insignificant since the p value of 0.270 > 0.05. This indicates that our model is a poor predictor of the role of Islamic banking on economic growth in Kenya.

The findings also established that at 95% confidence level total savings had a positive insignificant relationship with economic growth measured using GDP. This means that an increase in total savings by Islamic banks positively influences economic growth hence an increase in saving leads to positive economic growth. The findings also established that total advances have a negative insignificant relationship with economic growth. This indicates that a decrease in loans or advances by Islamic banks inversely influences economic growth which also means that if Islamic banks reduce lending economic growth is negatively affected hence less growth.

The study findings conform to those of agrees with the findings of Zhang et al (2012) who found a strong relationship between economic growth and commercial banks' lending. Aurang (2012) also studied the effect of commercial bank borrowing on economic growth in China and established that there was a bidirectional causal relationship between deposits, advances and profitability and economic growth. In addition, Tabash and Dhankar, (2014b) also established that Islamic banks' financing has contributed to the increase of investment and in attracting FDI in the long term and in a positive way. Ismail (2010) also established that Islamic banks play a valuable and integral part in the development of the national economy since Islamic banks can economically empower employees, shareholders and business partners, and can contribute to the sustainability of state treasuries and a diverse spectrum of important social development projects. Further, Aurangzeb (2012) also emphasized that there is a significant and strong link between the financial sector of a nation and the performance of overall country economy hence nations that have good financial system have a tendency to develop its economic growth more quickly.

CHAPTER FIVE

SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

5.1 Introduction

This chapter provides the summary of the findings, the conclusions from the study, recommendations for policy and practice, the study limitations and finally suggestions for further research.

5.2 Summary

This study examined the role of Islamic banking on economic growth in Kenya. The study focused on whether Islamic banks' lending and customer deposits spurred economic growth. To establish the relationship, rates of change in the amounts of loans given by commercial banks as regressed against economic growth. Data used for the research was obtained from the financial statements of the 23 Islamic and conventional banks with Islamic units banks in Kenya.

The regression results show that constant term was positive but not significantly different from zero with a beta of 4.120. The beta coefficients of savings had a positive relationship of 2.508 while advances had a negative relationship of -2.269. The coefficient of regression deposit was a positive statistically significant while advances were a negative as well as the whole regression was not statistically significant. Further, the variation in rate of change in Islamic bank lending and customer deposits was strongly explain by the variation in economic growth.

The interpretation of the findings is that there seems to find a positive relationship between deposits and economic growth while an inverse relationship between lending and economic growth. That is economic growth is geared by lending. The findings of this research seem to indicate that loan given to the Kenyan citizens and organizations contribute greatly to GDP growth rate. The implication could be that, either the loans impoverish Kenyans even more, or the loans are used for activities that do not contribute too economic growth.

5.3 Conclusions

As per the study findings Kenya seems to have had growth rates that tend towards six percent. This means the country is driving towards higher economic growth rate. The distribution of the rate of change in the amounts of loans issued to borrowers was normally distributed around the mean change in lending. Thus, this study concludes that the policies towards lending and the actual purchase of credit products statistically normal.

The study established that the correlation between economic growth rate and the rate of change in the amounts of loans issued was negative but weak. This indicates that though weakly, increase in lending was paired with a marginal reduction in economic growth. This leads to the conclusion that an increase in lending pairs with a slight drop in economic growth rate.

In the regression, the constant term was not statistically significantly different from zero; the coefficient of the rate of change in the amounts of loans was negative but statistically insignificant. The whole regression was statistically insignificant with variation in economic growth weakly explained by variation in the rate of change in the amounts of loans issued. This leads to the conclusion that Kenya's economic growth is totally variable. However, it is weakly related to changes in lending.

The study also establish a positive relationship between total savings and economic growth thus this study concludes that an increase in savings stirs economic growth since Islamic banks get more deposits which they advance to their customers. In addition, the study established an inverse relationship between total financing by Islamic banks Kenya thus this study concludes that a decrease in lending inversely affects economic growth while increase in lending by Islamic banks stirs economic growth. Finally, the study concludes that Islamic banking influences economic growth.

5.4 Recommendations, Policy and Practice

The study findings established that there is a positive relationship between savings in Islamic banks and economic growth. Thus, this study recommends that Islamic banks should develop effective policies on deposit mobilization as this would increase their total deposit hence more funds which they can advance inform of credit.

The study findings established that there is negative relationship between lending by Islamic banks and economic growth. Thus, this study recommends that Islamic banks should increase lending to different sectors of the economy as this would stir economic growth.

The study also recommend that the government should develop effective policies that will help the growth of Islamic banks in Kenya since their growth would help in improving the economy through savings and also mobilizing deposits.

5.5 Limitations of the Study

This scope of this study was limited to Banks offering Islamic banking services in Kenya. Thus the study findings may not be generalized to other commercial banks which do not offer Islamic banking services. In addition, the study was carried out in Kenya hence the findings may not be generalized to either countries which offer Islamic banking services.

The study covered a period of 6 years from 2008-2014. In addition, some of the banks had not been offering Islamic banking for the 6 years hence complete data was not obtained. Thus, it is not known whether the results would hold if a longer period would have been considered.

5.6 Suggestion for Further Research

The concept of Islamic banking is still new in Kenya and is yet to take root thus this study suggests a further study on the challenges facing Islamic banks in Kenya with a view of p5oving recommendation on how to deal with the challenges.

This study covered the role of Islamic banks on economic growth thus an additional study on the role of conventional banks in economic growth would be vital to establish whether they play similar roles.

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APPENDICES

Appendix I: List of Commercial banks offering Islamic Banking Services

1. Gulf African Bank
2. First Community Bank
3. Chase Bank
4. National Bank of Kenya
5. Standard Chartered Bank of Kenya
6. Barclays Bank of Kenya

Appendix II: Panel Data Used for Regression

Bank	Year	GDP	Total Savings	Total Advances
Bank 1	2014	5.3	13,338,591	9,765,509
Bank 1	2013	4.6	9,932,242	7,211,504
Bank 1	2012	4.6	8,523,054	5,452,627
Bank 1	2011	4.2	7,945,623	4,825,128
Bank 1	2010	5.7	7,211,563	4,236,814
Bank 1	2009	2.6	6,812,302	3,826,149
Bank 1	2008	1.7	6,201,256	3,426,308
Bank 2	2014	5.3	15,794,525	13,790,646
Bank 2	2013	4.6	12,969,806	10,665,498
Bank 2	2012	4.6	11,684,322	9,446,582
Bank 2	2011	4.2	10,865,268	7,439,551
Bank 2	2010	5.7	8,162,501	6,270,884
Bank 2	2009	2.6	6,424,890	4,950,218
Bank 2	2008	1.7	3,427,813	1,932,165
Bank 3	2014	5.3	104,733,709	65,641,491
Bank 4	2014	5.3	154,066,931	122,749,233
Bank 5	2014	5.3	164,779,000	125,403,000
Bank 5	2013	4.6	151,125,000	118,362,000
Bank 6	2014	5.3	79,124,210	53,821,223
Bank 6	2013	4.6	51,941,729	39,564,255
Bank 6	2012	4.6	36,978,406	29,742,477
Bank 6	2011	4.2	24,923,911	18,243,804
Bank 6	2010	5.7	16,880,006	11,131,009