# IMPACT OF TERRORISM IN THE OPERATIONS OF LICENCED FOREIGN BANKS IN KENYA

**BY**

**STELLA KHATENJE SHYAMALA**

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# DECLARATION

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

Signature: .................................... Date.....................................

**STELLA KHATENJE SHYAMALA**

This research project has been submitted for examination with my approval as University supervisor.

Signature: .................................... Date.....................................

**MR. ELIUD O MUDUDA**
**Lecturer,**
**Department of Business Administration,**
**School of Business,**
**University of Nairobi**

## DEDICATION

This work is dedicated to the Almighty God for the wisdom and gift of life that has made me realize and see the conclusion of this research, to my family especially my little girl Martina, M. Idele (RIP) and all those who helped me carry out this research.

## ACKNOWLEDGEMENTS

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To my academic Supervisor, Mr. Eliud Mududa for his great contribution and support offered that enabled this research project to take its present form, without his guidance and persistent help, this research would not have been successfully completed.

## ABSTRACT

Terrorism has proved to be one of the most difficult problems to deal with by the entire world, it affects a countries ability to attract and sustain business development and investment thus affecting its economy and the fight for eradicating poverty. Terrorism shows a long term disruption trend, among the most hit sectors is the world economy. Most of the big banks in Kenya are foreign and hence become an easy target for terrorist. The objective of this study was to establish the impact of terrorism in the operations of licensed foreign banks in Kenya. This study adopted a descriptive cross-sectional survey design because it allows for generalization of findings within a particular parameter. The 7 banks with operating licenses sufficed as the target population for this study and the study collected both primary and secondary data where primary data was collected using a semi structured questionnaire then were coded and analyzed using SPSS. The study found out that terrorism activities witnessed in the Country drove the cost of insurance for the licensed and foreign banks in Kenya up. This made operational costs increase thus diluting the operating profits and that terrorism activities reduced the scope of insurance covers for commercial banks. The influence that terrorism had on the operations of Licensed Foreign Banks led to duplication of roles for the sake of creating a back-up team, increased operational costs, influenced the compliance costs and increased the level of exposure for licensed foreign banks. The study concludes that terrorism activities reduced the scope of insurance covers and increased the cost of the banks, thus for them to fully cover their risks, they need to pay more and re-negotiate with the insurance industry players and were faced with duplication of roles for the sake of creating backup team so as to ensure continuity in business operations in case of being affected by a terrorism event. The study recommends that regulators could ensure that all banks have in place effective frameworks to identify, assess, monitor, and control or mitigate material operational risks resulting from terrorism as part of the overall approach to risk management and foreign banks themselves could take all necessary steps to ensure their ability to operate on an ongoing basis and limit losses in the event of severe business disruption, through adequate contingency and business continuity plans.

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# ACRONYMS

| | | |
|---|---|---|
| **IMF** | - | International Moentary Fund |
| **GWOT** | - | Global War on Terror |
| **NSE** | - | Nairobi Securities Exchanger |
| **AR** | - | Abnormal Returns |
| **CAR** | - | Cumulative Abnormal Returns |
| **US** | - | United States |
| **R & D** | - | Research and Development |
| **BBC** | - | British Broadcasting Co-orporation |
| **FDI** | - | Foreign Direct Investment |
| **GDP** | - | Gross Domestic Product |

# CHAPTER ONE

# INTRODUCTION

## 1.1 Background of the Study

In the recent years, terrorism has proved to be one of the most difficult problems to deal with by the entire world. The impacts of terrorism are heavily felt in a number of ways by the affected countries, either directly or indirectly. As government tightens security in public places and boarders businesses have become an easy target, the aim of terrorism is to disrupt and destroy ongoing business. It affects a countries ability to attract and sustain business development and investment thus affecting its economy and their fight for eradicating poverty, this takes them few or several steps back from the developments they had made (Berrebi & Klor, 2012) .

One of the critical decisions that international businesses have to make is the choice of which country to enter or invest in. Companies asses the risks they may encounter including political risk which is a major factor that most companies consider in evaluating a country’s risk, political risk is the fear of losses incurred in international business through sudden unexpected changes in the host countries political environment examples include revolutions, social unrest, labour strikes wars or terrorism. The losses can be financial, human, corporate image, intellectual property rights (Berman, Eli & David, 2008).

Terrorism shows a long term disruption trend, among the most hit sectors is the world economy (Azam, 2005). This is through drastic interference of the international business systems. An example of the worst hit areas is the banking industry. Most of the big banks in Kenya are foreign and hence become an easy target for terrorist examples of foreign banks include Standard Chartered Bank, Barclays Bank, PTA bank, and World Bank etc. Kenya has been one of the hardest hit countries with acts of terrorism the recent ones being the Westgate attack, the bus attack in north eastern, the quarry attack and Moi University Garissa Campus attack where there was loss of lives, property, jobs and investor confidence. Kenya having foreign banks operating in the country loss of investor confidence is not good for the banking industry.

### 1.1.1 Concept of International Business

International business includes not only international trade of goods and services but also foreign investment, especially foreign direct investment (Wilkins, 1974). Domestic business involves transactions within the country while international business involves conducting business or transactions outside the country of establishment of the business. No country developed or developing produces goods and services to meet all its requirements it needs to import what it cannot produce or that which seems expensive to produce but cheaper to import and export the excesses it has, an example Kenya exports flowers, tea, coffee etc because it is produced in excess or there is no good market for it locally. At the same time it imports cars which it cannot make, the last time she tried to make a car (Moi car) it never picked up.

An international business operation can be of different form; Exporting goods and services, Giving license to use the property of the licensor (patents or trade mark), starting a joint venture with a foreign company, and Opening a branch for producing & distributing goods in the host country (Subsidiary), turnkey projects (Wortzel and Wortzel, 1981). International business faces several risks, political being one of them and under political risk there's the risk of terrorism.

### 1.1.2 Banking Operations in Kenya

The banking industry in Kenya is regulated by the central bank of Kenya banking act, companies act among other regulations put down by the central bank of Kenya. Central bank of Kenya falls in the ministry of finance. The banks have come together under the Kenya bankers' association which is a lobby for local banking industry, and addresses issues affecting the banking sector. The industry has grown drastically due to increase in deposits ,assets , products, technology and increase in branch networks both locally and in the east Africa region this has led to increase in competition and diversification of products offered hence the tradition banking has taken a back seat. Banks in Kenya are either locally or foreign owned. According to the Central Bank of Kenya annual report of 2014 Kenya had 43 licensed banks and 1 mortgage finance company bank; 31 are locally owned and 13 are foreign owned. The locally owned financial institutions comprise three banks with significant shareholding by the Government of Kenya and State Corporations, 27 commercial banks and one mortgage finance institution, (Housing Finance) are owned by other private institutions and corporations.

According to the framework papers for the project (Spratt 2013; Griffith-Jones and Ewa Karwowski, 2013), opinion on the merits of foreign banks and state-owned banks has shifted considerably since the 2007 to 2008. Foreign banks can have both positive and negative effects. While they can bring valuable skills, technology and capital, they can also bring risks. Evidence from the recent financial crisis shows that countries where foreign banks dominate the market could suffer negative lending shocks, as turmoil in the home markets cause parent banks to withdraw capital from the developing countries where they operate. They can have negative impacts, particularly by bypassing the supply of credit to the less lucrative sections of the country. Foreign bank entry was never a major problem in Kenya; this is because foreign banks have been playing a major role since independence (IMF, 2008). Kenya continues to attract growing international interest from renowned international financial institutions as a preferred base for their regional operations. This brings about great opportunities for the economy of Kenya as part of the increasingly global financial markets.

### 1.1.3 Terrorism in Kenya

Terrorism is the premeditated use or threat to use violence by individuals or sub national groups to obtain a political or social objective through the intimidation of a large audience beyond that of the immediate victims (Enders, 2011). Terrorism has become the defining issue of international politics of the first decade of the 21stcentury. This refers to the calculated use of violence (or the threat of violence) against civilians in order to attain goals that are political or religious or ideological in nature; this is done through intimidation or coercion or instilling fear. International terrorism is practiced in a foreign country by terrorists who are not native to that country. International terrorism Occur primarily outside the territorial jurisdiction of a country or transcend national boundaries in terms of the means by which they are accomplished (Enders& Sandler, 2006).

There are so many forms of terrorism in existence today that it has become somewhat a problem when trying to understand terrorism in its entirety. In today's world the label terrorism is being attached to almost every act of violence or crime and includes; narco –terrorism, cyber-terrorism, pathological terrorism, and issue oriented terrorism, quasi terrorism, and artistic terrorism (Underhill, 2014).Combination of mounting global terrorism, tighter banking regulations and worldwide economic slowdown reduces market access prospects for emerging countries and increases scope of liquidity. Developed and developing countries all face slow growth brought about by terrorism. After 2011 the United States export was reshaped- the rise of international terrorism and the war on terror created a tough political environment. This led to new laws that gave the U.S law enforcement agency and president powers to investigate track down and prosecute anyone aiding terrorists and stop the flow of money to terrorist groups.

Kenya became a major partner in the Global War on Terror (GWOT) in the aftermath of September 11, 2001. Having historically been an ally of the United States, the country's importance was only reiterated following several major incidents in the last two decades. In 1998, the American embassies in Nairobi and Dar es Salaam (Tanzania) were attacked, taking the lives of hundreds and marking a shift in U.S. foreign policy. Most recently, a September, 2013 insurgent attack on the Westgate Shopping Mall in Nairobi made international headlines and took the lives of 67 individuals from nearly a dozen countries around the world, while reiterating the reputation of Kenya as a hub for terrorism, violent extremism, and factionalism.

**1.2 Research Problem**

According to Berrebi and Klor (2012), terrorism has become a major factor in international business environment and determines a lot about a business set and in a country, several studies have been conducted about terrorism in businesses and countries. Terrorism has become a fairly recent global phenomenon which almost every society finds itself exposed to from time to time, hence the need to understand its effect on the banking industry. Suder (2004) established how terrorist attacks have an important impact on the international business environment; she deals with the trends in international terrorism, threat, the evolving geopolitical and geo economic patterns in the pre and post September 11 era and the question to why this matters to the international business environment. she focuses on the forces in the trade and investment environment that alter the understanding of finance, country risk assessment the e divide and investment flows that are crucial to economic and corporate activities. Sanjo and Marcus (2014) carried out a study to examine the effects of terrorism in relation to International Business in Nigeria. They established that there is a significant relationship between terrorism and international businesses.

Among related studies that have been done locally are: Masese (2007) conducted an analysis of the phenomenon of terrorism and Kenya's counter-terrorism strategy, 2000-2007. Masese Established the challenge for the government being to evolve new and better methods of dealing with the vice including increasing its diplomatic engagement, involvement of the public and private sector enhancing the capabilities of the security forces and being proactive in anti-terrorism matters. Keitany (2012) which established the effect of terrorism on Kenyan security market using the case of Nairobi Securities Exchange (NSE). Keitany (2012) elaborates how the stock market plays a critical role in the national economy since it facilitates fundraising activities, trade, investment and economic growth and development. The three main terrorist events studied were the 1998 bombing of the US embassy in Nairobi, the 2002 bombing of Paradise hotel in Kikambala and the 2011 kidnapping of tourists and aid workers. Keitany and Lumumba (2013) examined the effect of terrorism on Kenya's securities market and established that there was significant short term negative stock returns around the terrorist event dates as evidenced by the decline in the NSE 20 share index, abnormal returns (AR) and the cumulative abnormal returns (CAR) around the terrorist event dates. Mwendwa (2014) established the impact of terrorist acts on international business investment decisions by multinational companies operating in Kenya. The study explores direct and indirect effects of terrorism on business investment decisions in order to come up with business continuity plans, business resilience strategies, crisis management programs and disaster planning and recovery measures for the business survival in the event of and after the acts of terrorism.

The foregoing studies were mainly concerned with the tourism sector and the Nairobi stock exchange whereas none has explored how terrorism affects the foreign banks in Kenya. This is the gap this study hopes to seal. This therefore lead to the question: what is the impact of terrorism in the operations of licensed and foreign banks in Kenya?

### 1.4 Research Objectives

The objectives of the study were;

i. To determine the impact of terrorism on foreign banks operations in Kenya
ii. To determine how terrorism influences the operations of licensed foreign banks foreign banks in Kenya

### 1.5 Value of the study

The findings of this study would be important to future scholars and academicians as it will act as an empirical source of literature. The future scholars can refer to this study to inform the development of literature in future studies related to terrorism and organizational performance. The study would further suggest areas for further research where future scholars and researchers can extend knowledge on in the effects of terrorism on organizations.

The findings of this study would further be important to the Government of Kenya through the Central Bank of Kenya in the development of policies and regulations governing the operations of international banks in Kenya. Through the findings of this study, the Government will learn the effects of terrorism activities on performance of foreign owned commercial banks.

The findings of this study would also be valuable to managers in commercial banks especially those that are foreign owned in the development of relevant policies and regulations regarding terrorism activities. It would inform the formulation of policies to survive terrorism activities and ensure safety of their clients.

**1.5 Chapter Summary**

This chapter presented the introduction to the study by clearly discussing the concepts and context of the study. The key concepts discussed included International Business banking operations and terrorism in the context of telecommunications industry. The chapter also presented research problem where the gap to be filled by the study was illustrated both internationally and locally. This was followed by the research objective and value of the study.

# CHAPTER TWO

# LITERATURE REVIEW

## 2.1 Introduction

This chapter introduces the existing literatures reviewed to provide a theoretical ground for the study. It gives a detailed account of the underlying concepts and variables on the impact of terrorism in the operations of licensed and foreign banks in Kenya

## 2.2 Theoretical Framework

This section highlighted some of the existing theories with regards to the impact of terrorism in the operations of licensed foreign banks. The purpose of the section was to examine the quantity of existing theories that have accumulated with regards to the topic under study .

### 2.2.1 Internalization Theory

The internalization theory of multinational firms proposes that direct international investment occurs when a firm has information-related intangible assets with public good properties. Firms with characteristics suggesting the presence of information-based assets experience a significantly positive stock price reaction upon announcing a foreign acquisition. On the other hand, firms apparently lacking such assets experience at best zero abnormal returns upon announcing overseas acquisitions (Morck & Yeung, 1992).

The internalization theory perceives international transactions to be of high risk and requiring extensive management time or resource commitments. Therefore the transfer of goods and services across countries is internalized by means of setting up foreign operations. Internationalization thus occurs because of cost reductions for the company when it internalizes. Savings are possible because the firm selects the optimal locations for its activities by assessing the economic cost of its transactions. Williamson (1975) was among others suggesting this approach which is also known as the transaction cost theory.

Clearly, the internalization theory has more relevance for larger companies. Especially for small INVs the capital requirements of setting up foreign operations are simply too high. McCauley (1999) Also the transaction cost approach does not explain internationalization activities of INVs that have little to do with reducing costs, but are directed towards other strategic objectives (Bloodgood, 1996). Occasionally, decisions to set up a foreign subsidiary were driven by the aim to achieve proximity to the customer or industry-leading clusters despite the resulting considerable cost increases (McDougall, 1994). Lastly, it has been observed that an increased commitment to foreign markets manifested itself in the expansion towards new markets rather than by increasing FDI in the established markets (Bell, 1995). Nevertheless the internalization theory has been applied to examine the relative costs and benefits of collaboration (Shrader, 2001).

When the transaction costs of collaboration are relatively high, then internalization occurs. However, firms that forgo collaboration also face costs of internalization such as additional payroll and equipment. Especially international new ventures may also miss opportunities to move into foreign markets if they do not leverage the resources of collaboration partners. Shrader (2001) found evidence supporting one of the original claims of the transaction cost theory that it is difficult and costly to transfer technological advantages to partners. Therefore ventures investing heavily in research and development (R&D) should use internalization rather than collaboration.

## 2.3 Extent of Terrorism

Many countries have been affected by the terrorism menace making it a global issue, big countries like the united states has also fallen victim to this and hence it is a crisis that needs to dealt with. Scott Stewart, Evolution and Trends in Terrorism Tradecraft (2012) explain that terrorism is constantly evolving and adapting due to countermeasures against terrorism, technology and target sets. The article asserts that Terrorism is an enduring reality. Scott predicts that increased security efforts involving international travel and advances in identification technologies will force terrorist to search for "clean skin" operatives; individuals who are unknown to security services and who have the ability to travel using legitimate documents or who do not need to travel due to being "in place" in the target area due to their citizenship or nationality. Efforts at impeding or freezing terrorist funding is forcing terrorist to the sale of narcotics and other criminal activity. This has also lead to a teaming of efforts between terrorist and Transnational Organized Crime. In light of these factors, the author predicts that future terrorist attacks will be more locally focused or committed by clean skin terrorist. The author also opines that a transition to soft targets may mean an increase in targeting of hotels, business and diplomatic missions. Evolution and Trends in Terrorism Tradecraft provides support to this research project proposal. This has proved to be true with the current attacks on Kenyan soil being carried out by Kenya citizen recruited in the al-Shabaab group, many parents have come forward claiming that their children are missing only to find then killed because they were trying or they carried out a terrorist attack .

Kenya is the regional powerhouse of the greater horn of Africa, is also the most stable and reliable democracy in the area. The role it plays in the fight against terrorism in eastern Africa and the horn is crucial in helping to reduce and eliminate terrorist threat and assisting broader United States and western antiterrorism efforts in both regions. Kenya is the economic, transportation and financial hub for East Africa, the greater Horn of Africa and the great lakes region. Kenya has felt the devastating effects of international terrorist attacks (Rotberg & foundation, 2005) in past few months many attacks have perpetrated against Kenya ,the Westgate attack mall and several attacks in Garissa where they have gone to an extend of attacking education institutions(Garissa university)

### 2.4 Impact of Terrorism on Banks Operations

There are several environmental factors that attribute to the smooth running of business. Pandey (2006) argue for a different approach to the entire matter of the terrorism environment. They feel inappropriate to begin by creating a taxonomy of different types of terrorism they suggest instead drawing up a list of factors that might predispose a society to terrorism e.g. lack of capacity of govern either due to self restraint of inadequate technical efficiency, accelerated change, destabilisation of value system and only then examining whether different sets of environmental conditions are correlated with different kinds of terrorism. No generalisation can be made with regard to the influence of environmental factors on terrorism. Many types of factors which constitute terrorism environmental and therefore affect the phenomenon were mentioned; economical, historical, cultural, ethnic, technological, geographical, demographic, psychological, political etc. No single factor can be identified as universal cause of terrorism or even as universal precipitating factor.

In reaction to the attacks, the insurance industry raised its premiums, reduced coverage and called on governments to step in and cover risks deemed too large for the private sector. Indeed, risks related to terrorism are difficult to price, not least because of the possibility that several catastrophic events occur at once (correlated risk). However, private sector initiatives specifically tailored to provide insurance for this type of risk are emerging. Market-based instruments, such as catastrophe bonds, are also available, although they are at present not actively traded. Private sector coverage of some types of terrorism risk may therefore be restored in the future. Government intervention to fill the gap in the meantime should be considered with caution and limited in time and scope. Mega-terrorism risk poses special challenges that cannot be fully addressed by the private sector and may require international action.

The impact of post 09/11 terrorism on the trade and investment environment .the macro level of consequences resulting from terrorism reflect that the September 11 2001 terrorist attack coupled the Afghan and Iraqi pre- emptive wars coincide with a major and probably long lasting re-assessment of a country's risk in international business. The combination of mounting global terrorism, tighter banking regulations and worldwide economic slowdown reduces market access prospects for emerging countries and increase scope of liquidity difficulties. Foreign direct investment flows have shrunk since their peak of 200 and trade tensions are mounting between Europe North America, Japan and the emerging market countries (Suder, 2004).With very many economies being affected by the effects of terrorism many businesses are affected as well, it becomes difficult to have expatriates who will agree to go to that country to work there for fear of their lives. Global terrorism has become an emerging issue in the training and development of expatriates in international human resource management.

Trade between nations is affected, an example is the war torn Somalia where many terrorist activities happen and are trained, currently there is no country or very few countries continue trading with her hence her people are affected. Economic imbalance also contributes to terrorism. In their analysis of terrorism in Africa, Campbell and Flournoy (2001) acknowledge the roles marginalization and poverty play among the Muslims that invite sectarian and inter-ethnic strife, despair, and anti-Western resentment. They also note the emergence of Islamic agencies, funded by Saudi and other Persian Gulf states and individuals, which are addressing the social 18 problems of Muslim communities while sowing seeds of discord and anti-Western sentiment and recruiting and providing safe havens for terrorist organizations. Since the Westgate mall attack many banks were affected in that they had branches and staff working there on that day and when it happened there was loss of property lives and even some people are still traumatised to date. This reduced investor confidence and even currently the Kenya shilling is very weak and economists predict that if the government doesn’t intervene it will continue to decline. This affects the business and inflation rate goes very high which means that most house hold cannot literally afford the basic needs. Since the country’s economy is affected so does the banking industry too.

Different types of terrorism have been identified and defined by lawmakers, security professionals and scholars. According Zalman (2014) types of terrorism she states that types differ according to the attack agent the attackers’ use. The researcher implores that state terrorism is where by states have and can be terrorist in that they use force or threat of force, without declaring war so as to terrorize citizens and achieve their political goal. This on its own affects the running of businesses in that area because most of them remain closed.

She further explains that the other form of terrorism is the eco-terrorism where environmental extremists sabotage property to inflict economic damage on industries while cyber terrorists use information technology to attack civilians and draw attention to their cause, by use of computer systems or telecommunications as a tool to attack. Cyber terrorists disable networked emergency systems or hack into networks housing critical financial information .The most affected by such terrorist activities is the banking industry and finally Narcoterorism is where terrorist groups use drug trafficking to fund their other operations and all this funds pass through banks, these are the types that relate to this study in one way or the other.

## 2.5 How Terrorism influences the Operations of Foreign Banks in Kenya

Studies at bank level tend to confirm the important role of the institutional environment. Demirguc et al (2004) find a strong link between institutional characteristics such as economic freedom, property rights protection and country legal governance, on bank net interest margin. Qian and Strahan (2007) show that strong creditor protection results in loans with higher concentration of ownership, longer maturities, lower interest rates and increase participation of foreign banks. Lensink et al (2008) conclude that well developed institutions are important for the efficient operations of foreign bank**.** According to the World Bank worldwide governance indicators, political stability and absence of violence/terrorism reflects perception of the likelihood that the government will be destabilised or overthrown by unconstitutional or violent means, including politically motivated violence and terrorism (Pasiouras, 2012).

Kenya remains a potentially prime goal for terrorists in its own right. It has substantial Western tourist bustle, the head office of the United Nations Environment Program and the United Nations Habitat Program, an outsized number of Western embassies and several international businesses. Kenya suffered dreadful impact in casualties and destruction of business and property in the bombing of the American embassy in 1998. That act and the 2002 attack on Israeli facilities in Mombasa, exposed the extent of terrorist cells operating in Kenya, 2012 Al-shabaab attacks, 2013 Westgate mall shooting and the 2015 Garissa attack (Rothchild, 2006) with such a track record Kenya stands a chance of losing foreign investment for fear of insecurity in the region.

The foreign banking industry is particularly affected because most the non Governmental organisations have accounts in these banks for ease of transfer of money from their foreign counter parts also most of the expatriates open their accounts in this banks because they know them from home where the bank has branches or are incorporated. If a country is constantly hit by terrorist attacks the foreign banks find it difficult to operate because most of their major customers close their accounts to flee back home and also some of their employees are not locals and hence they have to think of their security with such interferences normal work cannot be conducted because of the stress attached to it. The personnel decisions intended to mitigate the risk of terrorism often impose some unintended, long-term costs. Terrorism causes global managers to consider carefully the use of expatriates in foreign assignments (Ryans and Shanklin, 1980).

Barclays Bank plc and Standard Chartered Bank plc were fined millions of dollars for not putting in place mitigating factors on anti money laundering and terrorist financing. According to BBC news In 2014 Standard chartered agreed to pay 300m dollars to New York banking regulator because it failed to fix problems identified in 2012 this affected all the regions that the bank operates in because the misgiving of one country office  affects all. Barclay's bank South Africa was fines 30m Rand for Anti-money laundering hence this affected the office in Kenya. The non compliance to this makes the banks to face the risk of not being allowed to use the Dollar to trade or transact and it is the commonly used currency across all markets. It is believed that if a banking institution does not adhere to the antimoney laundering and terrorist financing then it could be aiding the terrorist to transfer money to their counterparts, hence this rule was put in place to frustrate terrorists and money launderer's activities. The banks have a software called Norkom that has all details for those drug traffickers and money launderers known worldwide, whereby before an account is opened the names are run through that software; if one is a drug trafficker an alert is triggered and details for the alert displayed and hence the account will not be opened if there is no trigger the account will be opened (Robinson, 1998).

When the banking systems get hacked millions get lost and hence banks have invested heavily in security. Their servers are very well secured. the only attack the cyber terrorists have managed to hack is stealing from customers through online banking where they create a phishing link and send it to random emails , once one access the link all their information is phished and their accounts hacked into and money transferred. Masese (2007) opine that another way still related to banking fraud is use of credit and debit card, in the past few years Barclays bank and standard chartered were highly hit with card scheming fraud where customers` cards were cloned and the perpetrators had access to their pins and money was stolen. In such a case the banks lose out on money because they have to refund the customers their money since their systems security had been hacked. Many people believe that foreign banks are for high end customers and that's why they fall as easy target for terrorist attack. It becomes difficult for other investors to invest since they are afraid that they too may fall victims (Keitany & Lumumba, 2013).

International firms may be able to discourage terrorist attack by maintaining an impeccable environmental and human rights record within their areas of operations (The Economist, 2000). If this is carried out in Kenya the banking environment especially for foreign banks will be good and hence attract many others to come and invest and hence boosting the Kenyan economy. If only governments would react appropriately so as to restore investor confidence as Baily puts it. The right response reactions especially through economic policy are critical to restore confidence into the economy and thus minimize the negative economic impacts of a terror attack (Baily, 2001)

The government must be involved in dealing with terrorism so as to put confidence in its citizen. All aspects of the anti-terrorist policy and operations should be under the overall control of the civil authorities and, hence, democratically accountable. Special powers, which may become necessary to deal with a terrorist emergency, should be approved by the legislature only for a fixed and limited period. The Balance of Terror (1998) Education is the key to end terrorism this is because young people are forced to join anti-social elements. If people are given education the trend towards terrorism will be reduced, Education reduces poverty levels and joblessness and hence peoples' minds are pre-occupied with more important things than being recruited in terrorists groups. Standard Chartered bank has started a financial literacy program where they train organisations and institutions about financial issues and how to plan. If this program is effective it will help to reduce misspending and more people will be empowered about saving.

## 2.6 Conceptual Framework

The study illustrated this framework so as to provide a quick preview of the study whereby the independent variables inclusive of indicators and the dependent variables are shown.

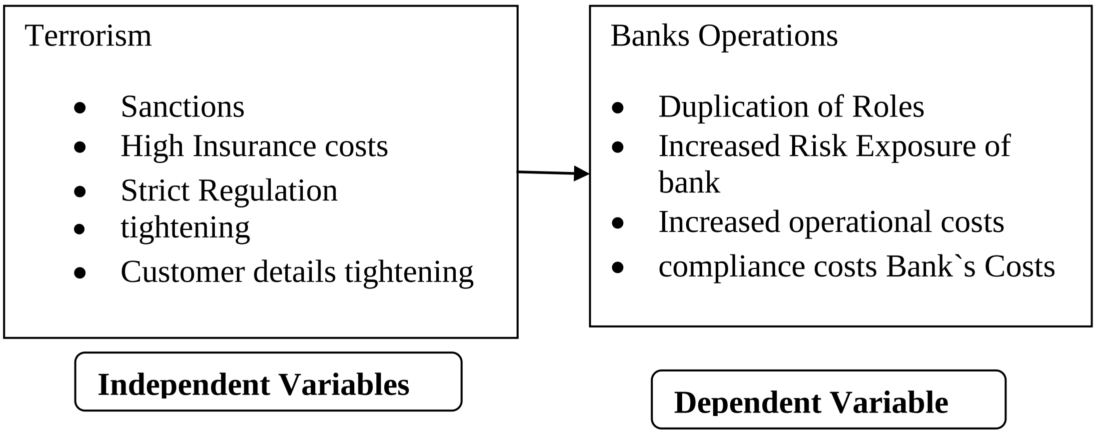


**Figure 2. 1: Conceptual Framework**

## 2.7 Empirical Studies

Several studies have been conducted on the impact of terrorism activities on businesses. For instance, Bilal, Talib, Haq, Khan and Islam (2012) examined how terrorism and macroeconomic factors impact on returns using a case study of Karachi Stock Exchange using daily basis data for Terrorism and monthly basis data for macro-economic factors from 1st July 2005 to 31st June 2010. Various statistical techniques were used including unit root Augmented Dickey Fuller test, Phillip Perron, Johansen's co-integration, Granger's causality test, ARCH, GARCH and GARCH-EVT. Findings revealed co-integration between macroeconomic factors and KSE stock returns which demonstrated that largest equity market of Pakistan KSE-100 Index had negative relationship with terrorism and causal relationship with interest rate; whereas, no relationship is found with inflation.

Kinyanjui (2014) examined the impact of terrorism on foreign direct investment in Kenya. The study noted that terrorist incidents have economic consequences by diverting foreign direct investment (FDI), destroying infrastructure, redirecting public investment funds to security, or limiting trade. Kenya as a country has lost a lot of finances in the fight against terrorism. In one of the country's effort to counter terrorism, Kenya launched military operations in neighbouring Somalia against Al Shabaab. Just as capital may take flight from a country plagued by a civil war, a sufficiently intense terrorist campaign may greatly reduce capital inflows.

A study by Johnston & Nedelescu (2006) examined what is the effective response of policy and regulation in order to protect financial markets at terrorist attacks. The study focused on the terrorist attacks in New York (2001) and Madrid (2004). The findings indicate that diversity, liquidity and firm financial markets are efficient tools to absorb the shock of the terrorist attacks, but in addition, the flexible response of the competent authorities, is also important.

Oladimeji and Oresanwo (2014) examined the effects of terrorism on the international business in Nigeria. Four hypotheses were formulated and analyzed through the use of Statistical Programme for Social Sciences (SPSS). The study recommended that there should be public enlightenment so that terrorist will realize that they are agents of economic destruction, provision of job opportunity for the young ones, laws that create financing of terrorism (FT) offenses should be enacted and freezing, seizure, and confiscation of the proceeds of crime, terrorist funding should be done and laws, regulations, or other enforceable means that impose the required obligations on financial institutions and designated non-financial business and professions and there should be provision of an appropriate institutional or administrative framework and laws enable authorities to discharge their duties as expected of them.

Karolyi and Martell (2010) examined the stock price impact of terrorist attacks, and identify 75 attacks between 1995 and 2002 in which publicly traded firms were targets. They found that human capital losses, such as kidnappings of company executives, are associated with larger negative stock price reactions than physical losses, such as bombings of facilities or buildings.

Persitz (2005) evaluated the effect of Palestinian terror on the Israeli economy by using counterfactual methodology and quarterly data for the macroeconomic aggregates of Israel and OECD countries from 1980 to 2003. He found that, since 1994, had there been no terror in Israel, the country's per-capita GDP in 2003 would have been 8.6% higher than it was. Predictions based on low future levels of terror and the absence of a peace process produced good out-of-sample fit for 2003-2005. Palestinian terror increased the shares of government expenditures and consumption and decreased the shares of trade balance and investment in GDP. Also observed was weak evidence of a structural change at the aggregate level.

### 2.8 Summary

This chapter reviewed existing literature with regards to terrorism and banks operations as stipulated in the study objectives. The chapter also examined existing theories relevant to the study objectives. Previous literature as done by previous researchers was also highlighted in this section. The study also drew the conceptual framework to offer a pictorial representation of the whole study whereby the independent variables were drawn in conjunction to their indicators against the dependent variable in the study.

# CHAPTER THREE

# RESEARCH METHODOLOGY

## 3.1 Introduction

The chapter discussed the methodology that was used in gathering the data, analyzing the data and reporting the results. It specifically presents the research design, population of the study data collection and data analysis.

## 3.2 Research Design

This study adopted a descriptive cross-sectional survey design. This is a type of descriptive research design involving the collection of information from any given sample of the population element once (Ngechu, 2004). Mugenda and Mugenda (2003) noted that a survey attempts to collect data from members of a population and describes phenomenon by asking individuals about their perceptions, attitudes, behaviour or values.

Cross-sectional research design was chosen because it allows for generalization of findings within a particular parameter. The data obtained was able to be standardized to allow easy comparison. This design was meant to enhance a systematic description that is accurate, valid and reliable as possible regarding the effects of response strategies on competitiveness of oil marketing companies in Kenya.

## 3.3 Population of Study

Kisulu and Tromp (2006) define a population as a group of objects which provide the sample that is being studied. The 7 banks with operating licenses sufficed as the target population for this study.

### 3.4 Data Collection

The study collected both primary and secondary data. Primary data was collected using a semi structured questionnaire. The open ended questions were used in order to allow respondents to provide information which they may deem relevant for the study. Closed ended questions were used in order to standardize the responses and save on the respondents' time taken to fill in the questionnaire. The researcher maintained a register of questionnaires, which were be sent, and which were received.

### 3.5 Data Analysis

In order to comprehend the responses and make inferences, the questionnaires collected from the field were coded and entered into statistical Package for Social Sciences (SPSS) for Analysis. The data collected were mainly quantitative because of the standardized questions by the use of a five point Likert. To analyze the Likert scale questions, descriptive statistics including mean and standard deviation was used in the analysis. For open ended questions, content analysis was used. The analyzed data was presented using frequency tables.

### 3.6 Summary

In this chapter, the researcher discussed the research design that was used in the study. The chapter also identified the target population for the study including the preferred data collection instruments adopted by the study in this case questionnaires which comprised of both open and closed questions. The chapter concluded by highlighting the data analysis techniques adopted by the researcher.

# CHAPTER FOUR: DATA ANALYSIS RESULTS AND DISCUSSIONS

## 4.1 Introduction

This chapter presents the data collected from the field, analysis and interpretation. The study sought to establish impact of terrorism in the operations of licensed foreign banks in Kenya. To achieve this, the study was guided by two objectives: to determine the impact of terrorism on foreign banks operations in Kenya; and to determine how terrorism influences the operations of licensed foreign banks foreign banks in Kenya. Data was collected using questionnaires as the data collection instruments whose presentation and interpretation is given below through the use of a frequency distribution tables, mean and standard deviation; and multiple regression analysis.

### 4.1.1 Response Rate

The study targeted a sample of 28 respondents from the licensed foreign banks in Kenya. Out of the 28 distributed questionnaires, 22 were filled and returned. This translated to a response rate of 78.60%. This response was good enough and representative of the population and conforms to Mugenda and Mugenda (2003) stipulation that a response rate of 70% and above is excellent. The findings were as shown in the Table 4.1:

**Table 4.1 Response Rate**

| | Frequency | Percentage |
|---|---|---|
| Response | 22 | 78.6 |
| Non-Response | 6 | 21.4 |
| **Total** | **28** | **100** |

## 4.2 Impact of Terrorism on Banks Operations

The study sought to establish the impact of terrorism on foreign banks operations in Kenya. Several statements were proposed upon which the respondents were required to indicate the extent to which they agreed with them. From the responses on a five point Likert scale ranging from great extent to no extent. From the Likert scale, the study computed mean and standard deviation for analysis as shown in the Table 4.2 below:

**Table 4.2 Impact of Terrorism on Banks Operations**

| Statements | Mean | Std Dev |
|---|---|---|
| Insurance costs of the Bank increased | 4.4172 | 0.439 |
| The scope of insurance covers were reduced | 4.2971 | 0.140 |
| Strict sanctions on trading in certain currencies to some countries | 3.9683 | 0.461 |
| Development of strict regulation rules by the Central Bank of Kenya | 3.7142 | 0.158 |
| Investment on security within the banking premises pushed up the operating costs | 4.1628 | 0.568 |
| Limited the number of expatriates allowed to work in the country | 2.9461 | 0.423 |
| Caused over-crowding in some branches within the Country | 2.6593 | 0.431 |
| Tightening Know Your Customer details for the Bank | 3.4816 | 0.357 |
| Hiring more security staff to oversee security issues in the Bank | 4.2716 | 0.916 |
| Limited trade finance services as investors reduced their international businesses volume | 2.4916 | 0.692 |
| High fluctuation in the Foreign exchange rate | 3.1273 | 0.816 |
| Increased level of nonperforming loans | 3.6178 | 0.719 |
| Increased level of bad loans in the Bank | 3.4917 | 1.026 |

As indicated in the Table above, asked whether terrorism activities insurance costs of the Bank increased, the mean was 4.4172 with a standard deviation of 0.439. These findings indicate that the respondents agreed to a great extent that terrorism activities witnessed in the Country drove the cost of insurance for the licensed foreign banks in Kenya up. This made operational costs increase thus diluting the operating profits.

On whether terrorism activities reduced the scope of insurance covers, the mean was 4.2971with a standard deviation of 0.140. These findings show that terrorism activities reduced the scope of insurance covers for commercial banks. This means that in order for them to fully cover their risks, they needed to pay more and renegotiate with the insurance industry players.

Regarding the impact of terrorism on sanctions on trading in certain currencies to some countries, the mean was 3.9683 with a standard deviation of 0.461. These findings indicate that following terrorism incidences in Kenya, the banks faced sanctions restricting them from sending some currencies to certain destinations and financing certain businesses. This limited their operational framework and hence performance. On whether terrorism activities led to development of strict regulation rules by the Central Bank of Kenya, the mean was 3.7142 with a standard deviation of 0.158. This means that in order to limit the financing of terrorism activities, regulatory rules had to be tightened. This meant that commercial banks were now under strict scrutiny in their businesses and were closely monitored by the regulator.

On the impact of terrorism activities causing investment on security within the banking premises to push up the operating costs, the mean was 4.1628 with a standard deviation of 0.568. Following terrorism incidences in the Country, all business premises moved to secure their premises. This included engaging more security experts which pushed up the cost of doing business in the Country. Regarding impact of terrorism activities limiting the number of expatriates allowed to work in the country, the mean was 2.9461 with a standard deviation of 0.423. As terrorism incidences hit the Country, more and more expatriates were more careful when applying to work in Kenya. In addition, the host companies spend more resources to ensure safe stay of the expatriates which pushed up the operating costs.

On whether terrorism activities caused over-crowding in some branches within the Country, the mean was 2.6593 with a standard deviation of 0.431. Following the terrorism incidences, some premises locations could not be easily accessed hence causing over-crowding in nearby premises. On whether terrorism activities caused tightening Know Your Customer details for the Bank, the mean was 3.4816 with a standard deviation of 0.357. Following terrorism incidences, tight rules were put on know your customer among all commercial banks. This was viewed as a way of ensuring terrorists did not use financial institutions to perpetrate their acts. On whether terrorism activities caused hiring more security staff to oversee security issues in the Bank, the mean was 4.2716 with a standard deviation of 0.916.

On whether terrorism activities caused limited trade finance services as investors reduced their international businesses volume, the mean was 2.4916 with a standard deviation of 0.692. These findings show that terrorism incidences did not affect finance services to a great extent. This is largely because Kenya is a net importer and as such, it relies on imported items which form part of the basic needs. This therefore meant that the Country had to continue transacting with the international world for smooth operations. On whether terrorism activities caused high fluctuation in the Foreign exchange rate, the mean was 3.1273 with a standard deviation of 0.816. Terrorism incidences had average effects on foreign exchange rate. The moderate effect was caused by capital expenditure in standard gauge railway and other investments undertaken by the Government. However, it limited the inflow of foreign currency as tourism almost came to its knees which could have caused a strain on the foreign exchange rate. On whether terrorism activities caused increased level of nonperforming loans, the mean was 3.6178 with a standard deviation of 0.719. These findings show that to some extent, terrorism incidences negatively impacted nonperforming loans as some loan servicing individuals were left unable to pay up their repayments on time. On whether terrorism activities caused increased level of bad loans in the Bank, the mean was 3.4917 with a standard deviation of 1.026. Besides delay in repaying bank loans, some business and individuals had their income streams cut off hence could not afford the repayment leading to increased level of bad loans.

The study further sought to establish the extent to which terrorism activities had affected foreign banks operations in Kenya. The findings were as shown in the Table below:

**Table 4.3: Extent to Which Terrorism Activities Affected Foreign Banks Operations in Kenya**

| Extent | Frequency | Percent |
|---|---|---|
| Very great extent | 12 | 57% |
| Great extent | 6 | 29% |
| Moderate extent | 3 | 14% |
| Total | 21 | 100% |

As shown in the Table above, majority of the respondents 57% indicated that terrorism activities impacted foreign banks operations in Kenya to a very great extent, 29% indicated great extent while 14% indicated moderate extent. These findings indicate that terrorism activities impacted foreign banks operations in Kenya to a very great extent.

## 4.3 Influence of Terrorism on the Operations of Licensed Foreign Banks

The study further sought to establish the influence that terrorism had on the operations of Licensed Foreign Banks Foreign Banks in Kenya. Several statements were given upon which the respondents were to indicate their extent of agreement with them. The findings were as shown in the Table 4.4 below:

**Table 4.4 Influence of Terrorism on the Operations of Licensed Foreign Banks**

| Statements | Mean | Std Dev |
|---|---|---|
| Led to duplication of roles for the sake of creating a back-up team | 4.219 | 0.6926 |
| Increased operational costs | 3.837 | 0.9420 |
| Increased foreign exchange rate exposure | 3.692 | 1.0294 |
| Increased compliance costs | 4.105 | 0.7381 |
| Increased capitalization of the Bank | 3.172 | 0.9918 |
| Increased risk exposure of the Bank | 4.391 | 0.5729 |

As indicated in the Table above, asked as to whether terrorism led to duplication of roles for the sake of creating a back-up team, the mean was 4.219 with a standard deviation of 0.6926. These findings indicate that the licensed foreign banks foreign banks were faced with duplication of roles for the sake of creating backup team so as to ensure continuity in business operations in case of being affected by a terrorism event.

On whether terrorism activities increased operational costs, the mean was 3.837 with a standard deviation of 0.9420. This means that the respondents indicated that terrorism activities influenced operations of licensed Foreign Banks to a great extent. On whether terrorism increased foreign exchange rate exposure, the mean was 3.692 with a standard deviation of 1.0294. These findings imply that the licensed foreign banks foreign banks were influenced by foreign exchange rate exposure to a great extent.

On whether terrorism activities in the country influenced the compliance costs, the mean was 4.105 with a standard deviation of 0.738. These findings imply that following various terrorism activities, licensed foreign banks foreign banks incurred more compliance costs. This therefore influenced the performance. On whether terrorism activities in the Country increased capitalization of the licensed foreign banks foreign banks, the mean was 3.172 with a standard deviation of 0.9918. These findings show that terrorism activities increased capitalization requirements of the banks in order to ensure a strong and stable banking sector in the Country.

On whether terrorism activities increased the level of exposure for licensed foreign banks, the mean was 4.391 with a standard deviation of 0.5729. These findings show that terrorism activities increased the risk exposure of licensed foreign banks foreign banks. Following the occurrence of various terrorism activities in the Country, several of their investments in the Country were affected hence the overall effect on performance recorded.

## 4.4 Discussion of Findings

From the findings above, the study established that terrorism activities witnessed in the Country drove the cost of insurance for the licensed foreign banks in Kenya up. These findings are consistent with the argument of Rotberg & foundation (2005) that in reaction to the attacks, the insurance industry raised its premiums, reduced coverage and called on governments to step in and cover risks deemed too large for the private sector. The causes caused by terrorism incidences could be too big to be covered by the insurance industry alone. In order to shield themselves from inability to compensate, insurance companies also take precautionary measures to protect their business hence the raise in premiums and restriction on the extent of cover.

The study further established that following terrorism incidences in Kenya, the banks faced sanctions restricting them from sending some currencies to certain destinations and financing certain businesses as supported by a mean of 3.9683. This is inconsistent with Ryans and Shanklin, 1980 that terrorism causes global managers to consider carefully the use of expatriates in foreign assignments.

The study also found out that the impact of terrorism activities is causing investment on security within the banking premises to push up the operating costs. The findings concurs with Karolyi and Martell (2010) that examined the stock price impact of terrorist attacks in which publicly traded firms are targets. They found that human capital losses are associated with larger negative stock price reactions than physical losses, such as bombings of facilities or buildings.

**4.5 Summary**

This chapter highlighted the results of analysis from the collected data. The interpretations drawn from the research findings were clearly linked to the study objectives. The researcher went further to even link the study findings to the already discussed empirical literature in chapter two.

# CHAPTER FIVE

# SUMMARY, CONCLUSION AND RECOMMENDATIONS

## 5.1 Introduction

These chapter discuses the summary of key data findings and draws conclusions from the findings based on the objectives. It also presents the recommendations made from the findings. The general objective of the study was to establish the impact of terrorism in the operations of licensed foreign banks in Kenya.

## 5.2 Summary of the Findings

The study found out that to a great extent terrorism activities witnessed in the Country drove the cost of insurance for the licensed and foreign banks in Kenya up. This made operational costs increase thus diluting the operating profits. Terrorism activities reduced the scope of insurance covers for commercial banks. The study further found that the operational framework of the banks have been limited by the banks facing sanctions restricting them from sending some currencies to certain destinations and financing certain businesses which have lowered their performance.

On the impact of terrorism activities causing investment on security within the banking premises to push up the operating costs the study found out that business moved to secure their premises. This included engaging more security experts which pushed up the cost of doing business in the Country. Terrorism activities caused hiring more security staff to oversee security issues in the Bank.

The study found out that the influence that terrorism had on the operations of Licensed Foreign Banks led to duplication of roles for the sake of creating a back-up team, increased operational costs, influenced the compliance costs and increased the level of exposure for licensed foreign banks. Following the occurrence of various terrorism activities in the Country, several of their investments in the Country were affected hence the overall effect on performance recorded.

## 5.3 Conclusions

The study concludes that terrorism activities reduced the scope of insurance covers and increased the cost of the banks, thus for them to fully cover their risks, they need to pay more and renegotiate with the insurance industry players. This would make operational costs increase thus diluting the operating profits.

The study also concludes that sanctions on trading in certain currencies to some countries had limited their operational framework and hence performance. Terrorism activities causing investment on security within the banking premises push up the operating costs which led to development of strict regulation rules by the Central Bank of Kenya.

The study further established that the licensed foreign banks were faced with duplication of roles for the sake of creating backup team so as to ensure continuity in business operations in case of being affected by a terrorism event and that terrorism activities increased capitalization requirements of the banks in order to ensure a strong and stable banking sector in the Country.

## 5.4 Recommendations

The study recommends that regulators could ensure that all banks have in place effective frameworks to identify, assess, monitor, and control or mitigate material operational risks resulting from terrorism as part of the overall approach to risk management.

Furthermore, foreign banks themselves could take all necessary steps to ensure their ability to operate on an ongoing basis and limit losses in the event of severe business disruption, through adequate contingency and business continuity plans. The terrorist attack highlights the importance of having operative business continuity plans across the financial system. At the same time, these attacks uncover a number of important vulnerabilities.

### 5.5 Suggestions for Further Study

The study recommends that studies should be done to replicate this research to other financial sectors, and more importantly conduct comparative studies within both local and foreign banking institutions to assess the impact of terrorism.

The study also recommends that in the future a study be conducted on the strategies adopted by the foreign banks to counter terrorism. This will be important in accessing how the strategies adopted are key to promoting domestic tourism and what other measures can be taken.

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## APPENDIX I: QUESTIONNAIRE

### SECTION I: GENERAL INFORMATION

Please tick or mark a cross the appropriate answer

1) Please indicate your functional responsibility in the company.

   Retail banking manager [ ] Trade services manager [ ]

   Corporate banking manager [ ] Risk Dept [ ]

   Other (please explain) ____________________________________________

### SECTION III: IMPACT OF TERRORISM ON BANKING OPERATIONS

2) In answering this question and the rest of the questions in this section, you are given a scale of 1 – 5 to help you respond easily; where:

   5 = very great extent

   4 = Great extent

   3 = Moderate extent

   2 = Little extent

   1 = No extent

What are the Impacts of terrorism on the operations of foreign banks?

| **Statements** | **1** | **2** | **3** | **4** | **5** |
|---|---|---|---|---|---|
| Insurance costs of the Bank increased | | | | | |
| The scope of insurance covers were reduced | | | | | |
| Strict sanctions on trading in certain currencies to some countries | | | | | |
| Development of strict regulation rules by the Central Bank of Kenya | | | | | |
| Investment on security within the banking premises pushed up the operating costs | | | | | |
| Limited the number of expatriates allowed to work in the country | | | | | |
| Caused over-crowding in some branches within the Country | | | | | |
| Tightening Know Your Customer details for the Bank | | | | | |

| | | | | | |
|---|---|---|---|---|---|
| Hiring more security staff to oversee security issues in the Bank | | | | | |
| Limited trade finance services as investors reduced their international businesses volume | | | | | |
| High fluctuation in the Foreign exchange rate | | | | | |
| Increased level of nonperforming loans | | | | | |
| Increased level of bad loans in the Bank | | | | | |

3) To what extent have terrorism activities affected foreign banks operations in Kenya?

Very great extent [ ]

Great extent [ ]

Moderate extent [ ]

Little extent [ ]

No Extent [ ]

4) In what ways has terrorism influenced the operations of your bank? Kindly use the scale of 1-5 to indicate how each of these effects have been felt in your Bank.

| **Statements** | **1** | **2** | **3** | **4** | **5** |
|---|---|---|---|---|---|
| Led to duplication of roles for the sake of creating a back-up team | | | | | |
| Increased operational costs | | | | | |
| Increased foreign exchange rate exposure | | | | | |
| Increased compliance costs | | | | | |
| Increased capitalization of the Bank | | | | | |
| Increased risk exposure of the Bank | | | | | |

**THANK YOU**

## APPENDIX II: LIST OF LICENSED FOREIGN BANKS

1. Standard Chartered Bank

2. Barclays Bank

3. Cfc Stanbic Bank

4. Citi Bank

5. United bank of Africa

6. Guarantee Bank

7. Eco Bank