

**DETERMINANTS OF PROFITABILITY IN THE BANKING INDUSTRY IN KENYA:**

**A CASE OF COMMERCIAL BANKS LISTED ON NAIROBI STOCK EXCHANGE**

**BY**

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## **DECLARATION**

This research project is my original work and has not been presented for any award in any other university.

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## **DEDICATION**

This research project is dedicated to my entire family, especially my loving daughter Natasha Wambui for her love, support and constant encouragement during the entire process.

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## **LIST OF ABBREVIATIONS AND ACRONYMS**

<b>ATM</b>	Automated Teller Machines
<b>CBK</b>	Central Bank of Kenya
<b>CBN</b>	Central Bank of Nigeria
<b>FGN</b>	Federal Government of Nigeria
<b>HR</b>	Human Resource
<b>ICT</b>	Information and Communication Technology
<b>I T</b>	Information Technology
<b>KPOSB</b>	Kenya Post Office Savings Bank
<b>MBHCs</b>	MultiBank Holding Companies
<b>MP</b>	Market-Power
<b>NSE</b>	Nairobi Stock Exchange
<b>SCP</b>	Structure Conduct Performance
<b>SPSS</b>	Statistical Program for Social Sciences
<b>SSA</b>	Sub-Saharan Africa
<b>UK</b>	United Kingdom
<b>WMS</b>	Workforce Management System

## **ABSTRACT**

Across the globe, the banking industry today enjoys a number of advantages compared to past years that would appear to contribute to their ability to generate profits. The importance of bank profitability can be appraised at the micro and macro levels of the economy. At the micro level, profit is the essential prerequisite of a competitive banking institution and the cheapest source of funds. It is not merely a result, but also a necessity for successful banking in a period of growing competition on financial markets. Hence, the basic aim of a bank's management is to achieve a profit, as the essential requirement for conducting any business. The objective of this study was to explore determinant of profitability in the banking industry in Kenya with specific focus to commercial banks listed in NSE where the variables were ownership, bank size, state of Information Technology (IT) and labour productivity. This research problem was studied through the use of a descriptive research design. According to NSE, there are 8 commercial banks listed in NSE. This study employed stratified sampling technique in coming up with a sample size of 86 from a total population of 207 respondents. The study relied mostly on primary data sources where self-administered questionnaire was utilized as source of data. Data was collected purely quantitative. Quantitative data was coded and entered into Statistical Packages for Social Scientists (SPSS Version 17.0) and analyzed using descriptive statistics. The finding was presented in form of frequency tables and explanation was presented in prose. The knowledge established from this study would be useful in helping the regulatory authorities and bank managers to formulate future policies aiming at improving the profitability of the banking sector. From the study findings, the study concluded that there was a positive relation between firm ownership and bank profitability. Also the study concluded that bank size determines banks profitability. The study also concluded that banks with diverse products and services experience high profitability and that bank with high value of assets accrue more profits. From the findings, the study concluded that banks that have embraced creativity and innovation influence its profitability and that application of IT ease the process and procedure of banking. Finally, the study concluded that banks that promote its staff on merits encourage hard work which in turn increases its productivity. The study recommends that there is a dire need of involving the bank owners, bank management and other stakeholders for the welfare of the bank in order to mitigate perception that banks are for a certain class in society or community. On bank size, the study recommended that banks open new branches on the untapped potential areas for the banking services such as by opening more branches and ATM centers as such will enhance their profitability capacity. The study recommended that due to globalization and technological innovation in the modern environment, banks should not be exempted from this innovation since its one of the major drivers of profitability within organizations. On labour productivity, the study recommended that employees should be motivated in their working both intrinsic and extrinsic in order to enhance their working attitude for the benefit of the organization, particularly by increasing its profitability.

# CHAPTER ONE

## INTRODUCTION

### 1.1 Background of the Study

The banking industry in general has experienced some profound changes in recent decades, as innovations in technology and the inexorable forces driving globalization continue to create both opportunities for growth and challenges for banking managers to remain profitable in this increasingly competitive environment. Most of the studies concerning bank profitability to date, including Short (1979), Bourke (1989), Molyneux and Thornton (1992), Demirguc-Kunt and Huizinga (1999) and Goddard, Molyneux, and Wilson (2004), have employed different linear models to estimate the impact of various factors that could be significant in terms of explaining profits.

The importance of bank profitability can be appraised at the micro and macro levels of the economy. At the micro level, profit is the essential prerequisite of a competitive banking institution and the cheapest source of funds. It is not merely a result, but also a necessity for successful banking in a period of growing competition on financial markets. Hence, the basic aim of a bank's management is to achieve a profit, as the essential requirement for conducting any business (Bobáková, 2009). At the macro level, a sound and profitable banking sector is better able to withstand negative shocks and contribute to the stability of the financial system. The importance of bank profitability at both the micro and macro levels has made researchers, academics, bank managements and bank regulatory authorities to develop considerable interest on the factors that determine bank profitability (Athanasoglou *et al.*, 2005). Determinants of bank profitability comprise characteristics of individual bank companies that affect their profitability. Shareholder and managerial decisions and activities can directly influence these characteristics which also differ from company to company.

Across the globe, the banking industry today enjoys a number of advantages compared to past years that would appear to contribute to their ability to generate profits.

Molyneux and Thornton (1992) were the first to explore thoroughly the determinants of bank profitability on a set of countries using a sample of 18 European countries during the 1986-1989 periods. They found a significant positive association between the return on equity and the level of interest rates in each country, bank concentration and government ownership. Abreu and Mendes (2001) investigate the determinants of bank's interest margins and profitability for some European countries in the last decade. They report that well capitalized banks face lower expected bankruptcy costs and this advantage translates into better profitability. Bashir (2009) examines the determinants of Islamic bank's performance across eight Middle Eastern countries for 1993-1998 periods. A number of internal and external factor were used to predict profitability and efficiencies. Controlling for macroeconomic environment, financial market situation and taxation, the results show that higher leverage and large loans to asset ratios, lead to higher profitability. The paper also reports that foreign-owned banks are more profitable that the domestic one. There is also evidence that taxation impacts negatively on bank profitability. Finally, macro-economic setting and stock market development have a positive impact on profitability.

According to Berger and Deyoung (2006), the banking industry in the United States has been in a constant process of geographic expansion in recent years, both within nations and across nations. Further, Berger and Deyoung (2006) reported that, at one time, nearly all customers were served by locally based institutions. In contrast, it is now much more likely that the bank or branch providing services is owned by an organization headquartered a substantial distance away, perhaps in another state, region, or nation. Gelos (2006) studies the determinants of bank interest margins in Latin America using bank and country level data. He finds that spreads are large because of relatively high interest rates because of macroeconomic risk, including from inflation, less efficient banks, and higher reserve requirements.

The UK banking system has witnessed a substantial growth and change in recent years and its total assets have expanded rapidly since 1990. The sector consists of both domestic and foreign banks whose total assets reached 4,234bn GBP on August 2003, more than three times the 1990 total of 1,266bn GBP. The assets of the UK-owned banks represent

48% of the total assets of the UK banking sector and have increased by 5% since 1990. Major trends in the UK banking sector over the last years include the conversion of building societies into banks, the consolidation of the UK banking industry and the entrance of non-financial firms into the financial services market. Following the Building Societies Act 1986 a number of building societies converted into banks, especially between 1994 and 1997. Indeed, the UK banking sector makes a significant contribution to the UK economy, accounting for an estimated 3.7% of the UK's Gross Domestic Product which is more than half of that generated by the financial sector as a whole (British Bankers Association, 2004). At the same time, the UK banking industry provides jobs for over 1.6% of UK employees and 40% of financial services employees (Maslakovic & McKenzie, 2006). Therefore knowledge of the internal and external determinants of banks profits and margins is essential not only for the managers of the UK banks but for numerous other stakeholders such as the government, the Bank of England, the British Bankers Association and the Financial Services Authority.

Guru et al. (2009) attempt to identify the determinants of successful deposit banks in order to provide practical guides for improved profitability performance of these institutions. The study was based on a sample of Seventeen (17) Malaysian commercial banks over the 1986-1995 periods. The profitability determinants were divided in two main categories, namely the internal determinants (liquidity, capital adequacy and expenses management) and the external determinants (ownership, firm size and external\economic conditions). The findings of this study revealed that efficient expenses management was one of the most significant in explaining high bank profitability. Among the macro indicators, high interest ratio was associated with low bank profitability and inflation was found to have a positive effect on bank performance.

Africa like any other continent is faced with stiff competition in the financial sector particularly in banking industry as each bank tries to be dominant in the market as the economy of each country grows. Al-Haschimi (2007) studies the determinants of bank net interest rate margins in 10 Sub Saharan African countries. He finds that credit risk and operating inefficiencies explain most of the variation in net interest margins across the

region. Macro-economic risk has only limited effects on net interest margins in the study. According to Al-Hashimi (2007) commercial banks appear very profitable in Sub-Saharan Africa (SSA). Average returns on assets were about 2% over the last 10 years, significantly higher than bank returns in other parts of the world.

Using bank level data for 80 countries in the 1988-1995 periods, Demirgüç-Kunt and Huizinga (2008) analyze how bank characteristics and the overall banking environment affect both interest rate margins and bank returns. In considering both measures, this study provides a decomposition of the income effects of a number of determinants that affect depositor and borrower behavior, as opposed to that of shareholders. Results suggest that macro-economic and regulatory conditions have a pronounced impact on margins and profitability. Lower market concentration ratios lead to lower margins or profits, while the effect of foreign ownership varies between industrialized and developing countries. In particular, foreign banks have higher margins and profits compared to domestic banks in developing countries, while the opposite holds in developed countries.

Naceur and Goaid (2007) investigate the determinants of the Tunisian bank's performances during the period 1980-1995. They indicate that the best performing banks are those who have struggled to improve labour and capital productivity, those who have maintained a high level of deposit accounts relative to their assets and finally, those who have been able to reinforce their equity. Naceur (2008) investigated the impact of banks' characteristics, financial structure and macro-economic indicators on banks' net interest margins and profitability in the Tunisian banking industry for the 1980-2000 periods. The study finds individual bank characteristics explain a substantial part of the within-country variation in bank interest margins and profitability. High interest margin and profitability tend to be associated with banks that hold a relatively high amount of capital, and with large overheads. The paper finds that inflation has a positive impact on banks' net interest margin; while economic growth has no incidence. Another factor is financial structure and its impact on banks' interest margin and profitability, find that concentration is less beneficial to the Tunisian commercial banks than competition. Stock market development has a positive effect on bank profitability. This reflects the complementarities between bank and stock

market growth. The study found that the disintermediation of the Tunisian financial system is favorable to the banking sector profitability.

In Kenya, commercial banks play an important role in mobilizing financial resources for investment by mobilizing investors and boosting businesses as well as offering financial services to the public with the aim of making profit. Lending represents the heart of the banking industry and loans are the dominant assets as they generate the largest share of operating income. As per the Central Bank of Kenya, bank supervision annual report (2010), at the end of December 2010, the banking sector comprised of 45 institutions, 41 of which were commercial banks, 2 mortgage finance companies, 1 non-bank financial institution and 1 building society. Despite their number being high their total assets account for only 48.2% of the sectors total assets.

Over the last few years, Kenyan Banks have realized tremendous growth in the last five years and have expanded to the East African region. The growth has been mainly underpinned by, the industry's wide branch network expansion strategy both in Kenya and in the East African community region, and automation of a large number of services and a move towards emphasis on the complex customer needs rather than traditional 'off-the-shelf' banking products. Players in this sector have experienced increased competition over the last few years resulting from increased innovations among the players and new entrants into the market (Banking Survey, 2001).

The banking industry in Kenya has also involved itself in automation, moving from the traditional banking to better meet the growing complex needs of their customer and globalization challenges. There has been increased competition from local banks as well as international banks, some of which are new players in the country. This has served the Kenyan economy well as the customers and shareholder are the ones who have benefited the most. According to Kiptui and Kipyegon (2008) as pressure mounts on the banking industry's profitability resulting from over reliance on interest income by banks, it is strategically imperative that banks focus on other revenue streams.

## 1.2 Statement of the Problem

The banking sector is the backbone of any economy and plays an important financial intermediary role. Therefore, its health is very critical to the health of the general economy at large. Given the relation between the well-being of the banking sector and the growth of the economy (Rajan & Zingales, 2008), knowledge of the underlying factors that influence the financial sector's profitability is therefore essential not only for the managers of the banks, but also for numerous stakeholders such as the Central Banks, Bankers Associations, Governments, and other Financial Authorities. Knowledge of these factors would be useful in helping the regulatory authorities and bank managers formulate future policies aimed at improving the profitability of the banking sector. The importance of bank profitability can be appraised at the micro and macro levels of the economy. Determinants of bank profitability comprise characteristics of individual bank companies that affect their profitability. Shareholder and managerial decisions and activities can directly influence these characteristics though they differ from company to company (Athanasoglou *et al.*, 2005).

The banking industry in general has experienced some profound changes in recent decades, as innovations in technology and the inexorable forces driving globalization continue to create both opportunities for growth and challenges for banking managers to remain profitable in this increasingly competitive environment (Molyneux & Wilson, 2004). According to Athanasoglou (2005), theoretical and empirical studies that have already been done were seminal in demonstrating the feasibility of conducting a meaningful analysis of the determinants of bank profitability, but some of the methods used by these studies failed to take into account the robust and dynamic nature of the economic environment in which they competed.

Notwithstanding the enormously complex and dynamic nature of the environment in which the bank compete, there is a growing body of evidence that suggests it is possible to discern relevant indicators of profitability for the banking industry today. However no local studies that have been done focusing on determinants of profitability in the banking industry. Kavale (2007) studied the factors firms consider when implementing strategies and the factors leading to success, especially for commercial banks sustainability and prosperity by

profiling strategic alliances in money transfer services in Kenya. Koigi (2002) carried out a survey on the Implementation of Profit Strategies experience by Kenya Post Office Savings Bank (KPOSB) and Citibank. While, Serem, (2002) did a survey on the effect of human resource practices on banks profit in Nairobi. In realization to the above the study aims at investigating the determinants of profitability in the banking industry in Kenya.

### **1.3 Purpose of the Study**

The purpose of this study was to determine profitability in the banking industry in Kenya.

### **1.4 Objectives of the Study**

The study was guided by the following objectives:

- i. To establish the extent to which bank ownership determines profitability in the banking industry in Kenya.
- ii. To examine the extent to which bank size determines profitability in the banking industry in Kenya.
- iii. To assess the extent to which state of information technology determines profitability in the banking industry in Kenya.
- iv. To establish the extent to which labour productivity determines profitability in the banking industry in Kenya.

### **1.5 Research Questions**

The study sought to respond to the following research questions.

- i) To what extent does bank ownership determines profitability in the banking industry in Kenya?
- ii) To what extent does bank size determines profitability in the banking industry in Kenya?
- iii) To what extent does state of information technology determines profitability in the banking industry in Kenya?
- iv) To what extent does labour productivity determines profitability in the banking industry in Kenya?

## **1.6 Significance of the Study**

The finding of the study may be of great importance to the government as it may apply the finding of the study to ensure banks play their key role more particularly in economic growth. Further, the finding of this study may benefit the government through ensuring policies put in place to govern bank sectors are favorable to their growth and that their profitability play a role in national building toward achieving millennium goal such as Vision 2030.

The findings of this study may also benefit the banking industry in Kenya. By using analyzed results, Business Development Managers in the banks will clearly understand the causes of declining growth and profit margins and be conversant with the best solutions in regards to profitability in their pursuit for increased wealth creation, and sustainability.

The study findings may be of great importance to various researchers involved in policy making. The report of this study will be easily acquired in the library and it may equip the learners with more knowledge and relevant information on determinant of profitability in the banking industry in Kenya. The study may also make a myriad contribution to the literature on determinant of profitability in the banking industry in Kenya which will be part of articles that may be helpful to researchers who want to further on their study.

## **1.7 Assumptions of the study**

The researcher assumed that the respondents would be honest, cooperative, factual (objectivity) and trustworthy in their response to the research instruments and would be available to respond to the research instruments in time. The questionnaires used were also assumed to give precise data and that the element of biasness was to never set in during the data collection and analysis. It was also the assumption of the researcher that the authorities in the banking would grant the required permission to collect data from their employees. The study further made the assumption that there would be no serious changes in the composition of the target population that would affect the effectiveness of the study sample.

### **1.8 Delimitations of the Study**

The survey covered the determinants of profitability in the banking industry in Kenya. The study interviewed management staffs in all banks within head office in Nairobi County. Questionnaires were used as the main data instrument source where they were distributed to the sampled respondents. The data for analysis was collected to the population of 207 management staffs within head office in Nairobi.

### **1.9 Limitations of the study**

The research instrument might give varying data depending on the individuals used against but this problem was addressed by applying both quantitative to qualitative approaches to research.

The respondents targeted were reluctant in giving information fearing that the information sought would be used to intimidate them or print a negative image about them or their bank. The researcher handled the problem by presenting an introduction letter from the Nairobi University and assured them that the information they gave was to be treated confidentially and it was to be used purely for academic purposes.

### **1.10 Definition of Significant Terms as used in the Study**

**Bank Size:** is the magnitude of a quantity, such as bank assets, capital base and credit portfolio.

**Guarantor** is a person who guarantees to pay for someone else's debt if he or she should default on a loan obligation.

**Information Technology:** the study, design, development, application, implementation, support or management of computer-based information systems.

**Labour Productivity:** measures the amount of goods and services produced by one hour of labour.

**Management:** is organization and coordination of the activities of a business in order to achieve defined objectives.

- Market power:** Extent to which a firm can influence the price of an item by exercising control over its demand, supply, or both.
- Market share** is the percentage of an industry or market's total sales that is earned by a particular company over a specified time period.
- Net equity interest** is an ownership interest in a business entity, from the concept of equity as ownership
- Bank Ownership:** is the ultimate and exclusive right conferred to a person(s) by a lawful claim or title, and subject to certain restrictions to enjoy, occupy, possess, rent, sell, use, or even give away the bank property.
- Profitability:** is the state or condition of the bank yielding a financial profit or gain.
- Quality:** it is an essential or distinctive characteristic, property, or attribute of banks staff, goods or services.

### **1.11 Organization of the Study**

This research is organized in five chapters. Chapter one introduces the research and presents the statement of problem, objectives, and research questions. The chapter also shows the significance, limitations and delimitations of the study. Chapter two encompasses the literature review on the various aspects concerning determinant of profitability in the banking industries. Chapter three discusses the methodology that was used to collect and analyze data while showing the target population, the sample population and the data collection instrument. Chapter four discusses the data analysis techniques, the findings of the study and presentation of the same findings. Chapter five introduces the conclusion, discussions of the study, recommendations of the study and finally suggestions for further reading.

## **CHAPTER TWO**

### **LITERATURE REVIEW**

#### **2.1 Introduction**

This chapter covers contributions from other scholars on determinant of profitability in the banking industry. The chapter is structured into theoretical review and empirical review, conceptual framework, critique of literature and finally summary and research gaps that the study was aiming to bridge.

#### **2.2 Profitability in the Banking Industry**

As financial intermediaries, banks play an important role in the operation of an economy. A number of studies have examined the determinants of banks' profits and margins in many countries around the world. Most of these studies consider internal factors (bank's specific characteristics) and external factors (financial industry and economic environment) and examine either a particular country or a number of countries. Berger & Deyoung (2006) on their study on globalization of financial institutions noted that between 1985 and 1998 the distance between the largest bank and the other affiliate banks in U.S. MultiBank Holding Companies (MBHCs) increased by over 50 percent on average, from 123.35 to 188.91 miles, as a number of MBHCs acquired banks in other states and regions. Moreover, the banking industry, like any other industry, will experience potential diseconomies to geographic expansion in the form of agency costs associated with monitoring junior managers in a distant locale; however, innovations in information processing and telecommunications may lessen these agency costs by improving the ability of senior managers located at the organization's headquarters to monitor and communicate with staff at distant subsidiaries (Berger & Deyoung, 2006).

In the modern banking industry, technologies such as ATM networks and transactional Internet websites allow banks to interact more efficiently with their customers regardless of geographic proximity; furthermore, recent innovations in financial technologies provide the capacity to provide these services using long-distance interfaces with customers. According to Berger and Deyoung (2006) greater use of quantitative methods in applied

finance, such as credit scoring, may allow banks to extend credit without geographic proximity to the borrower by ‘hardening’ their credit information. Likewise, new product mixes of financial engineering, such as derivative contracts, may provide banks of all sizes to unbundle, repackage, or hedge risks at lower costs without regard to the geographic proximity to the other party (Berger & Deyoung, 2006).

These financial innovations may also provide senior banking managers with the ability to monitor the decisions made by loan officers and managers at distant affiliate banks more easily, and to evaluate and manage the contributions of individual affiliate banks to the organization’s overall returns and risk more efficiently as well (Berger & Deyoung, 2006). Molyneux and Thorton (1992) examined the European banking sector and were among the first that examined the determinants of banks’ profitability in several countries. Other panel country studies are those of Abreu and Mendes (2001) and Staikouras and Wood (2003) who also examined the European markets, Hassan and Bashir (2003) who examined a sample of Islamic banks from 21 countries and Demirguc-Kunt and Huizinga (1999) who considered a comprehensive set of bank characteristics, macro-economic conditions, taxation, regulations, financial structure and legal indicators to examine the determinants of bank interest margins and profitability in over 80 countries. Most of these studies conclude that internal factors explain a large proportion of banks profitability; nevertheless external factors have also an impact on the performance. However, the relations between bank’s characteristics or external factors and profits and margins are not constant across countries or different periods within the same country.

Africa, having constituted of developing countries faces a similar problem of enacting favorable policies and strategies that enhances banks profitability. The Federal Government of Nigeria (FGN) and the Central Bank of Nigeria (CBN) have perennially sought permanent measures that would enhance the profitability and stability of banks operating in the Nigerian banking industry. Unfortunately, they have never completely succeeded in achieving this feat. For instance, from 1987-1991 financial sector reforms (intended to enhance competition in the sector, mobilize savings and lead to a more efficient allocation of resources) were implemented, encompassing elements of liberalization (such as the decontrolling of interest

rates) and measures to enhance prudential regulation and tackle bank distress (Oluranti, 2007). Also, between 1990 and 2004, bank regulators increased the minimum share capital requirement for banks operating in Nigeria five times, namely in 1991, 1997, 2000, 2001 and 2004 (Aburime & Uche, 2006). However, these measures were unsuccessful in curtailing the spate of bank distress and failures in the 1990s and beyond (Brownbridge, 2005).

Lending credence to Gambs' assertion, Tsiko (2006) on his study on commercial banks ranked among Africa's Top 100 within 20 commercial banks opined that difficult constraints facing an economy can adversely impact on the profitability of its banks. Tsiko cited Zimbabwe, in which commercial banks downsized their operations owing to difficult economic challenges. They opine that the positive relationship between inflation and bank profitability implies that bank income increases more with inflation than bank costs. High inflation rates are also generally associated with high loan interest rates, and therefore, high incomes. Banks also obtain higher earnings from float or delays in crediting customer accounts in an inflationary environment. However, if inflation is unanticipated and banks are sluggish in adjusting their interest rates, then there is a possibility that bank costs may increase faster than bank revenues and hence adversely affect bank profitability.

The banking and financial sector in Kenya is characterized by fragility, volatile interest rates, high-risk investment and inefficiencies. The industry further differs in ownership structure, financial liberalization level and accounting treatment of various sources of income. Deregulation and new technology have eroded banks comparative advantages and made it easier for non-bank competitors to enter these markets (DeYoung & Rice, 2011). Financial liberalization of early 1990s in Kenya opened the banking industry to a number of players leading to stiff competition and weakening of financial performance of a number of commercial banks leading to collapse of some. Kenya's commercial banking sector comprises of 3 public, 28 local (private), 11 foreign (private) and 2 Islamic (private) as at 31st December 2010 (CBK report, 2011).

Goddard, Molyneux and Wilson (2004) on his study using 34 banks in Europe stated that the banking industry has changed dramatically over a relatively short period, from being

a virtual cartel to a highly competitive market. Financial deregulation and increasing globalization have brought new competition to domestic banking, and allowed considerable diversification by banks, insurance companies and co-operatives. Information technology has provided many opportunities for creating new financial products and distribution methods, for example Automated Teller Machines (ATMs), Mobile Banking, Internet Banking, and more recently Agent Banking. This has hence reduced the need for investment in conventional branch infrastructure.

In Kenya, banks have also responded to the competitive environment. Most of the banks has completely centralized their banking services by networking all its branches and operations countrywide, making it a branchless operation. This achievement has been extremely vital in the consolidation of the banks business. Muriuki (2008) on his paper about Kenya Banks Record eleven percent Drop in Six-Month Profits, adds that some banks have developed high quality products through its personal and consumer-banking department to meet the needs of its retail customers and other emerging markets. These products include the Personal Loan, the launch of ATMs and the friendly service structure among others.

### **2.3 Ownership and Profitability in the Banking Industry in Kenya**

Ownership of the organization particularly financial institutions is widely reported to be a determinant of bank profitability. Micco *et al.*, (2004) on his study on bank ownership and performance in America using 18 bank concluded that foreign owned banks are more profitable than their domestic counterparts in developing countries and less profitable than domestic banks in industrial countries, perhaps due to benefits derived from tax breaks and other preferential treatments. Privately owned banks have also been assessed to be more profitable than their state owned (public) counterparts (Sapienza, 2004). Specifically, Athanasoglou *et al.* (2005) on their study on determinants of banking profitability in the South Eastern European Region sampling 24 banks posited that public banks' low profitability is due to the fact that, rather than maximizing profits, they respond to a social mandate.

Using data for more than 700 Czech firms that were consistently listed on the Prague Stock Exchange over the period 1992-95 in Czech Republic, empirical evidence from Claessens *et al.* (1997) identifies strong positive relationships between ownership concentration (top five investors' shares as a percentage of total shares outstanding) and firm management / profitability/market value. They explain that concentrated ownership gives the owners better incentives to monitor firms and make necessary changes in management. By contrast, in firms with diffuse ownership, no single owner has an incentive to "mind the store, so management is not disciplined for bad performance or rewarded for good performance. Mitton (2002) on his survey cross-firm analysis of the impact of corporate governance on the East Asian financial crisis using 21 financial institutions shows that firms with concentrated ownership showed better stock market performance during the Asian economic crisis.

When reviewing the literature on the impact of foreign ownership on bank profitability a distinction between emerging and developed countries must be made. Chang, Hassan & Hunter (1998) on efficiency of multinational banks with focus to 18 foreign owned bank in Europe, found that foreign banks to be less cost efficient. Foreign banks are proved to be less profitable than domestic banks (Sathye, 2001). The study of UK banks by Kosmidou *et al.* (2004) on his study on determinants of profits and margins in the Greek Commercial Banking Industry with focus to 12 foreign and 14 domestic banks, suggested that domestic banks outperform foreign ones. Also, Hassan & Lozano Vivas (1998) in his working paper on foreign banks on Athens, Georgia, production technology and efficiency found no substantial difference in profits of domestic and foreign banks with focus to domestic banks.

In the emerging markets results usually differ leaning in favor of banks with foreign ownership. For example, in their study of 11 transition countries Bonin, Hassan and Wachtel (2005) showed foreign-owned banks to be more cost-efficient. Fries & Taci (2002) studied on transition banking with special focus to European Bank concluded that banks with a majority foreign capital are more cost efficient than domestic ones. Isik & Hassan (2003) and Isik (2007) on their survey on efficiency ownership and market structure, corporate control

and governance in the Turkish banking industry, suggested that foreign owned banks are crucial in developing countries for disciplining local banks and boosting their efficiency. A study of the efficiency of Ukrainian banks by Kyj & Isik (2008) on the analysis of service characteristics and ownership focusing to pure domestic owned bank and pure foreign bank, they suggests that pure foreign ownership is more efficient in standalone basis. However, pure domestic ownership outperforms pure foreign ownership in technical efficiency. These unexpected results can be explained by the presence of various institutional voids in Ukraine. Such uncertain legal environment gives local banks an advantage suggesting that foreign banks should acquire local agents to maximize overall efficiency and profits provided that they maintain the control.

#### **2.4 Bank Size and Profitability in the Banking Industry in Kenya**

If the relative size of a firm expands, its market power and profits increases. This is the Market-Power (MP) hypothesis. The hypothesis is also referred to as the Structure-Conduct-Performance (SCP) hypothesis (Athanasoglou *et al.*, 2005). It has been argued that the effect of a growing size on bank profitability is significantly positive to a large extent (Smirlock, 1985). Kwan and Eisenbeis (2005) suggest that the difference in profitability among large and small banks is due to production technologies and outputs, which vary across them. The relative efficiency hypothesis (Clarke *et al.*, 1984) presupposes that larger banks (where size is measured by assets) are more efficient than smaller ones, and are more profitable as a result of this superior efficiency.

The preceding arguments on the effect of size on bank profitability overlap with the idea that large banks can benefit from economies of scale. However, some researchers suggest that little cost saving can be achieved by increasing the size of a banking firm (Berger *et al.*, 2000). They suggest that eventually very large banks could face scale inefficiencies, perhaps due to bureaucratic reasons (Athanasoglou *et al.*, 2005). Newly established banks are not particularly profitable (if at all profitable) in their first years of operation, as they place greater emphasis on increasing their market share and enlarging their firm, rather than on improving profitability (Athanasoglou *et al.*, 2005).

Empirical evidence from Athanasoglou *et al.* (2005) shows that labour productivity growth, which can only be achieved if the bank is large in its size, has a positive and significant effect on bank profitability. This suggests that higher productivity growth generates income that is partly channeled to bank profits. Banks target high levels of labour productivity growth through various strategies that include keeping the labour force steady, ensuring higher quality of newly hired labour, reducing the total number of employees, and increasing overall output via increased investment in fixed assets which incorporate new technology.

## **2.5 State of Information Technology and Profitability in the Banking Industry in Kenya**

Today's business environment is very dynamic and experiences rapid changes as a result of creativity, innovation, technological changes, increased awareness and demands from customers (Woherem, 2000). Business organizations, especially the banking industry of the 21st century operates in a complex and competitive environment characterized by these changing conditions and highly unpredictable economic climate with Information and Communication Technology (ICT) is at the centre of this global change curve.

The banking business is becoming highly ICT based due to its inter-sectoral link; it appears to be reaping most of the benefits of revolution in technology, as can be seen by its application to almost all areas of its activities (Akinuli, 1999). It has broadened the scope of banking practices and changed the nature of banking as well as the competitive environment in which they operate. A broad opening has been experienced around the world for banks and they are currently taking due advantage of these innovations to provide improved customer services in the face of competition and faster services that enhance productivity (Ovia,2001).

Technological advancement facilitates payments and creates convenient alternatives to cash and cheque for making transactions. Such new practices have led to the development of a truly global, seamless and Internet enabled 24-hour business of banking. Technological advance in payments are important due to the fact that it will be feasible to outsource quite a number of the banks' role in the payments system. Also banks' regulation can be more technologically dependent and better focused rather than focusing on conceptual guidelines.

ICT revolution both in terms of innovation rate, speedy operation, and cost per unit (portraying reduction in average total and marginal costs) has made a good number of banks embrace the use of ICT infrastructure in their operations (Akinuli, 1999). However there may be little interruptions at times due to network failures, which may make customers unable to carry out transactions at a particular point in time. This little shortcoming is not in any way comparable to the days when banking halls were characterized by long queues mainly as a result of delays in the traditional banking operations.

Harold and Jeff (1995) on his journal on 'don't let technology pass you by' with focus to ABA Banking contend that financial service providers should modify their traditional operating practice to remain viable in the 1990's and the decade beyond. Thus, ICT has emerged as a catalyst in the various industry of the world to aid the process and procedure required to ensure the realization of various organizational goals. The role of ICT in the banking sector became of interest to this study due to the significant role it plays in the economy by stimulating economic growth through the intermediation of funds to economic agents that need them for productive activities. This function is very vital for any economy that intends to experience meaningful growth because it makes arrangements that bring borrowers and lenders of financial resource together and more efficiently too than if they had to relate directly with one another (Ojo, 2007).

Irechukwu (2006) on his study on enhancing the performance of banking operations through appropriate information technology focusing on a sample of 21 banks in Nigeria itemized some bank services that have been revolutionized through the use of ICT as including account opening, customer account mandate, and transaction processing and recording. Information and Communication Technology has provided self-service facilities (automated customer service machines) from where prospective customers can complete their account opening documents direct online. It assists customers to validate their account numbers and receive instruction on when and how to receive their cheque books, credit and debit cards. ICT products in use in the banking industry include Automated Teller Machine, Smart Cards, Telephone Banking, Electronic Funds Transfer, Electronic Data Interchange, Electronic Home and Office Banking.

Ovia (2001) on his survey on enhancing the efficiency of the payment system in Nigeria with focus to Nigeria banks opined that the revolution in ICT has made the banking sector changed from the traditional mode of operations to presumably better ways with technological innovation that improves efficiency. ICT can enhance efficiency via its use and in recent times banks have been encouraged by the rapid decline in the price of ICT gadgets. This has perhaps increased the bank level of ICT usage. The increase might have also been attributable to business environment that became relatively flexible to accommodate new forms of technological change as a result of reforms in the country.

## **2.6 Labour Productivity and Profitability in the Banking Industry in Kenya**

The critical parameters determining profitability of any business organization are workforce productivity and effective workforce management. For a vast majority of businesses, the single largest cost of doing business is their workforce and thus, workforce productivity and effective workforce management can improve the return on the organization's largest single asset, its workforce (Alan, 2000). Thus, the importance of an efficient as well as effective workforce planning becomes all the more critical. If workforce planning is duly taken care of, it will increase productivity by having adequate talent with the right skills, in the right place, and at the right time. As a critical organizational process, workforce planning involves proactive planning of talent to ensure that the organization is adequately staffed for optimal organizational productivity. In its business partner role, it is important for Human Resource (HR) professionals to fully understand business cycles and how to align the talent pipeline with the business needs. The dynamics of the marketplace and the shortage of talent further imply that attraction and retention of talent is more important to increase organizational productivity (Brech, 2000). If workforce planning is mastered, it will increase productivity by having adequate talent with the right skills, in the right place, and at the right time. This in effect will become a source of competitive advantage.

Workforce Management System (WMS) is an essential tool when it comes to business planning. As far as business cycles in any industry is concerned, manpower planning plays a very important role to complement business planning for higher revenues,

better profits and efficient execution of growth plans (Olukole, 2003). A WMS can help in manpower planning on the basis of demand drivers, forecast HR plans, and then automatically support in allocating optimal workforce against such plans. Once allocated, WMS systems then help track and analyze workforce performance and practices to manage labour costs, minimize compliance risks and enhance people effectiveness.

HR functional heads need to become more transformational in today's age of the 'Knowledge Economy'. If markets like India are going to emerge as Bulwarks of the global economy and be in the forefront in the years to come, the people functions need to become more transformational to business by placing the right people, at the right place, at the right time to get the best value from their deployment (Pang, 2003). Over-scheduling or under-scheduling of people will only harm organizations with either a cost issue or a quality issue. As a matter of fact, HR leaders are increasingly working and taking ownership of these aspects along with business and going beyond the administrative second fiddle with routine chores of recruitment, performance appraisals and payroll (Banjoko, 2000). HR is transforming itself to play a constructive business impact role of a different magnitude. This changing paradigm is expected to help enhance employee productivity and bear a positive impact on organizational performance the key drivers for HR success.

There are a range of factors that influence productivity in an organization. First being the nature of the industry and the maturity of the business. For example, there are different factors to consider when it comes to tracking productivity in cyclic/seasonal and non-cyclical businesses (Werner, 2006). The second element that can affect productivity is how stable and automated are the processes. The third element is the working conditions that affect the overall quality of work and the output. And finally, the level of employee engagement that drives how much of discretionary effort people are willing to put in their jobs. This discretionary effort is usually determined by the morality, motivation and level of enthusiasm that people working in the group have.

However, Organizations across industry track and measure their productivity in terms of goal setting and achievement of individual targets and key results. As survey results show,

62% of respondents use adherence to time and deadlines for tasks assigned as a metric to track and improve employee productivity (Pang, 2003). Other metrics at the organizational level used to track productivity are employee cost to revenue or employee cost to profit generated. Unplanned absenteeism as a measure to track workforce productivity is used by 24% of respondents. It is interesting that though organizations have a process to track productivity, a minority of them have an integrated system underlying this process. Automation can be one of the levers for increasing workforce productivity in organizations, while digitizing can ease the execution and improvement of these activities.

## **2.7 Theoretical Framework**

This study was grounded on the study of innovator's solution theory. The theory is relevant in the study as it explains the process of innovation. According to Christensen and Raynor's (2003) theory of the innovator's solution is a brilliant analysis of why companies fail to innovate. It explains convincingly why corporate managements don't learn about good ideas, and why managers succumb to inherent pressures to run away from the challenge of disruptive competition rather than stand and fight. The decisions made as a result of these pressures make sense in the short run to the individuals involved, but in due course they send the organization into an inexorable death spiral.

But while their analysis of the causes of failure to undertake disruptive innovation is effective, their proposal for solving the dilemma of disruptive innovation is less helpful. The central premise of their thesis – the innovator's solution – is to accept the grim reality that big companies are inherently and constitutionally disinclined to tackle disruptive innovation. A modern organization will crush disruptive new ideas, because they represent a threat to management, to careers, to power structures, to customary ways of things, to client bases, to brands, to corporate culture. The authors' solution is to protect genuine innovators and their disruptive change ideas from these hostile forces.

Corporate leaders should put up a wall between the innovation and the existing hierarchy. Leadership should create an independent business unit, which will provide a safe

and protected environment for innovation. These innovations can flourish without having to fight off the interferences and intrusions and anti-innovation attitudes of the hierarchy.

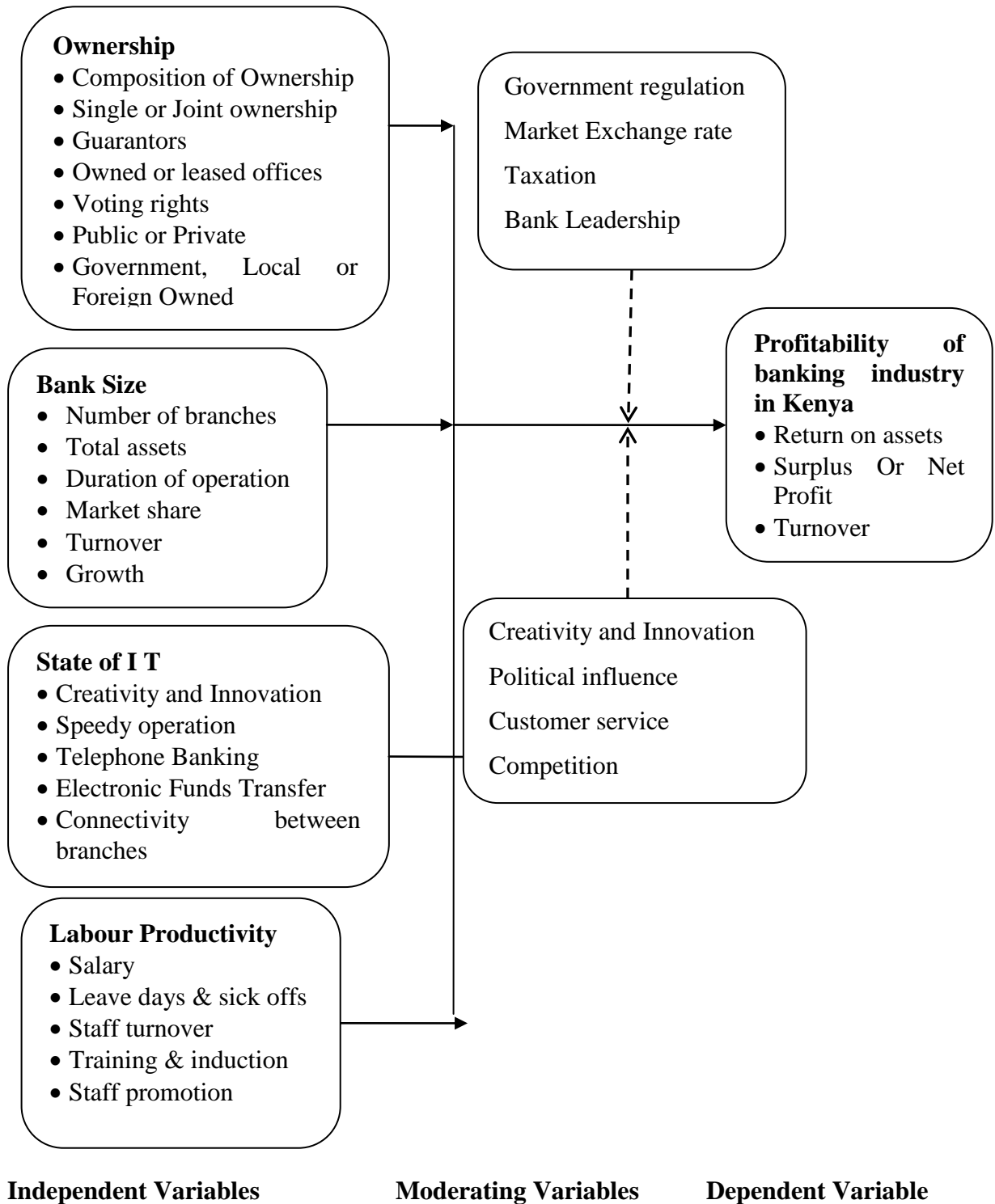
Allowing a different culture to flourish in a separate organization eventually leads to repeated power struggles and culture clashes, which members of the mainstream organization invariably win. Interest in the new ventures tends to be cyclical. Brief surges of enthusiasm, triggered by abundant resources and the desire to diversify, are followed by sharp declines. The life spans of both internal venture units and corporate venture capital funds, therefore, tend to be short – on average, only four to five years.

Oke and Goffin (2001) innovator's solution theory rests on the hope that if one can build enough commercial success in the marketplace, he/she has a better chance of eventually winning that battle of persuasion. Surely, their argument goes, the hard numbers will win the war. Unfortunately the track record shows that even with strong commercial success, numbers and reason are not enough to dislodge the forces of stasis and inertia.

## **2.8 Conceptual Framework**

Framework refers to the main structure or skeleton that not only gives form and shape to the whole system, but also supports and holds together all the other elements in a logical configuration. In this research, the conceptual framework was the concise description of the phenomenon under study accompanied by visual depiction of the variables under study (Mugenda, 2008). The independent variables include firm ownership, bank Size, Information Technology adoption and labour productivity while the dependent variable was profitability of banking industry.

**Figure 2.1 Conceptual Framework**



The banking sector plays an important financial role particularly on the economic growth and therefore, its health is very critical to the health of the general economy at large. Given the relation between the well-being of the banking sector and the growth of the economy (Levine, 1998), knowledge of the underlying factors that influence the financial sector's profitability is therefore essential not only for the managers of the banks, but also for numerous stakeholders such as the Central Banks, Bankers Associations, Governments, and other Financial Authorities. In this study, the dependent variable was profitability in the banking industry in Kenya while independent variables were ownership, bank size, state of information technology and labour productivity. Other factors such as Government regulation, market exchange rate, taxation, bank leadership, political influence, customer service, competition, creativity and innovation; even if not included in this study, determines the profitability of the banks in Kenya.

## **2.9 Summary of Literature Review and the Research Gap**

This chapter looked at the literature review which included the discussion of previous studies done by other scholars in relation to determinant of profitability. According to Berger & Deyoung (2006) noted that between 1985 and 1998 the distance between the largest bank and the other affiliate banks in U.S. MultiBank Holding Companies (MBHCs) increased by over 50 percent on average, from 123.35 to 188.91 miles, as a number of MBHCs acquired banks in other states and regions. Africa, having constituted of developing countries faces a similar problem of enacting favorable policies and strategies that enhances banks profitability. Lending credence to Gamb's assertion, Tsiko (2006) opined that difficult constraints facing an economy can adversely impact on the profitability of its banks. Tsiko cited Zimbabwe, in which commercial banks downsized their operations owing to difficult economic challenges. They opine that the positive relationship between inflation and bank profitability implies that bank income increases more with inflation than bank costs. High inflation rates are also generally associated with high loan interest rates, and therefore, high incomes). Financial liberalization of early 1990s in Kenya opened the banking industry to a number of players leading to stiff competition and weakening of financial performance of a number of commercial banks leading to collapse of some. Kenya's commercial banking

sector comprises of 3 public, 28 local (private), 11 foreign (private) and 2 Islamic (private) as at 31st December 2010 (CBK report, 2011).

From the available literature, ownership of the organization particularly financial institutions is widely reported to be a determinant of bank profitability. Micco *et al.*, (2004) concluded that foreign owned banks are more profitable than their domestic counterparts in developing countries and less profitable than domestic banks in industrial countries, perhaps due to benefits derived from tax breaks and other preferential treatments. It has been argued that the effect of a growing size on bank profitability is significantly positive to a large extent (Smirlock, 1985). Kwan and Eisenbeis (2005) suggest that the difference in profitability among large and small banks is due to production technologies and outputs, which vary across them. Empirical evidence from Athanasoglou *et al.* (2005) shows that labour productivity growth, which can only be achieved if the bank is large in its size, has a positive and significant effect on bank profitability. Business organizations, especially the banking industry of the 21st century operates in a complex and competitive environment characterized by these changing conditions and highly unpredictable economic climate with Information and Communication Technology (ICT) being at the centre of this global change curve (Woherem, 2000). Irechukwu (2006) itemized some bank services that have been revolutionized through the use of ICT as including account opening, customer account mandate, and transaction processing and recording. Alan (2000) opined that the critical parameters determining profitability of any business organization are workforce productivity and effective workforce management. For a vast majority of businesses, the single largest cost of doing business is their workforce and thus, workforce productivity and effective workforce management can improve the return on the organization's largest single asset, its workforce (Alan, 2000).

The chapter also presented theoretical review; the study was grounded on innovator's solution theory. The theory is explains convincingly why corporate managements don't learn about good ideas, and why managers succumb to inherent pressures to run away from the challenge of disruptive competition rather than stand and fight. The study also represents the conceptual framework by explain relationship between independent variables and dependent

variable. Finally, the study shows the gap that the study intended to bridge, most of these studies concluded that internal factors explain a large proportion of banks profitability; nevertheless external factors have also an impact on the performance. However, the relations between bank's characteristics or external factors and profits margins are not constant across countries or different periods within the same country. Therefore, research was required to investigate determinant of profitability in the banking industry in Kenya that this study was aiming to focus on.

## **CHAPTER THREE**

### **RESEARCH METHODOLOGY**

#### **3.1 Introduction**

This chapter provides an overview of the research methodology. It includes research design, research location, and population to be studied, details of the sample size and sampling procedure, instruments used issues of validity and reliability, data collection and data analysis procedures.

#### **3.2 Research Design**

Research design is the scheme, outline or plan that is used to generate answers to research problems. This research problem was studied through the use of descriptive research design. According to Kothari (2007) descriptive survey research design is a type of research used to obtain data that can help determine specific characteristics of a group. A descriptive survey involves asking questions (often in the form of a questionnaire) of a large group of individuals either by mail, by telephone or in person. The main advantage of descriptive survey research is that it has the potential to provide us with a lot of information obtained from quite a large sample of individuals. By employing this study design, this study focused on obtaining quantitative data from a cross-section of project members. It also collected qualitative data from key informants.

#### **3.3 Target Population**

Target population as described by Borg and Grall (2009) is a universal set of study of all members of real or hypothetical set of people, events or objects to which an investigator wishes to generalize the result. The target population of this study was the commercial banks listed on NSE while the study population was staffs working in the headquarters since they dealt directly with the day to day operations of the said commercial banks within the following specific departments, that is, Finance, Operations, Human Resource, Internal Audit and Credit. These banks were chosen since they involved both local and foreign owned banks. Mugenda and Mugenda (2003) explained that the target population should have

observable characteristics to which the study intends to generalize the result of the study. This definition assumes that the population was not homogeneous.

From the 8 banks, the possible number of respondents was 207 working in the following departments namely; Finance, Operations, Human Resource, Internal Auditors (IT) and Credit officers.

**Table 3.1: Target Population**

<b>Departments</b>	<b>Human resource</b>	<b>Credit</b>	<b>Operation</b>	<b>Internal audit</b>	<b>Finance</b>	<b>Total</b>
Barclays Bank of Kenya	3	6	9	3	3	24
CFC Stanbic Bank	3	6	7	2	3	21
Co-operative Bank of Kenya	5	6	10	3	3	27
Diamond Trust Bank Kenya	2	4	5	2	2	15
Equity Bank	5	12	12	6	6	41
Kenya Commercial Bank	4	12	11	6	6	39
NIC Bank	3	4	5	2	3	17
Standard Chartered Bank (K)	3	8	6	2	4	23
<b>Total</b>	<b>28</b>	<b>58</b>	<b>65</b>	<b>26</b>	<b>30</b>	<b>207</b>

### 3.4 Sample Size and Sampling Procedures

This section presented the methods and techniques used for sampling, the procedure of sampling and eventually how the final study sample was reached from the target population and the details of how data was obtained, processed and analysed.

#### 3.4.1 Sample Size

Sample size is finite part of a statistical population whose properties are studied to gain information about the whole. Sampling is selecting a given number of subjects from a defined population as representative of that population. Any statements made about the sample should also be true of the population. It is however agreed that the larger the sample the smaller the sampling error. Where external validity is important, one need to carry out purposive sampling from properly defined population. From the target population of forty

four (44) banks registered with CBK, the researcher purposively interviewed specific respondents in 8 listed banks in NSE. These respondents having been in banking industries and directly working in departments perceived to be oriented in dealing with banks profitability therefore aligned to the study research objectives.

### **3.4.2 Sampling Procedure**

The sampling procedure describes the list of all population units from which the sample will be selected (Cooper & Schindler, 2003). The study employed Stratified random sampling technique in coming up with 8 commercial banks from a group of 44 banks registered with CBK. Sample of responding staff was drawn from all the eight (8) banks in Nairobi where purposive sampling technique was used to come up with the following departments namely, HR, Credit, Operations, Internal Audit and Finance. Purposive sampling technique produce estimates of overall population parameters with greater precision and ensures a more representative sample is derived from a relatively homogeneous population. Based on Krejcie and Morgan's (1970) table for determining sample size, for a given population of 207, a sample size of 86 respondents was appropriate to adequately represent a cross-section of the population at 95% confidence level. The general rule-of-thumb for smaller populations is that a research needs to have at least 30% respondents but for bigger populations, a representative depends on the mode of selection. Further, Gay (2001) pointed that a sample of 10 - 40% is representative. The technique was applied so as to obtain a representative sample when the population does not constitute a homogeneous group.

**Table 3.2 Krejcie and Morgan’s Table for determining Sample Size**

<b>Departments</b>	<b>Human Resource</b>	<b>Credit</b>	<b>Operation</b>	<b>Internal Audit</b>	<b>Finance</b>	<b>Total</b>
Barclays Bank of Kenya	1	2	4	1	1	10
CFC Stanbic Bank	1	2	3	1	1	8
Co-operative Bank of Kenya	3	2	4	2	1	13
Diamond Trust Bank Kenya	1	2	2	1	1	6
Equity Bank	2	5	5	2	2	16
Kenya Commercial Bank	2	5	4	2	2	16
NIC Bank	1	2	2	1	1	7
Standard Chartered Bank (K)	1	3	2	1	3	11
Total	12	24	26	11	13	86

### **3.5 Research Instrument**

The study used a questionnaire to collect primary data. The questionnaire was used to collect data from the sampled staffs in the selected departments within the banks selected. Questionnaires are appropriate for studies since they collect information that is not directly observable as they inquire about feelings, motivations, attitudes, accomplishments as well as experiences of individuals (Mellenbergh, 2008). The questionnaire comprised of both open and close-ended questions. Saunders, (2003) stated that a questionnaire is useful in obtaining objective data because participants are not manipulated in any way by the study. According to Saunders, (2003) questionnaires have the added advantage of being less costly and using less time as instruments of data collection. The data instrument addressed the four research objectives. It was sub-divided into two sections; the first section of the questionnaire enquired general information about the respondents, while the second section answered the four objectives.

### **3.6 Reliability of Research Instrument**

Reliability of the research instrument is the measure of the degree to which a research instrument yields consistent results or data after repeated trial. Reliability answers the

question “Are scores stable over time when the instrument is administered a second time” (Creswell, 2003). The questionnaire was reviewed by the researcher’s professional peers and the researcher supervisor and then tested on a small pilot sample of respondents with similar characteristics as the study respondents. The pilot sample consisted of 10 management staffs from the same selected banks. The pilot group was done through random sampling. Mugenda and Mugenda (2003) suggest that the piloting sample should be 1 to 10% of study sample depending on the study sample size. Piloting helps in revealing questions that could be vague which allows for their review until they convey the same meaning to all the subjects (Mugenda and Mugenda, 2003).

To ensure reliability, the researcher used split-half technique to calculate reliability coefficient (Spearman-Brown coefficient formulae below) which was within the recommended reliability coefficient of between 0.7-1 (Nachmias & Nachmias 1996).

$$\text{Reliability of the overall test} = \frac{2 \times \text{reliability of } \frac{1}{2} \text{ tests}}{1 + \text{reliability of } \frac{1}{2} \text{ tests}}$$

This involved scoring two-halves of the tests separately for each person and then calculating a correlation coefficient for the two sets of scores. The responses were split into the odd numbers for one set and the even numbers for the other set of items. The results from the pilot study on the validity and reliability of data collected using the questionnaires are presented in table 3.3.

**Table 3.3: Reliability Coefficients**

<b>Variables</b>	<b>Cronbach's Alpha (<math>\alpha</math>)</b>	<b>Number of Items</b>
Ownership	0.721	22
Bank size	0.821	23
State of IT	0.743	23
Labour Productivity	0.791	23

The reliability of the questionnaire was evaluated through Cronbach's Alpha which measures the internal consistency. The Alpha ( $\alpha$ ) measures internal consistency by establishing if certain item measures the same construct. Cronbach's Alpha was established for every objective in order to determine if each objective would produce consistent results should the research be done later on. The findings of the pilot study shows that questions on bank size had the highest reliability ( $\alpha=0.821$ ) followed by labour productivity ( $\alpha=0.791$ ), then state of IT ( $\alpha = 0.743$ ) and finally ownership ( $\alpha=0.721$ ). This illustrates that all the four variables were reliable as their reliability values exceeded the prescribed threshold of 0.6 (Nunnally, 1978).

### **3.7 Validity of the Research Instrument**

Validity of the Research instrument is the quality of a data gathering instrument, which enables it to measure what it is supposed to measure. Creswell (2008) notes that validity is about whether one can draw meaningful and useful inferences from scores on the instrument. To ensure content validity, the instrument was reviewed by the researcher supervisor and other research experts. Content validity yields a logical judgment as to whether the instrument covers what it is supposed to cover. Content validity ensures that all respondents understand the items on the questionnaire similarly to avoid misunderstanding.

### **3.8 Data Collection Procedure**

After consent was given by the University of Nairobi to collect data, the researcher coordinated data collection process after seeking permission from local authorities. The researcher engaged three research assistants who assisted in data collection. The research assistants were taken through training to clearly understand the research instrument, purpose of the study and ethics of research. The researcher and research assistants administered the questionnaires to the respondents face to face. Locals were preferred in selecting research assistants who understood the local language to avoid communication barrier.

### **3.9 Data Analysis Techniques**

Data was cleaned, coded, entered and analyzed using Statistical Package for Social Science (SPSS, Version 17.0). SPSS was used because it is fast and flexible and provides

more accurate analysis resulting in dependable conclusions. Technically speaking, data processing implies editing, classification, coding, and tabulation of collected data so that they are amenable to analysis (Kothari, 2007). Data analysis involves computation of certain measures along with searching for patterns of relationships that exist between the dependent variable and independent variables. The data was analyzed according to variables and objectives of the study. Descriptive statistics was used to analyze, present and interpret data. Descriptive analysis involved use of frequency distribution tables and cross tabulation which was used to generate values between dependent and independent variables used in the study. Content analysis was used for the qualitative data from the interview guide of the open ended questions in the questionnaire. In addition, the researcher used multiple regression analysis (Karl Pearson's Coefficient Correlation) to establish the strength of the relationship between the dependent and independent variables.

The regression equation was:

$$Y = \beta_0 + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4 + \varepsilon$$

Where: **Y** is the dependent variable (profitability in the banking industry in Kenya),

**$\beta_0$**  is the regression coefficient/constant/**Y**-intercept,

**$\beta_1$ ,  $\beta_2$ ,  $\beta_3$  and  $\beta_4$**  are the slopes of the regression equation,

**$X_1$**  is the ownership

**$X_2$**  is the bank size,

**$X_3$**  is the state of information technology,

**$X_4$**  is the labour productivity,

**$\varepsilon$**  is an error term normally distributed about a mean of 0 and for purpose of computation, the

**$\varepsilon$**  is assumed to be 0.

### **3.10 Ethical Considerations**

While conducting the study, the researcher ensured that research ethics were observed. Participation in the study was voluntary. Privacy and confidentiality was observed by ensuring that respondents were never requested to indicate their personal details when

filling the questionnaire. The objectives of the study were explained to the respondents with an assurance that the data provided was to be used for academic purpose only.

### 3.11 Operational Definitions of Variables

The operationalization of variables is as shown in table 3.4 below;

**Table 3.4: Operationalization of Variables**

Objectives	Independent Variables	Indicators	Measure	Measurement Scale	Type of analysis	Tools of analysis
To establish how ownership determines profitability in the banking industry in Kenya	Ownership	- Composition of Ownership	% Composition	Nominal	Descriptive Regression	Frequency distribution tables, Tabulation & percentages
		- Single or Joint ownership	% ownership	Nominal		
		- Guarantors	Number	Nominal		
		- Owned or leased offices	Buy or Lease	Ordinal		
		- Net equity interest	Kshs	Nominal		
		- Voting rights	Number	Nominal		
		- Control	% Control	Nominal		
		- Public or Private	Type	Ordinal		
- Government, Local or Foreign	Type	Ordinal				

<b>Objectives</b>	<b>Independent Variables</b>	<b>Indicators</b>	<b>Measure</b>	<b>Measurement Scale</b>	<b>Type of analysis</b>	<b>Tools of analysis</b>
To scrutinize how bank size determines profitability in the banking industry in Kenya	Bank size	Number of branches	Number	Nominal	Regression	Frequency distribution tables, Tabulation & percentages
		Total assets	Kshs	Nominal		
		Duration of operation	Hours	Nominal		
		Market share	% Share	Nominal		
		Turnover	Kshs	Nominal		
		Growth	% Growth	Nominal		
		Increased investment	% Increase	Nominal		
		Number of staffs	Number	Nominal		
		Ratio of managers to staff	Ratio	Nominal		
Type of products	Quality	Ordinal				
Number of products & Services	Number	Nominal				

<b>Objectives</b>	<b>Independent Variables</b>	<b>Indicators</b>	<b>Measure</b>	<b>Measurement Scale</b>	<b>Type of analysis</b>	<b>Tools of analysis</b>
To assess how information technology determines profitability in the banking industry in Kenya	Information Technology	Creativity and Innovation	Quality	Ordinal	Regression	Frequency distribution tables & percentages
		Speedy operation	Time	Nominal		
		Easy process in ATM card, Cheque & Account opening.	Complexity	Ordinal		
		Smart Cards	Quality	Ordinal		
		Telephone Banking	Quality	Ordinal		
		Electronic Funds Transfer	Speed	Nominal		
		Home & Office Banking	Quality	Ordinal		
		Connectivity between branches	Hours	Nominal		
		System Security	Quality	Ordinal		
		System uptime	Hours	Nominal		
Accuracy	Quality	Ordinal				

<b>Objectives</b>	<b>Independent Variables</b>	<b>Indicators</b>	<b>Measure</b>	<b>Measurement Scale</b>	<b>Type of analysis</b>	<b>Tools of analysis</b>
To establish how Labour Productivity determines profitability in the banking industry in Kenya	Labour Productivity	Salary	Kshs	Nominal	Regression	Frequency distribution tables, Tabulation & percentages
		Overtime	Hours	Nominal		
		Leave days & sick offs	Days	Nominal		
		Staff turnover	Number	Nominal		
		Training & induction	Quality	Ordinal		
		Staff promotion	Criteria	Ordinal		
		Incentives & Rewards	Quality	Ordinal		
		Discipline	Criteria	Ordinal		
Appraisal and targets	Number	Nominal				
Work load	Extent	Ordinal				
	<b>dependent Variable</b>	<b>Indicators</b>	<b>Measure</b>	<b>Measurement Scale</b>	<b>Type of analysis</b>	<b>Tools of analysis</b>
Profitability in the banking industry in Kenya	Return on assets	on	Kshs	Nominal	Regression	Frequency distribution tables, Tabulation & percentages
		Or	Kshs	Nominal		
		Turnover	Kshs	Nominal		

## CHAPTER FOUR

### DATA ANALYSIS, INTERPRETATION AND PRESENTATION

#### 4.1 Introduction

This chapter focused on the data analysis, interpretation and presentation of the findings. The main purpose of this research was to examine determinants of profitability in the banking industry in Kenya with focus to commercial banks listed on Nairobi Stock Exchange. The study also sought to establish whether firm ownership, bank Size, state of Information Technology and labour productivity determines profitability of the bank. The researcher made use of frequency tables, percentages, mean and standard deviation to present data.

#### 4.2 Questionnaire Return Rate

The study sampled 86 respondents from the target population of 207 in collecting data with regard to determinants of profitability in the banking industry in Kenya where the focus was commercial banks listed on Nairobi Stock Exchange. The questionnaire return rate results are shown in Table 4.1.

**Table 4.1 Response Rate**

<b>Response</b>	<b>Frequency</b>	<b>Percentage</b>
Responded	62	72
Non response	24	28
<b>Total</b>	<b>86</b>	<b>100</b>

From the study, 62 out of 86 target respondents filled in and returned the questionnaire contributing to 72%. This commendable response rate can be attributed to the data collection procedure, where the researcher engaged three researcher assistants to administer questionnaires and waited for respondents to fill in, while respondents left with questionnaires were reminded to fill in the questionnaires through frequent phone calls and picked the questionnaires once fully filled. Any clarifications sorted by the respondents were accorded to without delay. This response rate was good, representative and conforms to

Mugenda and Mugenda (1999) stipulation that a response rate of 50% is adequate for analysis and reporting; a rate of 60% is good and a response rate of 70% and over is excellent. The questionnaires that were not returned were due to respondents not being available to fill them in time and after persistence follow-ups, there were no positive feedback from them. The response rate demonstrated the willingness of the respondents to participate in the study.

### 4.3 Demographic Characteristics of the Respondents

The study targeted staffs from the banks listed in NSE within their headquarters in Nairobi branches and from finance, operations, human resource, credit and internal audit departments. As such the results on demographic characteristics of these respondents were investigated in the first section of the questionnaire. They are presented in this section under; department they work, position held in the bank, period in years worked in the Bank and highest academic qualifications.

#### 4.3.1 Respondents Department of Work

Table 4.2 indicates departments in which respondents were working in their organization. From the findings most (22.6%) of the respondents were working at operations and human resource departments as shown in each case, 21% were serving at credit department, 18% were working at internal audit while 16% of the respondents were serving at finance department. This implies that all departments that were targeted by the study were involved and that the findings are not biased.

**Table 4.2 Respondents Department of Working**

<b>Department</b>	<b>Frequency</b>	<b>Percentage</b>
Operations	14	22.6
Human Resource	14	22.6
Internal Audit	11	17.7
Finance	10	16.1
Credit	13	21.0
<b>Total</b>	<b>62</b>	<b>100.0</b>

### 4.3.2 Position held by the Respondents in their Respective Banks

The study aimed to investigate position held by the respondents in their organisation. From the findings (33%) of the respondents were unit heads, 22% as assistance manager and directors, 18% were technical personnel, 14% were departmental heads while 4% were supervisors. Position held in the workplace leads to easier application and strategic practices that leads to better performance of the organization towards achieving organizational goals and objectives. This depicts that all participant of the study were under the level to which the study targeted as stipulated in previous chapter.

**Table 4.3 Position held by the Respondents in their Respective Banks**

<b>Position Held</b>	<b>Frequency</b>	<b>Percentage</b>
Supervisor	2	4
Technical personnel	11	18
Departmental Head	9	14
Unit Head	20	33
Director	14	22
Manager	14	22
<b>Total</b>	<b>62</b>	<b>100</b>

### 4.3.3 Respondents Working duration in Years

Table 4.4 illustrates working period in years of the respondents in their respective organization. From the findings majority (53%) of the respondents had worked in the organization for a period of 6-10 years, 36% had worked for a period of 1-5 years, 7% had worked for a more than 16 years while the rest (5%) had served in the organization for a period of 10-15 years. This implies that most of the respondents of this study had worked for a longer period within the organization thus conversant enough of the information that the study sought pertaining to the bank profitability.

**Table 4.4 Respondents working duration in years**

<b>Period of Service</b>	<b>Frequency</b>	<b>Percentage</b>
1- 5 Years	22	35.5
6 – 10 Years	33	53.2
10 – 15 Years	3	4.8
Above 16 Years	4	6.5
<b>Total</b>	<b>62</b>	<b>100.0</b>

**4.3.4 Education Level of the Respondents**

The study was also inquisitive to determine the highest level of the academic qualification that the respondent held. Table 4.5 shows the findings of the result, most (47%) of the respondents were graduate, 30% were post graduate (masters holder) while the rest (23%) had diploma as their highest level of education. This depicted that most of the respondents interviewed were well knowledgeable to understand and able to respond to the questionnaire in the manner intended.

**Table 4.5 Education Level of the Respondents**

<b>Level</b>	<b>Frequency</b>	<b>Percentage</b>
Diploma	14	23
Graduate	29	47
Post graduate	19	30
<b>Total</b>	<b>62</b>	<b>100</b>

**4.3.5 Consideration of Profitability**

Table 4.6 illustrates the summary of the findings on whether the banks consider profitability as the achievement of the organization. Anonymously (100%) respondents opined that they consider profitability as an achievement. This implies that most of banks had set policies to ensure their operations are focused to increase profitability.

**Table 4.6 Consideration of Profitability as a Bank achievement**

<b>Statement</b>	<b>Frequency</b>	<b>Percentage</b>
Yes	62	100
No	0	0

#### **4.4 Ownership and Bank Profitability**

Further the study requested the respondents to indicate whether ownership of the bank determines its profitability. From the findings, majority (79%) of the respondents were of the opinion that ownership of the bank determines bank profitability while the rest (21%) of the respondents opined that bank ownership has no relation to its profitability.

**Table 4.7 Extent to which Bank Ownership determines its Profitability**

<b>Statement</b>	<b>Frequency</b>	<b>Percent</b>
Yes	49	79
No	13	21
<b>Total</b>	<b>62</b>	<b>100</b>

#### **4.4.1 Ownership and how it determines Bank Profitability**

Table 4.8 illustrates the finding of the study on the respondent level of agreement. From the findings, most of the respondents agreed that locally owned banks are more profitable than foreign owned and that bank with few guarantors accrue more profit than banks with more guarantors as shown by mean score of 4.13 and 4.11 respectively. Respondents also agreed that banks with owned premises accrue more profit than banks with rented premises as depicted by mean score of 3.97. Further, respondents agreed that private owned banks are more profitable than public owned banks as illustrated by mean score of 3.50. Respondent were neutral that Banks with more shareholders are more profitable since they have more capital for investments as shown by mean score of 3.48. Respondents were also neutral that pure domestic ownership banks outperforms pure foreign ownership in technical efficiency, banks with concentrated ownership show better stock market performance, banks with a majority foreign capital are more cost efficient than domestic ones

as shown by mean score of 3.26, 3.23 and 3.21 respectively. Further respondents disagreed that bank with more net equity interest accrue less profit compared to bank with less net interest rate, jointly owned banks are less profitable, public owned bank experience less profits, sole owned bank accrue more profits, foreign Owned banks are more profitable and that pure foreign ownership banks are more efficient in standalone basis as depicted by mean score of 3.16, 3.13, 3.11, 3.10, 3.10 and 2.90 respectively.

**Table 4.8 Respondents level of agreement on Bank Ownership to its Profitability**

<b>Statement</b>	<b>Mean</b>	<b>STDev</b>
To what extent do you agree that composition of ownership influences our bank profitability	3.35	1.294
Bank with many directors accrue less profit than the bank with less number of directors	3.32	1.340
Bank with few directors makes decisions fast enabling speedy execution of policies hence more profitable	3.48	1.184
Bank with high equity interest accrue more profit compared to bank with less net interest	3.16	.834
Bank with more shareholders has more capital to invest on and therefore more profitable	3.48	1.388
Bank with few shareholders pays less dividend and hence accrues more profit	3.23	1.047
Indicate your level of agreement whether bank with owned premises accrue more profit than bank with rented premises	3.97	.905
Sole owned bank are less profitable due to inadequate capital base	3.10	.882
To what level of agreement do you agree that jointly owned bank are more profitable	3.13	.896
Government owned banks are more profitable due subsidies given to them.	2.66	1.023
Private owned banks are more profitable since the owners are involved in all aspects of management	3.56	1.002
Public owned banks experience less profit due to inadequate accountability	3.11	1.368

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Locally owned bank are more profitable due to tax waivers they get from the government	4.13	1.490
Foreign owned banks are more profitable due to huge sums of cash pumped into them for investments	3.10	.983
Banks with more Guarantors are profitable due to increased capital base.	3.50	1.238
Banks with few Guarantors are more profitable since they pay less interest from their loans	4.11	.851
Banks with concentrated ownership show better stock market performance	3.23	1.193
Banks with a majority foreign capital are more cost efficient than domestic ones	3.21	1.133
Pure foreign ownership banks are more due to high expertise of the leaders that manage them	2.90	1.315
Pure domestic ownership banks outperforms pure foreign ownership in technical efficiency	3.26	1.055

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#### **4.4.2 Extent to which Bank Ownership Influences Bank Profitability**

Table 4.9 illustrates the findings of the study on the extent that bank ownership influence profitability of the bank. Majority (50%) of the respondents' purported that bank ownership influences its profitability to a great extent, 24% were of the opinion that bank ownership influence profitability of the bank to a very large extent, 14% opined that bank ownership influence profitability of the bank to a moderate extent, 7% were of the opinion that bank ownership influence profitability of the bank to a low extent while 5% argued that bank ownership influence profitability of the bank to a very low extent.

**Table 4.9 Extent to which Bank Ownership Influences Bank Profitability**

<b>Level of agreement</b>	<b>Frequency</b>	<b>Percentage</b>
To a very low extent	3	4.8
To a low extent	4	6.5
To a moderate extent	9	14.5
To a great extent	31	50.0
To a very great extent	15	24.2
<b>Total</b>	<b>62</b>	<b>100.0</b>

#### **4.5 Bank Size and Bank Profitability**

The study further requested the respondents to indicate the number of branches their bank have. According to the findings, most (68%) of the respondents' indicated that their bank have more than 61 branches, 13% indicated that their bank have between 31-45 branches, while 10% indicated that their bank have between 46-60 and 16-30 branches respectively.

**Table 4.10 Number of branches**

<b>Number of Branches</b>	<b>Frequency</b>	<b>Percentage</b>
16-30	6	9.7
31-45	8	12.8
46-60	6	9.7
61 and above	42	67.8
<b>Total</b>	<b>62</b>	<b>100</b>

##### **4.5.1 Determination of Bank Profitability by Number of Branches**

Table 4.11 summarizes the study findings, on whether numbers of branches for a bank determines its profitability. From the findings, 69% of the respondents indicated that numbers of bank branches determines its profitability while the rest (31%) opined that number of bank profitability does not determine bank profitability.

**Table 4.11 Determination of Bank Profitability by Number of Branches**

<b>Statement</b>	<b>Frequency</b>	<b>Percent</b>
Yes	43	69.4
No	19	30.6
Total	62	100

**4.5.2 Respondent level of agreement on Bank Size and its influence to Profitability**

Table 4.12 illustrates the finding of the study on the respondent level of agreement. From the findings, most of the respondents agreed that banks with diverse products and services experience more profits, superior products and services influence banks profitability and that banks with high value of assets accrue more profits as depicted by mean score of 4.55, 4.52 and 4.45 respectively. Also respondents agreed that banks that operates for longer hours in a day make more profits than banks that operate for less hours, banks with increased investment accrue more profits and that banks with few manger and more operators are more efficient hence more profitable as illustrated by mean score of 4.26, 4.23 and 4.16 respectively. On the other hand, banks with many managers and few operators creates power confusion resulting to low profitability, bank growth rate is significantly positive on bank profitability and that very large banks face scale inefficiencies, due to bureaucratic nature of its procedures hence low profit as depicted by mean score of 3.16, 2.97 and 2.76 respectively.

**Table 4.12 Respondents level of agreement on Bank Size to its Profitability**

<b>Statement</b>	<b>Mean</b>	<b>STDev</b>
Banks with high value of assets accrue more profits	4.45	.862
Bank growth in terms of credit portfolio influences its profitability	3.89	1.010
Banks that operates for longer hours in a day make more profits than banks that operate for less hours	4.26	.723
Banks with large customer base make more profits	3.40	1.498
Banks with small customer base make translates to less profits	4.12	.882
Banks with small customer base translates to less profits	3.19	1.321

Banks with large market share experience more profit than ones with smaller market share	3.63	1.480
Banks with diverse products and services experience more profits	4.55	.670
Superior products and services influence banks profitability	4.52	.646
Banks with increased investment accrue more profits	4.23	.777
Banks with many managers and few operators creates power confusion resulting to less profitability	3.16	1.244
Banks with few managers and more operators are more efficient hence more profitable	4.16	1.043
Large banks are more profitable due to economies of scale on their production	2.76	1.456
Very large banks face scale inefficiencies, due to bureaucratic nature of their procedures hence low profit	3.90	.844
Product growth has a positive and significant effect on bank profitability	3.60	1.194
Higher productivity growth generates income that directly results to high bank profits	3.77	1.093
Reducing the total number of employees (restructuring) increases profitability	3.44	1.250
Increasing overall output via increased investment in fixed assets have positive relation to bank high profit	3.19	1.252
Lack of major investment does not affect bank profitability	2.97	1.390
Bank growing size is significantly positive on bank profitability	3.34	1.159

### 4.5.3 Extent to which Bank Size Determines its Profitability

Further the study requested the respondents to indicate the extent to which bank size determines its profitability. From the findings, 42% of the respondents opined that bank size determines bank profitability to very great extent, 31% were of the opinion that bank size influence bank profitability to a moderate extent, 15% to a great extent, 7% to a low extent while a similar numbers purported that bank size influence bank profitability to a very low extent as indicated by the table 4.13.

**Table 4.13 Extent to which Bank Size Influences Bank Profitability**

<b>Level of Agreement</b>	<b>Frequency</b>	<b>Percentage</b>
To a very low extent	4	6.5
To a low extent	4	6.5
To a moderate extent	19	30.6
To a great extent	9	14.5
To a very great extent	26	41.9
<b>Total</b>	<b>62</b>	<b>100</b>

#### **4.6 State of Information Technology and Bank Profitability**

The study requested the respondent to indicate whether the banks that embrace creativity and innovation in the state of its Information Technology are a factor that determines its profitability. Anonymously (100%) as shown in table 4.14 of the interviewed respondents' indicted that the banks that embraced creativity and innovation through application of IT is a major factor that determines its profitability.

**Table 4.14 Embracement of Creativity and Innovation in the state of IT**

<b>Statement</b>	<b>Frequency</b>	<b>Percentage</b>
Yes	62	100
No	0	0

#### **4.6.1 Ease of process and procedure of banking through IT application**

Table 4.15 shows the study findings on whether application of IT eases the process and procedure of banking. According to the findings, all (100%) of the respondents indicated that application of IT eases the process and procedure of banking.

**Table 4.15 Ease process and procedure of banking through IT application**

<b>Statement</b>	<b>Frequency</b>	<b>Percentage</b>
Yes	62	100
No	0	0

#### **4.6.2 Respondents Level of Agreement on Bank state of IT to its Profitability**

Table 4.16 illustrates the finding of the study on the respondent level of agreement on state of IT to its Bank Profitability. From the findings, most of the respondents strongly agreed that banks that embrace technology have speedy operation enabling more productivity as indicated by the mean score of 4.95, also respondent strongly agreed that their banks are becoming highly ICT based due to their inter-sectoral linkages that appears to be reaping most of the benefits of revolution in technology as shown by mean score of 4.81. Further, respondents strongly agreed that ICT revolution in terms of innovation increases speedy operation and therefore reduce cost per unit in production, and this has led a good number of banks to embrace the use of ICT infrastructure in their operations that improves efficiency as shown by mean score of 4.79 in each case. Respondents have also agreed that IT has assisted customers to validate their account numbers and receive instruction on, when and how to receive their cheque books, credit cards and debit cards and also have agreed that accuracy of results generated by bank systems that embrace use of Smart Cards which in turn results to more profitability as depicted by mean score of 4.65 and 4.66 respectively. IT has broadened the scope of banking practices and changed the nature of banking as well as the competitive environment in which they operate as illustrated by mean score of 4.61. They have also agreed that Technological advancement in the banking industry has facilitated payments and creates convenient alternatives to cash and cheque for making transactions as depicted by mean score of 4.26. Also respondents agreed that electronic Home and Office Banking as illustrated by mean score 4.11. Finally, respondents disagreed that cost of acquiring better IT infrastructure for our bank is the major cause of low profits thereby decrease profitability as illustrated by mean score of 2.29.

**Table 4.16 Respondents Level of Agreement on Bank state of IT to its Profitability**

<b>Statement</b>	<b>Mean</b>	<b>STDev</b>
Banks which embrace use of Smart Cards results to more profitability	4.65	0.482
Use of Telephone Banking increases profitability in the bank	4.44	0.500
Use of Electronic Funds Transfer by banks facilitates increased business by customers hence more profit	4.53	0.620
Better connectivity between bank branches have reduced cost of operations	4.66	0.542
Use of ICT has rendered some employees redundant hence saved some costs	4.11	1.057
System security adopted after technological advancement has resulted to bank profitability	4.48	0.620
System stability have created more confident to the client hence increase customer base	4.32	0.845
Cost of acquiring better IT infrastructure for our bank is the major cause of low profits	2.29	1.464
Bank that enhance creativity and Innovation are more efficient hence more profitable	4.48	0.864
Banks that embrace technology have speedy operation enabling increased productivity	4.95	0.216
IT has broadened the scope of banking practices and changed the nature of banking as well as the competitive environment in which they operate hence profitability	4.47	0.646
Banks that has embraced ICT appears to be reaping most of the benefits of revolution in technology.	4.81	0.398
Banks that have adopted IT has broadened the scope of banking practices and changed the nature of banking as well as the competitive environment in which they operate	4.61	0.491
Technological advancement in the banking industry has facilitated payments and creates convenient and non-risky alternatives to cash and cheque for making transactions	4.26	0.974

Banks that have adopted ICT revolution in terms of innovation have benefited from speedy operation and reduced cost per unit hence more profits	4.79	0.410
Our banks has modified it operation with relation to technological advancement in order to remain viable in the market	4.53	0.503
Account opening, customer account mandate and transaction processing and recording have been revolutionized through the use of ICT within our bank hence increased profit	4.48	0.504
IT has assisted customers to validate their account numbers, receive instruction on, when and how to receive their cheque books, credit and debit cards	4.65	0.482
ICT has made our bank change from the traditional mode of operations to presumably better ways with technological innovation that improves efficiency	4.79	0.410
ICT has enhanced accuracy in our banking operation hence eradication of errors and fraud that diminish its profit	4.44	1.002

#### 4.6.3 Extent to which state of IT determines its Bank Profitability

Table 4.17 illustrates the findings of the study on the influence of state of IT on bank profitability. Majority (74%) of the respondents' purported that state of IT influences bank profitability to a very great extent while the rest 26% were of the opinion that IT influences bank profitability to a great extent.

**Table 4.17 Extent to which Bank state of IT determines its Profitability**

Level of agreement	Frequency	Percentage
To a great extent	16	25.8
To a very great extent	46	74.2
<b>Total</b>	<b>62</b>	<b>100.0</b>

#### 4.7 Labour Productivity and Bank Profitability

The study requested the respondents whether they regarded labour productivity as a factor contributing to bank profitability. According to the findings, all (100%) of the respondents pointed that labour productivity influences bank profitability. This indicates that there is positive relationship to labour productivity and firms profitability.

**Table 4.18 Extent to which Labour Productivity determines Bank Profitability**

Statement	Frequency	Percentage
Yes	62	100
No	0	0

#### 4.7.1 Rating Labour Productivity influence to Bank Profitability

Table 4.19 illustrates the study findings on the rating of labour productivity and its influence to bank profitability. Majority (93%) of the respondents were of the opinion that labour productivity in their bank was good while the rest (7%) opined that labour productivity in their firm was poor.

**Table 4.19 Rating Labour Productivity influence to Bank Profitability**

Statement	Frequency	Percentage
Good	58	93.5
Average	4	6.5
<b>Total</b>	<b>62</b>	<b>100.0</b>

#### 4.7.2 Respondents Level of Agreement on labour Productivity to Bank Profitability

The study requested the respondents to indicate their level of agreement on the statement relating to labour productivity and its determinants to profitability. From the findings most of the respondents strongly agreed that banks that promotes its staff on merits encourages hard work hence increased productivity, banks with adequate staff training and induction increases competency and efficiency in its production, banks that shares its profit with its employees in terms of issuing bonuses increases its productivity since staff feel to be part of the business, banks with adequate talented staffs are more innovative and productive

hence makes high profits, banks that appraises the performance of its staff in a more objective manner develop a culture for its employees to achieve and exceed on their targets hence increase their productivity, Banks with better employee engagement are able to deal with employees problems faster and less costly, employees that receive appropriate remuneration are more productive and that presence of incentives and rewards in our banks promotes motivation to improve productivity as depicted by mean score of 4.87, 4.82, 4.77, 4.66, 4.61, 4.60, 4.58 and 4.53 respectively. Respondents agreed that banks with proactive workforce planning ensures optimum manpower utilization and that banks with poor staff discipline are less productive and accrue losses as indicated by these mean scores 4.47, 4.37 respectively. Respondents also agreed that banks that does not reward its best performing employees promotes low morale and productivity and inefficient execution of employee growth plans leads to high staff turnover therefore decreasing their productivity as shown by mean score of 4.24 in each case. Finally most of the interviewed respondents disagreed that those banks with high overtime means they are less efficient and therefore less profitable as depicted by mean score of 2.24.

**Table 4.20 Respondents level of agreement on Bank Labour Productivity to its Profitability**

<b>Statement</b>	<b>Mean</b>	<b>STDev</b>
Bank with high overtime means its less efficient and therefore less profitable	2.24	0.862
Banks with high overtime translates to higher production and hence more profits	3.39	1.046
Employees that receive appropriate remuneration are more productive	4.58	0.615
Employees who receive less leave days are more fatigued and prone to making many errors that results to decreased profits	3.79	0.926
Low staff turnover decreases cost of hiring and training hence more profit	3.69	1.182
Banks with many employees is prone to employee redundancy and high wage bill that lowers profits	3.92	0.874
Bank with employees requesting frequent sick offs is less profitable	3.56	1.236

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Banks with few employees overloads its workers leading to minimal productivity	3.95	0.913
Bank with adequate staff training and induction increases competency and efficiency in its production	4.82	0.497
Inefficient execution of employee growth plans leads to high staff turnover therefore decreasing their productivity	4.24	0.740
Bank that promotes its staff on merits encourages hard work hence increased productivity	4.87	0.338
Presence of Incentives and rewards in our bank promotes motivation to improve productivity	4.53	0.804
Banks that does not reward its best performing employees promotes low morale and productivity	4.24	1.066
Bank that appraises the performance of its staff in a more objective manner develop a culture for its employees to achieve and exceed on their targets hence increase their productivity.	4.61	0.633
Bank with poor staff discipline is less productive and accrue losses.	4.37	0.583
Employee with huge work load are less efficient and productive hence decreases bank profit	4.15	0.786
Bank with adequate talented staffs is more innovative and productive hence makes high profits	4.66	0.477
Bank with proactive workforce planning ensures optimum manpower utilization	4.47	0.593
Bank with better employee engagement is able to deal with employees problems faster and less costly	4.60	0.557
Banks that shares its profit with its employees in terms of issuing bonuses increases its productivity since staff feel to be part of the business	4.77	0.422

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### 4.7.3 Extent to which Labour Productivity determines Bank Profitability

Table 4.21 shows results of the findings on the extent to which labour productivity determines bank profitability. From the findings, (65%) of the respondents were of the opinion that labour productivity determines bank profitability to a very great extent, 32% purported that labour productivity determines bank profitability to a great extent while 3% alleged that labour productivity determines bank profitability to a moderate extent.

**Table 4.21 Extent to which Labour Productivity determines Bank Profitability**

<b>Level of agreement</b>	<b>Frequency</b>	<b>Percentage</b>
To a moderate extent	2	3.2
To a great extent	20	32.3
To a very great extent	40	64.5
<b>Total</b>	<b>62</b>	<b>100.0</b>

### 4.8 Profitability in the Banking Industry in Kenya

The researcher requested the respondent to indicate how they would rate profitability in their banks. According to the findings, all (100%) of the respondents were of views that surplus or net profit is extremely good, 94% opined that profitability on return on assets is good while 6% opined otherwise. On turnover, 61% respondents opined that its good while 39% were of the views that profitability on turnover is performing poorly.

**Table 4.22 Rating of Profitability**

<b>Profitability</b>	<b>Good</b>	<b>Poor</b>	<b>Good</b>	<b>Poor</b>
Turnover	38	24	61%	39%
Surplus Or Net Profit	62	0	100%	0%
Return on Assets	58	4	94%	6%

#### 4.9 How Profitability in the Banking Industry relates with Bank Ownership, Bank Size, state of IT and Labour Productivity

To establish the relationship between the independent variables and the dependent variable the study conducted coefficient of correlation of variables, multiple regression and coefficient of determination of variables analysis.

##### 4.9.1 Coefficient of Correlation of Independent Variables with Bank profitability

In trying to show the relationship between the study variables and their findings the study used the Karl Pearson's coefficient of correlation ( $r$ ). According to the findings as indicated in table 4.23, it was clear that there was a positive correlation between bank profitability and firm ownership as shown by a correlation value of 0.521, it was also clear that there was a positive correlation between bank profitability and bank size with a correlation value of 0.618, there was also a positive correlation between bank profitability and state of IT with a correlation value of 0.587 and a positive correlation between bank profitability and labour productivity with a correlation value of 0.553. This shows that there was a positive correlation between bank profitability and firm ownership, bank size, state of IT and labour productivity.

**Table 4.23 Coefficient of Correlation of Variables**

Variables		Bank Profitability	Firm ownership	Bank Size	Information Technology	Labour productivity
<b>Bank Profitability</b>	Pearson Correlation	1				
	Sig. (2-tailed)					
<b>Firm ownership</b>	Pearson Correlation	.5210	1			
	Sig. (2-tailed)	.0032				
<b>Bank Size</b>	Pearson Correlation	.6180	.3421	1		
	Sig. (2-tailed)	.0021	.0014			
<b>Information Technology</b>	Pearson Correlation	.5870	.1240	.0621	1	
	Sig. (2-tailed)	.0043	.0120	.0043		
<b>Labour productivity</b>	Pearson Correlation	.5530	.3420	.0000	.1660	1
	Sig. (2-tailed)	.0172	.0031	1.000	.0031	

The researcher further conducted a multiple regression analysis so as to identify the determinant of profitability within banking industry Kenya. The main purpose of multiple regressions is to learn more about the relationship between several independent or predictor variables and a dependent variable. The researcher applied the statistical package for social sciences (SPSS) to code, enter and compute the measurements of the multiple regressions for the study. As per the SPSS generated table 4.24, the equation

$$(Y = \beta_0 + \beta_1X_1 + \beta_2X_2 + \beta_3X_3 + \beta_4X_4 + \varepsilon) \text{ becomes:}$$

$$Y = 1.279 + 0.510X_1 + 0.613X_2 + 0.525X_3 + 0.531X_4 + 0$$

The regression equation above has established that taking all factors into account (firm ownership, bank size, state of IT and labour productivity) constant at zero, profitability among commercial banks in Kenya will be 1.279. The findings presented also shows that taking all other independent variables at zero, a unit increase in firm ownership will lead to a 0.510 increase in bank profitability; a unit increase in bank size will lead to a 0.613 increase in bank profitability; a unit increase in state of IT will lead to a 0.525 increase in bank profitability and a unit increase in labour productivity will lead to a 0.531 increase in bank profitability as shown in table 4.24. This infers that bank size determine bank profitability to a great extent followed by labour productivity then state of IT while firm ownership determine the little to bank profitability within commercial bank.

**Table 4.24 Regression Coefficients of Variables**

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	$\beta$	Std. Error	Beta		
<b>Constant/Y Intercept</b>	1.279	1.316		1.451	0.357
<b>Firm Ownership</b>	0.510	0.310	0.172	4.242	0.0276
<b>Bank Size</b>	0.613	0.322	0.067	3.452	0.0202
<b>State of IT</b>	0.525	0.156	0.210	3.382	0.0285
<b>Labour productivity</b>	0.531	0.245	0.148	3.358	0.0249

#### 4.9.2 Coefficient of Determination of Variables

The coefficient of determination was carried out to measure how well the statistical model was likely to predict future outcomes. The coefficient of determination, ( $r^2$ ) is the square of the sample correlation coefficient between outcomes and predicted values. As such it explains the contribution of the four independent variables (firm ownership, bank size, state of IT and labour productivity) to the dependent variable (profitability in the banking industry in Kenya). Of the four independent variables that were studied, they contribute 55.1% of the bank profitability as represented by the adjusted ( $r^2$ ) as shown on table 4.25. This therefore means that other factors not studied in this research (intervening variables) contribute 44.9% of bank profitability in Kenya. Therefore, further research should be conducted to investigate the other factors not under the study but also determines bank profitability.

**Table 4.25 Model Summary**

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<b>Model</b>	<b>r</b>	<b><math>r^2</math></b>	<b>Adjusted <math>r^2</math></b>	<b>Std. Error of the Estimate</b>
1	0.742	0.551	0.641	0.0438

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## **CHAPTER FIVE**

### **SUMMARY OF FINDINGS, DISCUSSIONS, CONCLUSIONS AND RECOMMENDATIONS**

#### **5.1 Introduction**

This chapter provides the summary of the findings, the discussions, the conclusions and recommendations of the study based on the objectives of the study. The chapter also presents the suggestions for further studies.

#### **5.2 Summary of the Findings**

On firm ownership, the study established that concentration of firm ownership determine bank profitability as indicated by 79% of the respondents. The study established that locally owned banks are more profitable than foreign owned banks as shown by mean score of 4.13. Additionally, the study noted that bank with owned premises accrue more profit than bank with rented premises as depicted by mean score of 3.97. Likewise, private owned banks are more profitable and that they accrues more profit than their public owned counterparts as illustrated by mean score of 3.50. Inclusively, the study established that ownership concentration influence profitability of the bank to a great extent as pointed by 50% of the interviewed respondents.

On bank size variable, the study established that most banks have more than 61 branches as depicted by 68% of interviewed respondents hence confirmed that number of branches determines bank profitability. On the same, the study noted that banks with diverse products and services, superior products and services experience more profits and that banks with high value of assets accrue more profits as depicted by mean scores of 4.55, 4.52 and 4.45 respectively. Likewise the study revealed that banks that operates for longer hours in a day make more profits than banks that operate for less hours, banks with increased investment accrue high profits and that banks with few managers and more operators are more efficient hence more profitable than banks with many managers and few operators as illustrated by mean score of 4.26, 4.23, 4.16 and 3.16 respectively. Additionally, the survey

revealed that bank size influence bank profitability to very great extent as indicated by 42% of the respondents.

On the state of Information Technology variable, the study revealed that all banks embrace creativity and innovation and therefore the state of its Information Technology is one factor that determines their profitability. It also showed that application of IT ease the process and procedure of banking. Likewise, the study illustrated that banks that embrace technology have speedy operation enabling more productivity and that banks that become highly ICT based due to their inter-sectoral linkages, appears to be reaping most of the benefits of revolution in technology as indicated by the mean score of 4.95 and 4.81 respectively. On the same, the study revealed that IT influences bank profitability to a very great extent as depicted by mean score of 74% of the respondents.

On labour productivity, the study noted that its a major influence of bank profitability as revealed by the respondents. Majority of respondents revealed that labour productivity in their bank was good as shown by 93% of the interviewed respondents. Further, the study revealed that banks that promotes their staff on merits encourages hard work hence increased productivity, banks with adequate staff training and induction increases competency and efficiency in their production, banks that shares their profit with their employees in terms of issuing bonuses increases their productivity since staff feel being part of the business, banks with adequate talented staffs are more innovative and productive hence makes high profits, banks that appraises the performance of their staff in a more objective manner develop a culture for their employees to achieve and exceed on their targets hence increase their productivity, banks with better employee engagement are able to deal with employees problems faster and less costly, employees of a banks that receive appropriate remuneration are more productive and that presence of incentives and rewards in our bank promotes motivation to improve productivity and hence increase profitability as depicted by mean score of 4.87, 4.82, 4.77, 4.66, 4.61, 4.60, 4.58 and 4.53 respectively. On the same the study revealed that 65% of the respondents feel that labour productivity determines banks profitability to a very great extent.

Finally, the study established that surplus or net profit was extremely good in most of the banks as indicated by (100%) of the respondents. 41% opined that profitability on return on assets is good while 61% of the interviewed respondents opined turnover as good.

### **5.3 Discussion of the Findings**

The study sought to establish the extent to which bank ownership determines profitability in the banking industry in Kenya, to examine the extent to which bank size determines profitability in the banking industry in Kenya, to assess the extent to which state of information technology determines profitability in the banking industry in Kenya and to establish the extent to which labour productivity determines profitability in the banking industry in Kenya.

On ownership, the study established that majority (79%) of the respondents were of the opinion that ownership of the bank determines bank profitability. Claessens *et al.* (1997) identifies strong positive relationships between ownership concentration (top five investors' shares as a percentage of total shares outstanding) and firm management/profitability/market value. They explain that concentrated ownership gives the owners better incentives to monitor firms and make necessary changes in management. Further, most of the respondents agreed that locally owned banks are more profitable than foreign owned and that banks with few guarantors accrue more profit than banks with more guarantors, this findings concurred with Sathye (2001) that foreign banks are proved to be less profitable than domestic banks. Also respondents agreed that banks with owned premises accrue more profit than banks with rented premises. Finally, the study found that bank ownership influence its profitability to a great extent the finding concurred with Kyj & Isik (2008) on the analysis of service characteristics and ownership focusing to pure domestic owned bank and pure foreign bank, they suggests that pure foreign ownership are more efficient in standalone basis.

To bank size, most (68%) of the respondents' indicated that their bank have more than 61 branches, this findings tallied with Smirlock (1985) that the effect of a growing size on bank profitability is significantly positive to a large extent. Further, 69% of the respondents indicated that numbers of bank branches determine its profitability. The finding colluded with Berger *et al.*, (2000) concurred with the preceding arguments on the effect of

size on bank profitability overlap with the idea that large banks can benefit from economies of scale. However, some researchers suggest that little cost saving can be achieved by increasing the size of a banking firm. The findings concurs with empirical evidence from Athanoglou *et al.* (2005) shows that labour productivity growth, which can only be achieved if the bank is large in its size, has a positive and significant effect on bank profitability. Also, respondents agreed that banks with diverse products and services experience more profits, superior products and services influence banks profitability and that banks with high value of assets accrue more profits. Finally, 42% of the respondents opined that bank size determines bank profitability to very great extent. Kwan and Eisenbeis (2005) suggest that the difference in profitability among large and small banks is due to production technologies and outputs, which varies across them.

Further, on state of Information Technology, anonymously (100%) indicted that the banks that embraced creativity and innovation through application of IT is a major factor that determines its profitability. Also (100%) of the respondents indicated that application of IT eases the process and procedure of banking. These finding concurred with Woherem (2000) finding that today's business environment is very dynamic and experiences rapid changes as a result of creativity, innovation, technological changes, increased awareness and demands from customers. Further, most of the respondents strongly agreed that banks that embrace technology have speedy operation enabling more productivity. The role of ICT in the banking sector became of interest due to the significant role it plays in the economy by stimulating economic growth through the intermediation of funds to economic agents that need them for productive activities (Ojo, 2007). Finally, respondent strongly agreed that their banks are becoming highly ICT based due to their inter-sectoral linkages that appears to be reaping most of the benefits of revolution in technology. Further respondents strongly agreed that ICT revolution in terms of innovation increases speedy operation and therefore reduce cost per unit in production, and this has led a good number of banks to embrace the use of ICT infrastructure in their operations that improves efficiency while (74%) of the respondents' purported that state of IT influences bank profitability to a very great extent. The study finding correspond to Akinuli (1999) finding that the banking business is becoming highly ICT based due to its inter-sectoral link; it appears to be reaping most of the

benefits of revolution in technology, as can be seen by its application to almost all areas of its activities.

On labour productivity, all (100%) of the respondents pointed that labour productivity influences bank profitability. Further, majority (93%) of the respondents were of the opinion that labour productivity in their bank was good. These findings corresponded to Alan (2000) that the critical parameters of determining profitability of any business organization are workforce productivity and effective workforce management. For a vast majority of businesses, the single largest cost of doing business is their workforce and thus, workforce productivity and effective workforce management can improve the return on the organization's largest single asset, its workforce. Finally, most of the respondents strongly agreed that banks that promotes its staff on merits encourages hard work hence increased productivity, banks with adequate staff training and induction increases competency and efficiency in its production, banks that shares its profit with its employees in terms of issuing bonuses increases its productivity since staff feel being part of the business, banks with adequate talented staffs are more innovative and productive hence makes high profits, banks that appraises the performance of its staff in a more objective manner develop a culture for its employees to achieve and exceed on their targets hence increase their productivity. These findings agreed with Brech (2000) that the dynamics of the marketplace and the shortage of talent further imply that attraction and retention of talent is more important to increase organizational productivity. Also Olukole (2003) pointed that organizational process, workforce planning involves proactive planning of talent to ensure that the organization is adequately staffed for optimal organizational productivity. In its business partner role, it is important for Human Resource (HR) professionals to fully understand business cycles and how to align the talent pipeline with the business needs. Further, (65%) of the respondents were of the opinion that labour productivity determines bank profitability to a very great extent. According to Banjoko (2000) HR leaders are increasingly working and taking aspects of labour productivity along with business and going beyond the administrative second fiddle with routine chores of recruitment, performance appraisals and payroll hence effective organization performance.

## 5.4 Conclusion

The study set out to establish the determinants of profitability in the banking industry in Kenya with focus to commercial banks listed on Nairobi Stock Exchange. From the study findings, the study concludes that there is positive relation between bank ownership and bank profitability. It was clear from the study that locally owned banks is more profitable than foreign owned banks and that bank with few guarantors accrues more profit than banks with more guarantors. Additionally, the study concluded that banks with owned premises accrue more profits than banks with rented premises and that private owned banks are more profitable and that it accrues more profits than their public owned counter parts.

The study also sought to assess whether bank size determines its profitability and it deduced from the findings that bank size determines banks profitability. The study also concluded that banks with diverse products and services, superior products and services accrues high profitability and that banks with high value of assets accrue more profits. Further, the study concluded that banks that operates for longer hours in a day make more profits than banks that operate for less hours, banks with increased investment accrue more profits and that banks with few managers supervising several operators are more efficient hence more profitable.

The study examined how state of Information Technology determines bank profitability. From the findings the study concluded that banks that have embraced creativity and innovation in the state of its Information Technology determines its profitability and that application of IT ease the process and procedure of banking. Likewise, the study concluded that banks that embrace technology have speedy operation enabling more productivity and that banks that become highly ICT based as a result of its inter-sectoral link appears to be reaping most of the benefits of revolution in technology.

To determine the extent to which labour productivity determine profitability, the study concluded that productivity influences bank profitability and that labour productivity in most of the banks was good as a result of emphasizes given to it. Further, the study concluded that banks that promotes its staff on merits encourages hard work hence increased

productivity, banks with adequate staff training and induction increases competency and efficiency in its production, banks that shares its profit with its employees in terms of issuing bonuses increases its productivity since staff feel to be part of that business, banks with adequate talented staffs are more innovative and productive hence makes high profits, banks that appraises the performance of its staff in a more objective manner develop a culture for its employees to achieve and exceed on their targets hence increase their productivity. Banks with better employee engagement are able to deal with employees problems faster and less costly, employees that receive appropriate remuneration are more productive and that presence of incentives and rewards in a bank promotes motivation to improve productivity.

On profitability measures, the study revealed that surplus or net profit was extremely good in most of the banks while return on assets and turnover was good.

### **5.5 Recommendation**

Looking forward toward the realization of the economic pillar of Kenya's Vision 2030 demands that, the financial institution focus on making high profits in order to eliminate social problems facing Kenyan citizens today, control emerging and endemic financial problems such as unbanked populations through reaching to remote areas and other potential areas. Having investigated determinants of profitability in the banking industry in Kenya with focus to commercial banks listed on Nairobi Stock Exchange, the following recommendations are made.

On bank ownership, the study recommends that there is a dire need of involving the bank owners, bank management and other stakeholders for the welfare of the bank in order to mitigate perception that banks are for a certain class in society or community. This can be done through sensitizing prospective clients about ownership composition, management profiles and make the strategic plans public thereby win the trust of everyone hence increase profitability of the banks. Also the study recommends that CBK and other governing authority such as association of banks should come up with policies that guide financial institutions at large to make certain decision when coming up with their management structure that will depict the needs of the clients without any discrimination.

On bank size, the study recommended that banks should consider opening new branches on the untapped potential areas for them to make high profits by increasing their customer base, opening of more branches and ATM centers as such will enhance their profitability capacity. Banks with more branches and interior access to the unbanked or marginalized areas will realize high profits hence banks should not ignore the concept of enlarging their market size thereby boosting their profitability.

On state of Information Technology, the study recommended that due to globalization and technological innovation that the modern businesses are operating in, banks should not be exempted from this innovation since its one of the major drivers of profitability within organizations. Likewise the study recommended that organization and management should embrace IT and accept their operation to be done through technological adoption in order to improve their service delivery through a quality and quick process.

On labour productivity, the study recommended that employees should be motivated in their working both intrinsic and extrinsic in order to enhance their working attitude for the benefit of the organization. Also the study recommended that staff leave and other fringe benefits of the employees should be recognized in order to create positive attitude towards work as well as creating space for employees to be innovative thereby improving their productivity level hence increase bank profitability.

## **5.6 Suggestion for Further Studies**

The study has explored determinants of profitability in the banking industry in Kenya with focus to commercial banks listed on Nairobi Stock Exchange. The banking sector in Kenya however is comprised of various other financial institutions which differ in their way of management and have different settings all together. This warrants the need for other studies which would ensure generalization of the study findings for all the financial institutions in Kenya and hence pave way for new policies. The study therefore recommends other studies be done with an aim to investigate determinants of profitability in the banking industry in Kenya in other banking institution other than those listed in NSE in order to give a general result that depict real situation in the banking sector.

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## APPENDICES

### Appendix I: Letter of Transmittal

Fredrick Macharia Maina  
P O Box 70380 00400  
Nairobi.

17<sup>th</sup> June 2013

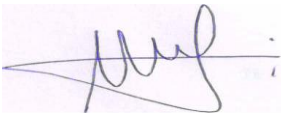
Dear Sir/Madam

**RE: DETERMINANTS OF PROFITABILITY IN THE BANKING INDUSTRY IN KENYA.**

I am a Master of Arts student at the University of Nairobi and in my final year of study. As part of the requirement for the award of the degree of Master of Arts in Project Planning and Management, I'm undertaking a research project on "**Determinants of Profitability in the Banking Industry in Kenya: A Case of Commercial Banks Listed on Nairobi Stock Exchange**". In this regard, I'm kindly requesting for your support in terms of time, and by responding to the attached questionnaire. Your accuracy and candid response will be critical in ensuring objective research.

It will not be necessary to write your name on this questionnaire and for your comfort, all information received will be treated in strict confidence. In addition, the findings of the study will surely be used for academic research purposes and to enhance knowledge in the field of Banking. Thank you for your valuable time on this.

**Yours faithfully**



**Fredrick Macharia Maina.**  
**University of Nairobi**

**Appendix II: Letter of Authorization**



**UNIVERSITY OF NAIROBI**  
COLLEGE OF EDUCATION AND EXTERNAL STUDIES  
SCHOOL OF CONTINUING AND DISTANCE EDUCATION  
**DEPARTMENT OF EXTRA-MURAL STUDIES**  
NAIROBI EXTRA-MURAL CENTRE

**Your Ref:**

**Main Campus  
Gandhi Wing, Ground  
Floor P.O. Box 30197  
NAIROBI**

**Our Ref:**

**Telephone: 318262 Ext. 120**

**UON/CEES/INEMC/15/433**

**17<sup>th</sup> June 2013**

**TO WHOM IT MAY CONCERN**

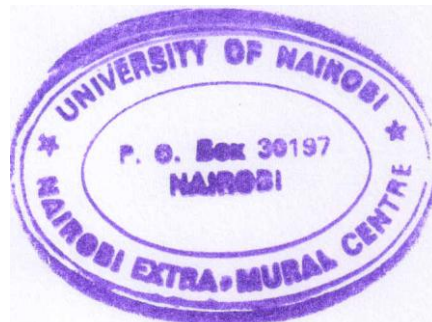
**RE: MAINA FREDRICK MACHARIA - REG. NO. L50/67241/2011**

This is to confirm that the above named is a student at the University of Nairobi College of Education and External Studies, School of Continuing and Distance Education, Department of Extra- Mural Studies pursuing Master of Arts in Project Planning and Management.

He is proceeding for research entitled “**determinants of profitability in the banking industry in Kenya. A case of commercial banks listed on Nairobi Stock Exchange**”

Any assistance given to him will be appreciated.

**CAREN AWILLY**  
**CENTRE ORGANIZER**  
**NAIROBI EXTRA-MURAL CENTRE**



**Appendix III: Questionnaire for the banking staff**

**DETERMINANTS OF PROFITABILITY IN THE BANKING INDUSTRY IN KENYA: A CASE OF COMMERCIAL BANKS LISTED ON NAIROBI STOCK EXCHANGE**

Am studying Master of Project Planning and Management program at University of Nairobi and I have designed the following questionnaire about the above topic. Kindly and humbly answer all the questions to the best of your knowledge. Indicate with a tick or filling in the space(s) provided.

**SECTION A: GENERAL INFORMATION**

1) Name of your Bank .....

2) Kindly indicate your department

- |                     |     |                |     |
|---------------------|-----|----------------|-----|
| Finance             | [ ] | Human Resource | [ ] |
| Internal Audit (IT) | [ ] | Operations     | [ ] |
| Credit              | [ ] |                |     |

Others (specify) .....

3) Indicate the position that you hold in the Organisation.

- |             |     |                     |     |
|-------------|-----|---------------------|-----|
| Director    | [ ] | Manager             | [ ] |
| Team Leader | [ ] | Departmental Head   | [ ] |
| Supervisor  | [ ] | Technical Personnel | [ ] |

Any other (specify).....

4) How long have you worked in this Bank?

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

5) What is your highest level of education?

- |               |     |          |     |
|---------------|-----|----------|-----|
| Post Graduate | [ ] | Diploma  | [ ] |
| Certificate   | [ ] | Graduate | [ ] |

Any other (specify).....

6) Does your organization consider profitability as an achievement in its operations?

Yes  No

**SECTION B: DETERMINANTS OF BANK PROFITABILITY**

**PART I: Ownership**

1) Do you think ownership of the bank determines its profitability?

Yes  No

2) Indicate your level of agreement to the statement below relating to firm ownership and its influence to the bank profitability. Use a scale of 1-5, where 1- strongly disagree,

2- disagree, 3- neutral, 4- agree, 5- strongly agree.

Statement	1	2	3	4	5
To what extent do you agree that composition of ownership influences our bank profitability					
Bank with many directors accrue less profit than the bank with less number of directors					
Bank with few directors makes decisions fast enabling speedy execution of policies hence more profitable					
Bank with high equity interest accrue more profit compared to bank with less net interest					
Bank with more shareholders has more capital to invest on and therefore more profitable					
Bank with few shareholders pays less divided and hence accrues more profit					
Indicate your level of agreement whether bank with owned premises accrue more profit than bank with rented premises					
Sole owned bank are less profitable due to inadequate capital base					
To what level of agreement do you agree that jointly owned bank are more profitable					

Government owned banks are more profitable due subsidies given to them					
Public owned banks experience less profit due to inadequate accountability					
Private owned banks are more profitable since the owners are involved in all aspects of management					
Locally owned bank are more profitable due to tax waivers they get from the government					
Foreign owned banks are more profitable due to huge sums of cash pumped into them for investments					
Banks with more Guarantors are profitable due to increased capital base.					
Banks with few Guarantors are more profitable since they pay less interest from their loans					
Banks with concentrated ownership show better stock market performance					
Banks with a majority foreign capital are more cost efficient than domestic ones					
Pure foreign ownership banks are more due to high expertise of the leaders that manage them					
Pure domestic ownership banks outperforms pure foreign ownership in technical efficiency					

3) In your own opinion, indicate the extent to which bank ownership determines its profitability?

To a very great extent      [   ]                      To a great extent      [   ]

To a moderate extent      [   ]                      To a low extent      [   ]

To a very low extent      [   ]





- 3) Kindly indicate your level of agreement to the statement aspect of IT and its influence to the bank profitability. Use a scale of 1-5, where 1- strongly disagree, 2- disagree, 3- neutral, 4- agree, 5- strongly agree.

<b>Statement</b>	<b>1</b>	<b>2</b>	<b>3</b>	<b>4</b>	<b>5</b>
Banks which embrace use of Smart Cards results to more profitability					
Use of Telephone Banking increases profitability in the bank					
Use of Electronic Funds Transfer by banks facilitates increased business by customers hence more profit					
Better connectivity between bank branches have reduced cost of operations					
Use of ICT has rendered some employees redundant hence saved some costs					
System security adopted after technological advancement has resulted to bank profitability					
System stability have created more confident to the client hence increase customer base					
Cost of acquiring better IT infrastructure for our bank is the major cause of low profits					
Bank that enhance creativity and Innovation are more efficient hence more profitable					
Banks that embrace technology have speedy operation enabling increased productivity					
IT has broadened the scope of banking practices and changed the nature of banking as well as the competitive environment in which they operate hence profitability					
Banks that have embraced ICT appears to be reaping most of the benefits of revolution in technology					

Banks that have adopted IT has broadened the scope of banking practices and changed the nature of banking as well as the competitive environment in which they operate					
Technological advancement in the banking industry has facilitated payments and creates convenient and non-risky alternatives to cash and cheque for making transactions					
Banks that have adopted ICT revolution in terms of innovation have benefited from speedy operation and reduced cost per unit hence more profits					
Our banks has modified it operation with relation to technological advancement in order to remain viable in the market					
Account opening, customer account mandate and transaction processing and recording have been revolutionized through the use of ICT within our bank hence increased profit					
IT has assisted customers to validate their account numbers, receive instruction on, when and how to receive their cheque books, credit and debit cards					
ICT has made our bank change from the traditional mode of operations to presumably better ways with technological innovation that improves efficiency					
ICT has enhanced accuracy in our banking operation hence eradication of errors and fraud that diminish its profit					



Bank with employees requesting frequent sick offs is less productive					
Banks with few employees overloads its workers leading to minimal productivity					
Bank with adequate staff training and induction increases competency and efficiency in its production					
Inefficient execution of employee growth plans leads to high staff turnover therefore decreasing their productivity					
Bank that promotes its staff on merits encourages hard work hence increased productivity					
Presence of Incentives and rewards in our bank promotes motivation to improve productivity					
Banks that does not reward its best performing employees promotes low morale and productivity					
Bank with poor staff discipline is less productive and accrue losses					
Bank that appraises the performance of its staff in a more objective manner develop a culture for its employees to achieve and exceed on their targets hence increase their productivity					
Employee with huge work load are less efficient and productive hence decreases bank profit					
Bank with adequate talented staffs is more innovative and productive hence makes high profits					
Bank with proactive workforce planning ensures optimum manpower utilization					
Bank with better employee engagement is able to deal with employees problems faster and less costly					
Banks that shares its profit with its employees in terms of issuing bonuses increases its productivity since staff feel to be part of the business					



#### **Appendix IV: List of Banks Listed on NSE**

1. Barclays Bank of Kenya
2. CFC Stanbic Bank
3. Co-operative Bank of Kenya
4. Diamond Trust Bank Kenya
5. Equity Bank
6. Kenya Commercial Bank
7. NIC Bank
8. Standard Chartered Bank (K)