

**AN EVALUATION ON THE EFFECT OF DEPOSIT INTEREST  
RATE ON THE PERFORMANCE OF COMMERCIAL BANKS:  
CASE OF NAIROBI CENTRAL BUSINESS DISTRICT**

**EGERTON UNIVERSITY LIBRARY**

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A research project submitted to the Board of Post graduate studies in partial fulfillment for the requirement of the award of Master of Business Administration degree of Egerton University



**EGERTON UNIVERSITY**

June, 2010

**DECLARATION AND RECOMMENDATION**

**DECLARATION**

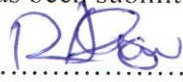
This project is my original work and has never been presented in any University or institution for examination.

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**RECOMMENDATION**

This project has been submitted with our approval as University supervisors

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## **DEDICATION**

This project is dedicated to my wonderful Dad, Mom and the rest of my family members for their continuous support and their tireless effort that made the project a success.

## **ACKNOWLEDGEMENT**

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## ABSTRACT

A commercial bank like any other organization operates within an environment that demands operations with meaningful returns. It therefore becomes very important for a bank to find ways and means of not only managing but attracting customer deposits by providing returns to its customers. However, this has not been the case as the deposit interest rates of commercial banks have not been changing over the years. The study seeks to assess how deposit interest rate affects the performance of commercial banks. Similar studies show that there is a correlation between the deposit interest rate and the performance of the bank. Mwege et al (1990) finds that real deposit rates have a positive effect on financial savings which in turn motivate investors to increase their financial assets. The population consisted of 42 commercial banks. Using Krejcie and Morgan, (1970) formula for selecting sample size, 36 commercial banks were selected within Nairobi Central Business District. The Sample was divided into two strata. The secondary data was collected from financial statements of the commercial banks. The data was analyzed using the multi-regression technique and Correlation Analysis. The t-test was used to establish significance of each hypothesis. The results showed that the deposit rate had no significant effect on the profit level, the deposit level and default rate. However credit demand had a significant effect on the deposit level and profit level, while leverage ratio had a significant effect on the default rate among other factors. Further studies need to be done on the different types of deposits and how the other factors would play an important role on the deposit level and profitability of commercial banks, and also on how the regulatory policies affect the performance of commercial banks

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## **LIST OF ACRONYMS**

CBK-Central Bank of Kenya

GDP-Gross Domestic Product

LS-Loan Sales

MNE- Multi National Enterprise

MNC-Multi National Corporation

NIM-Net Interest Margin

NPL-Non-Performing loan

ROE- Return on Equity

ROTA- Return on Total Assets

SME- Small medium Enterprise

USA-United States of America

## CHAPTER ONE: INTRODUCTON

### 1.1 Background of the study

Bank liabilities are the funds banks obtain and the debts they incur, primarily to make loans and purchase securities. These Bank liabilities include various types of deposits, borrowing and other liabilities. In the recent past banks have experienced increased competition for consumer funds as alternatives for checking, savings and time deposits have become increasingly available to the public.

Initial reforms in the banking sector in the early 1980s responded to the concern that foreign owned banks had a majority share in the Kenyan market. Financial institutions proliferated as licensing requirements were relaxed. Lack of uniformity in banking regulation across different types of institutions, allowed bank financial intermediaries to avoid interest rate ceilings and attract deposits from Commercial banks by offering higher deposit interest rates.

In 1986 poorly enforced regulations on capital and reserve requirements resulted in the failing of four commercial bank groups that owned large near bank financial intermediaries (Swamy, 1994). By 1989, many more financial institutions were on the brink of failing. In that year, the Kenya government reformed the banking laws. It narrowed regulatory gaps, strengthened licensing and capital requirements, created deposit insurance, set minimum reporting requirements, and increased penalties. The Central Bank capacity to enforce regulation was strengthened and nine small banks were restructured.

Nevertheless, political interference kept taxing the Central Bank enforcement capacity and many more institutions grew in distress. Financial liberalization started in 1990 with the removal of all charges and fees from the ceiling of Commercial bank rates, which allowed the effective interest rate to exceed the ceiling. (Swamy, 1994)

By placing interest rates on deposits, the banks are increasing their costs, which will have an effect on the bank's profitability. Bankers, if left to decide on their own, would generally prefer a high proportion of demand deposits and low yield time and savings deposits, because these are among the least expensive of all bank sources of funds and often include a substantial percentage of core deposits. (Rose P, 2002).

However this does not mean demand deposits pay no interest. While there may not be explicit interest rates paid there are high implicit interest cost incurred on such deposits. Specifically in providing demand deposits through checkable accounts, a bank must provide a whole set of associated services from providing cheque books to clearing cheques to sending out statements with cleared cheque or cheque images. Because such services absorb real resources of labor and capital they are still costly for banks to provide. (Cornett and Saunders, 1999).

Research suggests that deposits actually do respond to changes in interest rate levels, at least in so far as the composition is concerned. There is for instance a clear shift in deposit from the non-interest earning current account to interest earning account. This increases if the interest rate on deposits also increases. In Kenya the share of demand

deposits in total deposits fell from 54.9% in 1970 to 48.5% in 1988. Most of the demand deposits appear to have shifted to savings account whose share in total rose 23.8% in the late 80's to 33.2% in the 90's, Instrument of economic policy in Africa, (1995). Economic prosperity means that prices are low, inflation rates are low, income is high and the economy of a country is performing well.

This encourages more people to save and as a result the amount of deposits held by commercial banks increases. Deposit interest rates can be used to shape the kind of customer bases each bank serves. Changing these rates affect not only the spread between bank loan rates and deposit interest rates but also balances and deposit mix decisions which in turn influence bank growth and profit margins. (Edmister, 1982). Banks must also ensure efficient customer service, since this has an impact on the growth of the deposits.

This study has focused on commercial Banks within the Central Business District because this is where the headquarters for most Commercial Banks are located. Nairobi city is the capital of Kenya. Nairobi district is situated at an elevation of about 1660m (about 5450 ft) in the highlands of the southern part of the country. Nairobi is Kenya's principal economic, administrative, and cultural center and is one of the largest and fastest growing cities in Africa.

Nairobi grew around the central business district which takes a rectangular shape around the Uhuru Highway, Haille Selasse Avenue, Moi Avenue and University way. It includes

many of Nairobi's important buildings, including the City hall, Parliament building and the City square is also located within the perimeter. As at January 2008 there were forty two (42) Commercial banks following the exit of Prime Capital and Credit banks which was acquired by Prime Bank Ltd in December 2007 and the entry of Gulf African Bank Ltd in November 2007.

## **1.2 Statement of the problem**

Commercial banks rely on their customers for sustainability and as such should strive to attract new customers and retain loyal customers. On the other hand customers are motivated to place their money with various commercial banks because of the interest earned on the deposits. However over the years deposit interest rates have not changed significantly with changes in the economy yet banks operate in an environment where competition is very high and customers have a variety of investment alternatives with better returns. Thus the study seeks to assess the effect of deposit interest rate on performance of the commercial banks in terms of profit level, deposit level and default rate.

## **1.3 General objective of the study**

To determine the effect of deposit interest rate on the performance of a commercial bank

## **1.4 Specific objectives of the study**

- i) To assess the effect of deposit interest rate among other factors on deposit level of commercial banks
- ii) To assess the effect of deposit interest rate among other factors on profit level of commercial banks

iii) To assess the effect of deposit interest rate among other factors on the default rate of commercial banks

### **1.5 Hypotheses of the study**

- i) Deposit interest rate has no significant effect on the profit level of commercial banks
- ii) Deposit interest rate has no significant effect on the deposit level of commercial banks
- iii) Deposit interest rate has no significant effect on the default rate of commercial banks

### **1.6 Justification of the study**

The significance of this study is to show how deposit interest rate affects customer loyalty and in the long run the market share of a bank. Assessing the growth of banks in terms of size and branch expansion is important so as to know if deposit interest rates in such banks are attractive enough to warrant customer loyalty.

It will also help bank management to balance between growth and profitability strategies because; while aggressive competition for costly deposits and other sources will help a bank grow faster it will often be at the price of severe profit erosion.

It also helps in understanding that the real risk taker in a banking relationship is the depositor because from a policy point of view banks take other people's money and lend it to parties over whom the depositor has no control

Last but not least is to provide a reason for customers to monitor and assess the changes in the deposit interest rates and how it affects their savings and also to assess the performance of the bank.

## 1.7 Scope of the study

The researcher was not able to have access of required data and information of all the banks hence embarked on a sample size.

## 1.8 Definition of terms

**Loan-** A loan is a type of debt. Like all debt instruments, a loan entails the redistribution of financial assets over time, between the lender and the borrower. The borrower initially receives an amount of money from the lender, which they pay back, usually but not always in regular installments, to the lender. This service is generally provided at a cost, referred to as interest on the debt

**Capital requirement-** is a bank regulation, which sets a framework on how banks and depository institutions must handle their capital. The categorization of assets and capital is highly standardized so that it can be risk weighted.

**Default-** This is the risk that the borrower will become bankrupt, abscond or otherwise not pay the loan.

**Demand account-** also known as checking or current account is a deposit account held at a bank or other financial institution, for the purpose of securely and quickly providing frequent access to funds on demand, through a variety of different channels.

**Deposit-** a specific sum of money taken and held on account by a financial institution, (e.g. a bank) as a service provided for its clients. Financial institutions that take deposits are required to be regulated in virtually all jurisdictions

**Deposit insurance-** is a measure taken by banks in many countries to protect their clients' savings, either fully or in part, against any possible situation that would prevent

the bank from returning said savings. Deposit insurance institutions are for the most part government run or established, and may or may not be a part of a country's central bank.

**Deposit interest rate-**Deposit interest rates are the rates offered by the various commercial banks and depository financial institutions on the various deposit schemes offered by them. The interest rates on deposits represent the price that the banks and the financial institutions are willing to pay to the account holders for using their funds. The deposit interest rates may vary from account to account and even bank to bank depending on the features offered to the depositors.

**Liberalization-** refers to a relaxation of previous government restrictions, usually in areas of social or economic policy. Most often, the term is used to refer to economic liberalization, especially trade liberalization or capital market liberalization or even financial liberalization

**Ceiling-** is used to describe a governmentally-mandated upper limit. Examples include the ceiling on gasoline prices set by government or the ceiling on Savings and Loan interest rate.

**Multinational corporation-** (MNC) or multinational enterprise (MNE) is a corporation or enterprise that manages production establishments or delivers services in at least two countries. Multinational corporations (MNC) can be divided into three broad groups: Horizontally integrated multinational corporations, vertically integrated multinational corporations and Diversified multinational corporations

**Non-performing loan-**is a loan that is in default or close to being in default. Many loans become non-performing after being in default for 3 months, but this can depend

on the contract terms.“ A loan is none-performing when payments of interest and principal are past due by 90 days or more, or at least 90 days of interest payments have been capitalized, refinanced or delayed by agreement, or payments are less than 90 days overdue, but there are other good reasons to doubt that payments will be made in full” (IMF)

**Reserve requirement**-(or required reserve ratio) is a bank regulation, that sets the minimum reserves each bank must hold to customer deposits and notes. These reserves are designed to satisfy withdrawal demands, and would normally be in the form of fiat currency stored in a bank vault (vault cash), or with a central bank.

**Savings accounts**- are accounts maintained by commercial banks, savings and loan associations, credit unions and mutual savings banks that pay interest but can not be used directly as money (by, for example, writing a cheque). These accounts let customers set aside a portion of their liquid assets that could be used to make purchases while earning a monetary return.

**A time deposit** -also known as a fixed deposit is a money deposit at a banking institution that cannot be withdrawn for a certain "term" or period of time. When the term is over it can be withdrawn or it can be held for another term. The longer the term, the better the yield on the money. A certificate of deposit is a time-deposit product.

## CHAPTER TWO: LITERATURE REVIEW

### 2.1 Historical Development of Deposit Interest Rate

Time deposits and savings accounts generally rank second to demand deposits as the least costly deposits for a bank. Savings deposits are relatively cheap for banks because of the low interest rate they carry and in many cases, the absence of monthly statements for depositors

However, many passbook savings accounts have substantial deposit and withdrawal activity; some savers attempt to use them as checking accounts. Many banks have moved to discourage rapid turnover in the savings deposit by limiting withdrawals and charging activity fees. While demand deposits have about the same gross expenses (including interest and operating expenses) as time deposits do the higher the service fee levied against checking account customers help to lower the net cost of checkable deposits below the net cost of time accounts

The critical difference in terms of banks profitability is the service fee most checkable accounts generate for a bank. This fact helps explain why, faced with rising operating cost in recent years bank have more aggressively priced their checkable deposits asking depositors to pay a bigger share of their activity cost they create for a bank when the customers write cheques.

Interest bearing checking account generate about twice the volume of net returns (after earnings from bank loans and investment portfolios are added) than regular checking

accounts (non-interest bearing) generate. While bankers would prefer to sell only the cheapest deposits to the public it is predominantly the public preference that determines which types of deposits will be created. Banks that do not wish to conform to customer preferences will simply be outbid for deposits by those who do. This is what determines the banks market share of customer deposit. (Ross, 2002)

## **2.2 Bank Performance**

Kenya's economy is market -based, with a few state-owned infrastructure enterprises, and maintains a liberalized external trade system. The country is generally perceived as Eastern and central Africa's hub for financial services. After independence, Kenya promoted rapid Economic growth through public investment, encouragement of smallholder agricultural production, and incentives for private industrial investment. (Gavin, K, 1980).

Due to the nature of their business, commercial banks expose themselves to the risks of default from borrowers. Prudent credit risk assessment and creation of adequate provisions for bad and doubtful debts can cushion the banks risk. However, when the level of non- performing loans is very high, the provisions are not adequate protection

According to the CBK July, 1999 the level of NPLs in 1998 was estimated at Shs. 80 billion or 30% of advances, up from 27% in 1997 as compared to 81.3 billion or 33.4% of total loans in November 2001. According to the Central Bank of Kenya supervision report (Central Bank of Kenya Supervision Report, 1999) profitability of the banking sector declined sharply from shs.4.4billion in 1998 to only Shs 0.2 billion in 1999. This was due to increased provisions for the non-performing loans by most institutions.

Although the volume of total non-performing loans declined, provisions on loan losses increased in 2002. The bank made provisions of Kshs 4.7 billion showing that it is still adversely weighed down by non-performing loans. Besides the impact of these provisions on profitability, the concentration of such loans made recovery hard owing to the poor state of the economy. This shows that the default rate and profitability play an important role in affecting the performance of the commercial bank (Kalani 2009)

The major assets of a bank are its loans to individuals, businesses, and other organizations and the securities that it holds, while its major liabilities are its deposits and the money that it borrows; either from other banks. Assets are used by businesses to generate income. Loans and securities are a bank's assets and are used to provide most of a bank's income. However, to make loans and to buy securities, a bank must have money, which comes primarily from the bank's owners in the form of bank capital, from depositors. Therefore managing the deposit level of the bank is important in ensuring a positive effect on performance of the commercial bank.

### **2.3 Factors Affecting Bank Performance**

#### **Deposit Interest Rate**

Deposit interest rates are the rates offered by the various commercial banks and depository financial institutions on the various deposit schemes offered by them. The interest rates on deposits represent the price that the banks and the financial institutions are willing to pay to the account holders for using their funds. The deposit interest rates may vary from account to account and even bank to bank depending on the features offered to the depositors. For the year 2002-2006 Barclays bank of Kenya had the highest

deposit interest rate of 8.51% and City finance had the lowest deposit interest rate of 0.02%

### **Leverage Ratio**

Financial leverage takes the form of a loan or other borrowings, the proceeds of which are invested with the intent to earn a greater rate of return than the cost of interest. Leverage allows greater potential returns to the investor that otherwise would have been available, but the potential for loss is also greater: if the investment becomes worthless, the loan principal and all accrued interest on the loan still need to be repaid.

Thus leverage ratio indicates the extent to which the business is reliant on debt financing generally, the higher this ratio, the more risky a creditor will perceive its exposure in the business, making it correspondingly harder to obtain credit. For the year 2002-2006 Co-operative Bank of Kenya had the highest Leverage ratio of 92.23% and City finance had the lowest leverage ratio of 34.50%

### **Credit demand**

Credit demand refers to the amount of money people wish to hold, or the function determining this. Availability of funds at banks may not automatically lead to increased credit, if banks are unwilling to lend or if the demand for credit is low. Credit could also be constrained by demand factors such as lack of credit-worthy borrowers and investment opportunities. For the year 2002-2006 Barclays bank of Kenya had the highest credit demand of Ksh 65830.60 million while City finance had the lowest amount of Ksh 369.90 million.

## **Operation cost**

These are costs incurred in carrying out a bank's day to day activities and may include salaries paid to employees, research and development costs, legal fees, accountant fees, bank charges, office supplies, electricity bills, business licenses. The operating costs are normally divided into selling expenses and administrative and general expenses. For the year 2002-2006 City Finance bank had the highest operating cost percentage of 94.21% while Imperial bank had the lowest operating cost percentage of 42.35%.

## **2.4 Recent Empirical Studies**

Lewis (1980) developed a model to capture the relationship between deposit demand and explicit deposit interest rate per dollar and implicit deposit interest rate. He argued that imposition of deposit interest rate ceiling created incentives in addition to the payment of explicit deposit interest rate. He argues that in a deposit-constrained savings deposit market the competitive mechanism is exercised through provision of financial and non-financial goods and services to depositors in order to increase deposit holdings.

These goods and services take a great variety of forms but to the financial intermediary result in added expenditures for labour, capital equipment of intermediate product. (e.g. supplies or goods purchased for distribution to depositors) Lewis also studied the costs of financial intermediation in the savings and loan industry in a framework that allocates total costs into the costs incurred in non-rate competition and costs incurred in the production of financial intermediary services. Using a cross-section of state data points for the years 1972-1974, he made estimates of elasticity, deposit interest rate, average production cost, and implicit deposit interest rate to net revenue and ratio of implicit

deposit interest rate to observed average cost. From the analysis Lewis observed the net revenue per dollar constitutes the available funds to be passed on to the depositor in the form of an implicit deposit interest rate.

The proportion or share of net revenues that are passed on to the depositors depends on the strength of the depositors' response to the goods and services provided by the implicit deposit interest rate. When the elasticity of implicit deposit interest rate approaches zero (i.e. weak market response), the share of net revenues passing to the depositors approaches zero. Conversely with a strong deposit response to implicit deposit interest rates measured by a very high value of above elasticity, the depositors' share of net revenue approaches unity. Thus the greater the deposit sensitivity to implicit deposit interest rate, the larger will be the proportion of net revenue paid in implicit deposit interest rate.

He finally observed that the imposition of deposit interest rate ceiling in 1966 in the U.S.A led to an increase in net revenue in 1972 and 1973 and provided incentives to increase the number of branches and fixed facilities of savings and loans. The trend ultimately led to a 25% increase in the number of savings and loan offices between 1972 and 1974.

In yet another study Sealey (1980) developed a model that integrates deposit interest rate setting, risk as well cost consideration. The model was based on the assumption that asset and deposit markets are perfectly competitive so that quantity settings are the relevant

behavioural model in both markets. It also ignored the resources cost incurred in intermediary operations. Sealey observed that although uncertainty about loan and security are important in determining the behaviour of the depository financial intermediary, random deposit supplies are at the heart of the liquidity problem of all these institutions.

He further investigated the effects of risk aversion on optimal deposit interest rates when loans are fixed. He observed that there are instances where intermediaries have fixed loans and must set deposit interest rates. Intermediation is more likely where the greater the correlation between loan and deposit interest rate and the smaller the variance of loan rates.

Nevertheless, some studies have found a statistically positive significant effect of interest rate on saving. In a sample of 14 Asian countries, using pooled time series data, Fry (1978) finds that interest rate has a positive and significant effect on saving. However, Giovanni (1983) fails to find a significant effect in the same sample of 11 Asian countries. Gupta (1978) in a pooled time series econometric analysis, estimate of a Saving function for Asia and Latin America but does not find support for financial repression. Gupta's analyses suggest that real income is the most important determinant of national savings.

On the other hand, most studies find support for the hypothesis that real deposit rates have a positive and significant effect on financial savings. The theory of determination of

financial savings is different from that of national savings. To save in financial assets is portfolio choice among investors' assets. Mwega, et al. (1990), find that real deposit rates have a positive effect on financial savings. Since financial saving is part of the total private saving, this result suggests that increases in real deposit rates induce investors to switch from real assets to financial assets. Seek and Nil (1993), too in a study of 21 African countries, find significant positive effect of real deposit rate on financial saving.

Some studies also claim to find evidence that high interest rates improve the quantity and quality of investment. It is reported in the 1989 World Development Report that investments in all the countries with positive real rates were more productive than average. Investments were generally less productive than average in the countries with strongly negative real rates. Fry (1988) finds support for the hypothesis that financial liberalization improves efficiency. In Fry's study, incremental capital output ratio is regressed against real interest rate.

Kibe (2003) determined the relationship between interest rate spread and profitability of commercial Banks in Kenya. He emphasized that interest rate was measured between lending and deposit interest rate. Profitability indicators used were Return on Total Assets (ROTA), Return of equity (ROE) and Pre net interest (NIM). According to Kibe, Kenya Commercial Banks charge relatively high interest rates on loans and pay low interest rates on deposits. This has not however saved commercial Banks from a banking crisis. Factors influencing profitability of commercial banks include; (a) interest rate risk

management exposure to the bank resulting from unexpected variation in interest rates, (b) Credit risk management of defaults, (c) Liquidity management i.e. access to cash and (d) NIM interests on assets.

He concluded that interest rate spread contributes less than 50% towards the profitability of commercial banks in Kenya. Interest rates spread explains that 38.4% of profitability as measured by (NIM), 40.1% as measured by ROTA and 43.3% when measured by ROE variations in commercial banks will no longer rely on interest rate spread as well as main source of profitability. Commercial Banks in the in the long run will rely less and less on their traditional inter-mediatory role and instead towards other innovative way of raising fee income. He also recommended that shareholders of commercial banks to ensure management diversity of commercial banks source of profitability from the traditional over reliance on the interest rate spread. He also recommended that small banks will need to merge in order to exploit the management and production synergy

In an attempt to examine the possible links between the structure and performance of banks in Nigeria, Apholabi *et al* (1976) developed a least square regression model from a sample of fifteen commercial banks. The study focused on performance of the sector for two years, 1973 and 1974. They observed that commercial banking business in Nigeria had always been in an industry with a high concentration of inputs (deposit) and output (Loans and advances) in very few hands. The results of the analysts revealed that the hypothesis of a strong positive relationship between profitability and market share was generally supported.

Rose (1993) concluded that medium size banks are the most profitable in terms of ROA and ROE. If these assertions are bona fide in commercial banks context, then the relationship between commercial banks profitability and size variable must have a global maximum. Logarithm of total assets of individual banks could have an impact on bank profitability on the commercial bank. The study offered an insight into the internal determinants and the external determinants of profitability of commercial banks. The factors indicated in this theoretical study are consistent with the profitability variables.

The internal determinants included in this theoretical study are items involving total revenue and total cost. The internal variables included in this study are asset portfolio mix, total expenses, liability composition, and liquidity ratio and capital structure. In addition to the above, the external determinants are taken into consideration i.e., competition, regulation, inflation, market share, market growth, firm size and interest rate. The variables specified for this study are consistent with the variables used in much of the literature on bank profitability. (Bourke, 1989, Molyneux and Thornton, 1992).

Sopani (2001), in his paper analyses the impact of financial liberalization reforms on the Malawian Banking Sector. In Particular, it tests the impact of banking sector reforms on financial savings and whether such reforms have brought competition hence efficiency in the banking sector, using both descriptive statistics and econometric analysis. Key financial indicators such as ratio of M2/GDP, M1/M2 and interest rate spreads are employed to analyze the degree of financial deepening.

Co-integration and error correction techniques are used to estimate short-run and long run response of financial saving to various parameters, i.e. per capita income, real deposit interest rates, lagged foreign aid and expected real deposit interest rates have significant effects in explaining both short-run and long-run variations in financial savings. It is also found the real deposit interest rates have a positive significant effect on financial saving.

Over the last few years, financial liberalization in Africa has dismantled interest ceilings and credit allocation or quotas, providing flexibility and increasing competition among banks. With less government intervention, markets have experienced positive real interest rates following a fall in inflation rates and an increase in nominal rates. Yet, customers do not yet enjoy the benefits of financial deregulation, whereas commercial bank depositors are well rewarded. Moreover, despite an increase in interest rates on bank deposits, rising lending rates increased commercial bank's interest rate spreads, making them considerably wider than those of other non banking financial institutions.

Investment in government securities became a hindrance in this competitive environment, as yields on these obligations were much lower than the returns realized by banks on their loans and investments. Hence, banks were willing to pay more for deposits than the Non financial institutions could offer their customers. Notwithstanding efforts to invest part of their funds in commercial paper, began to suffer from this stiff competition from other market securities, (Sopani, 2001).

Christopher (1980) attempted to examine the effect of loan sales (LS) and standing letters of credit (SLC) issue on the default risk of deposits. He developed a model of analyzing the payoff characteristics of SLCs and loan sales. The model was then used to analyze the effect of capital requirements and deposit insurance on the incentive to engage in off balance sheet activities. This empirical analysis was based on the sample of fifty-eight banks and the information of interest was monthly stock prices and balance sheet formation.

Two models were developed; one relating average interest rate paid on certificates of deposit to balance sheet measures of credit risk, interest rate and financial leverage. The other model related certificates of deposit to the variance in the bank's stock returns over the presuming twelve months. On the basis of empirical results he observed that the motive for loan sales and SLC issues is to avoid an under investment problem that arises when a bank has a risky debt outstanding. He argues that SLCs and loan sales like secured debt reduce the under investment problem by permitting the bank to sell claims to a proportion payoff of new loans that would otherwise accrues to existing deposits.

Jarko and Christa (2006) concluded that, firms are more likely to default the less liquid and the less profitable they are, in their paper, default rates in the loan market for SMEs. Based on the existing literature on bankruptcy, they selected two control variables which were crucially important for the financial wealth of the firms. First, the SMEs that had of relatively higher cash amounts and finance available in their bank accounts (relative to

total assets) are significantly less likely to default on their loans in the next 18 months than the rest of the sample.

This variable reflects the liquidity and solvency channels. Second, companies that had high earnings before taxation (as a share of total assets) are also less likely to default on their loan in the following reporting period than the average of the sample. This channel indicates the profitability of the SMEs. From the point of view of the discussion on financial ratios, bank loans as a share of current short-term liabilities represent the debt factors of financial distress. Both the theoretical literature on agency problems and the empirical literature on the determinants of corporate bankrupt suggest that more highly indebted firms are more likely to default.

The interest rate may be useful for mobilization of financial savings as the liberalization theory rightly argues. However, the transmission of deposits to potential borrowers or the willingness on banks to lend depends much on the banks expected return. Bank lending may not increase monotonically as interest rate increases, even if there were investors willing to pay higher interest rates. Banks face adverse selection imperfect information and information asymmetry, as interest rates increase actual credit supply may decrease, as expected bank returns on lending is expected to fall. The expected bank returns (taking into account the possibility of defaults) may fall because at higher interest rates safer borrowers, that is, those that are less likely to default may be deterred by the high cost of borrowing.

According to Stiglitz and Weiss (1981) and Stiglitz (1993), there is an optimal value of interest rate at which, the expected return to the bank will be maximum, beyond this level banks will lend less as the risk of loss increases. As deposits rates increase to mobilize deposits, banks also increase lending rates, otherwise it would be of no profit for the bank to lend. An increase in deposits will not simply translate into increased credit, irrespective of the willingness of banks to lend and the demand for loans as the liberalization theory predicts.

The willingness of banks to lend may depend on such factors default rates, net worth (this may help cushion losses), bankruptcies in the financial system, interest rates and the characteristic of the potential borrower.

(Adriana arizena,2009), confirms that argument by proponents of interest rate liberalization that high deposit rates may mobilize financial savings may be acceptable, the assumption that credit is deposit constrained, without due consideration of demand factors and the willingness of banks to lend is too simplistic. Repression theories emphasize the importance of the supply of funds at banks. He argues that the supply and demand of funds from formal financial institutions are determined by different factors. Consequently, it is possible that the demand for credit may be lower than the supply of funds or vice versa.

Availability of funds at banks may not automatically lead to increased credit, if banks are unwilling to lend or if the demand for credit is low. If credit is constrained by demand factors such as lack of credit-worthy borrowers and investment opportunities, then these

issues are equally important and thus deserve to be addressed in the efforts to enhance private sector activity.

McKinnon (1973) hypothesized complementarity between money holdings and capital accumulation. He argued that, in developing countries, investors rely on self finance and since capital markets are underdeveloped, they (investors) need to accumulate money before investment takes place. High positive real deposit rates are necessary to encourage agents to accumulate funds.

The other channel argued by Shaw (1973) is that high positive rates on financial assets encourage financial savings, with increased deposit liabilities, the financial sector lends more resources for productive investment. The diagnosis presented implies that credit is constrained by deposits. It neglects demand factors and the willingness of banks to lend. It is as Says Law says 'supply determines its own demand' increased deposits at the banks will automatically result in increased lending. Proponents of the repression theory have also argued that high lending rates will discourage low yielding investments, thus increase overall productivity of capital resources.

Commercial banks were required to hold 6 percent of their net deposits at the Central Bank in December, 1986 this cash ratio was raised to 8 percent in April, 1993. The raising of the cash ratio is a means of restricting credit and money creation by banks. In the fractional banking system, any increase in deposits makes it possible for a bank to increase credit subject to the cash ratio, existing demand and willingness of the bank to

lend. Thus one would expect that any increase in deposits, *ceteris paribus*, whether as a result of increase in deposit rate or otherwise will result in an increase in credit. In this way, the argument that an increase in deposits will enable banks to increase credit, follows automatically from the operation of the fractional banking system as banks try to maximize their returns.

Devinaga Rasiah, (2002), in his paper *Theoretical Framework of Profitability as Applied to Commercial Banks in Malaysia* Concluded that the competition for deposits is really a competition for profits. Commercial banks compete for deposits in order to become larger and thus to be able to supply more funds to the public. However such financial growth is profitable only if the commercial bank does not incur additional expenses to obtain and retain cash.

Capital structure in commercial banks is made up of shareholders' funds, reserves and retained profits. In addition, capital also represents a source of funds along with deposits and borrowings which is regulated by the capital adequacy requirements. The capital structure is assumed to affect the profitability of commercial banks via its effect on leverage and hence on risk.

To this extent, the assets of the commercial banks can either be capital or debt financed. However, debt financing can be more risky compared to capital financing in view of the credit risk and liquidity risk faced by the commercial banks. A commercial bank with higher capital asset ratio would be able to assume higher risk. This may induce the

commercial banks to absorb greater risk in their asset portfolios in the hope of maximizing expected returns.

Loans are among the highest yielding assets a bank can add to its balance sheet, and they provide the largest portion of operating revenue. In this respect, the banks are faced with liquidity risk since loans are advanced from funds deposited by customers. However, the higher the volume of loans extended the higher the interest income and hence the profit potentials for the commercial banks. At this point, it is also worth noting that banks with a high volume of loans will also be faced with higher liquidity risk. A high volume of loans alone is not a guarantee for high interest income.

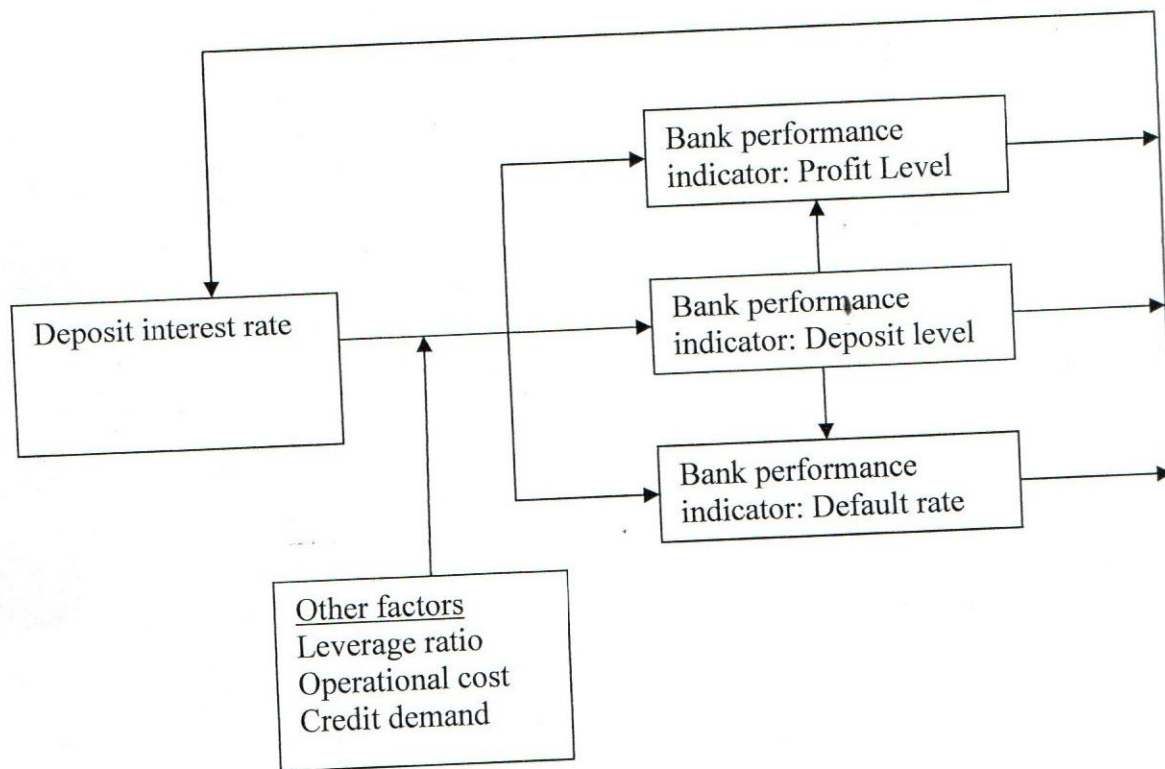
An institution aiming at full self-sufficiency must, of course, set a spread between loan and deposit interest rates that enables institutional profitability. However, adjusting the interest rates requires some experimentation. For example, a savings instrument that features easy and quick access (liquidity) and is in high demand can be labour-intensive to manage. It is, therefore, costly to a bank especially if there are a large number of very small accounts.

Experience indicates that most savers who select liquid accounts are not highly interest rate sensitive, generally preferring better service to higher interest rates. Labour and other non-financial costs must be considered when setting interest rates on deposits. These costs are difficult to determine in advance, so pilot-tests are needed to estimate cost accurately. (Sopani, 2001)

Zambrano, Vera and Faust (2001), find that operating costs have are significant to explain banking spreads in Venezuela. The paper also shows that commercial banks in become more efficient with financial liberalization. While they are quite profitable in that they provide their shareholders with high return, they remain inefficient in the use of such funds.

The cost of labour, property, rents and technology would be the most significant cost items in the commercial banks operating expenses. The proportion of staff cost to total operating cost in most Asian counties is reaching an unprecedented level of between of 60% to 65%. That is, the more cash a commercial bank has the greater is its capacity to make profits. And because the commercial bank always utilises its funds to the full in lending funds, the greater is the commercial banks' profitability.

## 2.5 Conceptual Framework



**Figure 1: Effects of deposit interest rate on Bank performance**

*Source: Own*

Deposit interest rate affects the performance of banks which is shown by three indicators, profit level, deposit level and default rate.

Deposit interest rate affects the profit level in terms of the interest spread rate. The interest spread rate is the spread between interest on loan and interest paid on deposit which will affect the performance of the bank. An increase in deposit interest rate reduces the interest spread rate, which impacts negatively on the profitability of the bank hence a negative effect on the performance of the bank. A decrease in the deposit interest rate

increase the interest spread rate hence a positive effect on profit level and consequently have a positive effect on the performance of the bank

An increase in the deposit rate acts as an incentive to customer to place their money with a bank. This leads to an increase in the deposit held by the bank. This improves the liquidity position of the banks and ability to provide cash in the face of unanticipated withdrawals, hence a positive effect on the performance of the bank. A decrease in deposit rate discourages customer to place their money with the bank, thereby reducing the deposit level of the bank. This affects the liquidity position of the bank and has a negative effect on the performance of the bank .

If the deposit interest rate increases the default rate increases. For banks to improve their profit level they may increase the interest rate on loans when the deposit interest rates increase. As a result loans become expensive and hence lead to an increase of non-performing loans thus increasing the default rate. This will have a negative effect on the performance of the bank. However if the deposit interest rate reduces, banks may not increase the interest rate on loans. Loans become more affordable and default rate reduces, this has a positive effect on the performance of the bank.

An increase in the deposit level could mean that bans have an increase in loan able funds which in turn improves the returns for banks and might have a positive effect on the performance of the bank. A decrease in the deposit level could mean reduction in loan able funds which in turn reduces the returns for banks and might have a negative effect

on the performance of the bank. An increase in deposit level may imply increase in funds for banks to lend at an affordable interest rate, this reduces the rate at which customers default and cushions the bank against bad debts and thus a positive effect on the performance of the banks

### **2.5.1 Other Factors**

An increase in the operational cost has a negative effect on the profit level of commercial banks. Costs reduce income and lead to reduced profit, hence a negative effect on the performance of the bank. A decrease in the operational cost increases income and consequently profits thus having a positive effect on the performance of a commercial banks.

An increase in credit demand has a positive effect on the profit level. When the credit demand increases the number of loans and advances made by the bank increases. As a result interest income earned by the bank increases and lead to increased profits. This has a positive effect on the performance of the bank. A decrease in credit demand reduces number of loan and advances made by the bank hence reducing the interest income. This reduces profits, which means a negative effect on the performance of the bank.

A high leverage ratio increases the probability of having a high number of non-performing loans. This will mean that the default rate will increase hence a negative effect on the performance of the bank. A low leverage ratio implies low risk and may reduce the default rate hence appositve effect on the performance of the bank.

## CHAPTER THREE: RESEACH METHODOLOGY

### 3.1 Research design

This is an exploratory research design that has enabled the researcher collect data and examine the effect of the independent variables on the dependent variables

### 3.2 Population of the study

The population of the study comprised all commercial banks in Nairobi Central Business District. The populations size consisted of forty two (42) commercial banks operating in Nairobi city twelve (12) of which are foreign owned and thirty (30) are local owned. Out of the thirty (30), three (3) are considered public financial institutions.

### 3.3 Sampling Technique

The technique that was used in this study is stratified sampling and the banks were picked by use of convenience random sampling. The sample was stratified into two groups, the foreign owned and Local owned. The random sample per strata was calculated using the sample proportion to the total size.

#### 3.3.1 Sample size

The following formula was used for estimating sample size. (Krejcie and Morgan, 1970)

$$S = \frac{N P (1-P)}{D^2 (N-1) + P (1-P)}$$

$$S = 36$$

where S is the sample size

N is the population size =42

P is Population Proportion that for table construction has been assumed=.50 as magnitude yields maximum possible sample size required.

D is the degree of accuracy as reflected by the amount of error that can be tolerated in the fluctuation of a sample proportion = 1.96

### 3.3.2 Sampling procedures

The population was divided into two stratum. The first strata comprised of foreign owned banks with a total number of 12 banks. The second comprised of the local banks with a total number of 30 banks. The sample size was 36 banks. The researcher used sampling proportion to size to select the number of banks to be sampled within each strata.

$$\text{Sampling proportion to size} = (t/N) * n$$

where t= Total number of banks within a strata

N= Total population of banks, 42

n= Sample size, 36

Therefore sample size=36 commercial banks

Total banks in Nairobi Central Business District =42

Foreign owned banks =12

Sampling proportion to size is =  $(12/42) \times 36 = 10$

Local banks =30

Sampling proportion to size is =  $(30/42) \times 36 = 26$

Sample size =36

Ten banks in the first strata and twenty six banks in the second strata were selected through convenience sampling.

### **3.4 Data collection**

The researcher used secondary data from published materials such as the annual reports and the financial statements. The information was collected using a checklist. As such information collected included deposit rates, profit level, default rate, deposit level, operating cost, leverage ratio, credit demand and bank age for all the 36 banks from the year 2002-2006.

### **3.5 Analytical Method**

Multi regression technique has been used to assess the effect of the dependent variable and independent variable. This technique is suitable because there is more than one independent variable. Correlation Analysis was also used to show the relationship between the dependent variables, which have been affected by similar independent variables.

#### **3.5.1 Multi Regression**

According to Freedman (1982) a line in a two dimensional or two-variable space is defined by the equation  $Y=a+bX$ ; in full text: the  $Y$  variable can be expressed in terms of a constant ( $a$ ) and a slope ( $b$ ) times the  $X$  variable. The constant is also referred to as the intercept, and the slope as the regression coefficient or B coefficient. Multiple regression helps us understand how the typical value of the dependent variable changes when any one of the independent variables is varied, while the other independent variables are held fixed its also used for prediction and forecasting. The regression parameters or coefficients  $b_i$  in the regression equation is as follows

$$Y = b_0 + b_1 X_1 + b_2 X_2 + b_3 X_3 + \dots + b_k X_k$$

There are 3 Multiple regressions referred as seemingly but unrelated regressions i.e with different dependents but similar independent variables. The routine for estimation remains multiple regression as below. Thus the following equations will be used.

$$y_1 = a + b_1x_1 + b_2x_2 + b_3x_3 + b_4x_4$$

$$y_2 = a + b_1x_1 + b_2x_2 + b_3x_3 + b_4x_4$$

$$y_3 = a + b_1x_1 + b_2x_2 + b_3x_3 + b_4x_4$$

where;  $y_1$  = Deposit level

$y_2$  = Profit level

$y_3$  = Default rate

$a$  = the intercept

$x_1$  = deposit rate

$x_2$  = leverage ratio

$x_3$  = Operational cost

$x_4$  = Credit demand

### 3.5.2 Correlation Analysis

According to Rogers (1988) the quantity  $r$ , called the *linear correlation coefficient*, measures the strength and the direction of a linear relationship between two variables. The linear correlation coefficient is sometimes referred to as the *Pearson product moment correlation coefficient*. The Pearson correlation is +1 in the case of a perfect positive (increasing) linear relationship, -1 in the case of a perfect decreasing (negative) linear relationship, and some value between -1 and 1 in all other cases, indicating the degree of linear dependence between the variables. As it approaches zero

there is less of a relationship. The closer the coefficient is to either -1 or 1, the stronger the correlation between the variables.

$$r = \frac{n \sum xy - (\sum x)(\sum y)}{\sqrt{n(\sum x^2) - (\sum x)^2} \sqrt{n(\sum y^2) - (\sum y)^2}}$$

Thus the following equations will be used

$$\text{Correlation}(r) = [N \sum y_1 y_2 - (\sum y_1)(\sum y_2) / \text{Sqrt}([N \sum y_1^2 - (\sum y_1)^2][N \sum y_2^2 - (\sum y_2)^2])]$$

$$\text{Correlation}(r) = [N \sum y_2 y_3 - (\sum y_2)(\sum y_3) / \text{Sqrt}([N \sum y_2^2 - (\sum y_2)^2][N \sum y_3^2 - (\sum y_3)^2])]$$

$$\text{Correlation}(r) = [N \sum y_3 y_1 - (\sum y_3)(\sum y_1) / \text{Sqrt}([N \sum y_3^2 - (\sum y_3)^2][N \sum y_1^2 - (\sum y_1)^2])]$$

where N = Number of elements

$y_1$  is Deposit level

$y_2$  is Profit level

$y_3$  is Default rate

$\sum y_1 y_2$  = Sum of the product of deposit level and profit level

$\sum y_2 y_3$  = Sum of the product of profit level and default rate

$\sum y_3 y_1$  = Sum of the product of default rate and deposit level

$\sum y_1$  = Sum of deposit level

$\sum y_2$  = Sum of profit level

$\sum y_3$  = Sum of default rate

$\sum y_1^2$  = Sum of square deposit level

$\sum y_2^2$  = Sum of square profit level

$\sum y_3^2$  = Sum of square default rate

## CHAPTER FOUR: RESULTS AND DISCUSSION

### 4.1 Determinants of deposit level

To address the first objective, a multiple regression with the deposit level as the dependent variable was estimated. Model results show an F value of 73.6 which was significant at 1% and an adjusted  $R^2$  of 91%. This shows that the independent variables used significantly explain 91% of changes in deposit level as shown below

**Table One: Parameter Estimates of factors that influence deposit level**

F	73.57	P	0.0001			
$R^2$	91%					
Variable	Label	DF	Estimate	Error	t Value	Pr >  t
Intercept	Intercept	1	-11695	12456	-0.94	0.3553
Deposit rate	Deposit rate	1	262.61612	299.0154	0.88	0.3868
Leverage ratio	Leverage ratio	1	51.88191	103.5768	0.5	0.6201
Operating cost	Operating cost	1	54.99757	91.87803	0.6	0.5539
Credit demand	Credit Demand	1	0.94011	0.10015	9.39	<.0001

From the parameter estimates, only Credit demand is significant. Deposit rate, leverage ratio and operating cost, are not significant.

This implies that deposit interest rate tends to remain constant over a number of years thereby not bringing attractive returns to the customer. As such customers tend to direct their money to other financial investments like shares.

According to CBK's 2007/08 annual report, the level of savings among Kenyans has been declining over the years especially with Government securities becoming a cheaper

and safer investment. The average lending and deposit interest rates are currently fixed at 14.06 per cent, and 4.48 per cent respectively. This compares unfavorably with 91-days T-Bill rate and 182-days T-Bill rates that stood at an 8.557 per cent and 9 per cent respectively.

Giovani (1993) fails to find any significant effect of deposit rate on savings in a sample of 11 Asian countries using a pooled time series data. Gupta (1978) suggests that real income is the most important determinant of national savings

The credit demand has a significant effect on the deposit level of a commercial bank because a bank's ability to lend may be constrained by the level of deposits and its willingness to do so. According to Shaw (1973), with increased liabilities the financial sector lends more resources for productive investment hence any increase in deposit will result in increased credit

#### **4.2 Determinants of Profit level**

To address the Second objective, a multiple regression with the profit level as the dependent variable was estimated. Model results show an F value of 9.08 which was significant at 1% and an adjusted  $R^2$  of 54%. This shows that the independent variables used significantly explain 54% of changes in profit level as shown below

**Table Two: Parameter Estimates of factors that influence profit level**

F	9.08	P	0.0001			
R <sup>2</sup>	54%					
Variable	Label	DF	Estimate	Error	t Value	Pr >  t
Intercept	Intercept	1	240.3396	1492.52	0.16	0.8731
Deposit rate	Deposit rate	1	4.70607	35.8281	0.13	0.8964
Leverage ratio	Leverage ratio	1	-3.49402	12.4106	-0.28	0.7802
Operating cost	Operating cost	1	-1.14407	11.0088	-0.1	0.9179
Credit demand	Credit demand	1	0.04939	0.012	4.12	0.0003

From the parameter estimates, only Credit demand is significant, deposit rate, leverage ratio and Operating cost are not significant.

This can be as a result of the interest spread rate. A key indicator of financial performance and efficiency is the spread between lending and deposit interest rates. This is what is referred to as the interest spread rate and what normally contributes to profitability changes. This means deposit interest rate on its own cannot contribute significantly to profitability changes.

Kibe (2003) emphasized that factors influencing profitability of commercial banks include interest rate risk managements exposure to the bank resulting from unexpected variation in the interest spread rate, credit risk management of default and liquidity management. Rose (1993) concluded that the internal determinants of profitability of a commercial bank are items involving total revenue and total cost

Credit demand had a significant effect on the profit level. Credit represents loan and advances issued by commercial banks. The returns from the loans and advances form the basis of the interest income earned by a commercial bank. Therefore as the credit demand increases the interest income increases which impacts positively on the profit level of commercial banks

### 4.3 Determinants of Default rate

To address the third objective, a multiple regression with the deposit level as the dependent variable was estimated. Model results show an F value of 3.69 which was significant at 1% and an adjusted  $R^2$  of 27.8%. This shows that the independent variables used significantly explain 27% of changes in deposit level as shown below

**Table Three: Parameter Estimates of factors that influence Default rate**

F	3.69	P	0.01			
$R^2$	27%					
Variable	Label	DF	Estimate	Error	t Value	Pr >  t
Intercept	Intercept	1	91.46153	30.131	3.04	0.0049
Deposit rate	Deposit rate	1	0.12034	0.7233	0.17	0.869
Leverage ratio	Leverage ratio	1	-0.8429	0.2506	-3.4	0.0021
Operating cost	Operating Cost	1	-0.08262	0.2223	-0.4	0.7127
Credit demand	Credit demand	1	0.000477	0.0002	1.97	0.0682

From the parameter estimates, only Leverage ratio is significant, Deposit rate, Operating cost and Credit demand are not significant

This indicates that default rate is greatly determined by non-performing loans and as such deposit interest rate may not play an important role in changing the default rate. However the default rate still plays a significant role in affecting the profitability of the bank because of the provisions that are made for bad debts.

Leverage ratio also had a significant effect on the default rate. Banks invest depositors' money in loans at rates high enough to cover the cost of funds and operating expenses and yield a profit margin. A high leverage ratio indicates difficulty in paying interest and principal while obtaining more funding hence the more risky a bank will perceive its exposure in business, thereby increasing the probability of having a high number of non performing loans.

Rasiah (2002) emphasized that the asset of a commercial bank can either be capital or debt financed. However debt financing can be more risky compared to capital financing in view of the credit risk and liquidity risk faced by commercial banks. In this respect banks are faced with liquidity risk since loan are advanced from funds deposited by customers.

#### 4.4 Correlation Analysis

Using a Correlation Analysis to show the relationship between deposit level, profit level and default rate the following is obtained

**Table Four: Correlation Analysis of dependent variables**

		deposit level	profit level	default rate
deposit level	Pearson Correlation	1	-0.192	.379
	Sig.(2-tail)		0.263	0.022
	N	36	36	36
profit level	Pearson Correlation	-0.192	1	-0.089
	Sig.(2-tail)	0.263		0.608
	N	36	36	36
default rate	Pearson Correlation	.379*	-0.089	1
	Sig.(2-tail)	0.022	0.608	
	N	36	36	36

The above model shows that the deposit level has a significant effect on default rate at 0.05 level of confidence and shows they are positively correlated.

From the Correlation Analysis the deposit level and default rate had a positive correlation. Christophe (2003) showed that the existence of a guarantee fund which insures deposits reduces the depositors' incentives to monitor the bank and therefore reduces market discipline. Thus with increased deposit level, bank use deposits to finance risky credits and can generate excess risk. This kind of behavior could lead to a more costly default of the bank.

He also used total loans to total deposit ratio which showed there was a negative relationship between the amount of deposits used in this intermediation process and the degree of exposure that bank has to liquidity or insolvency risk. In addition, the lower the amounts of deposits used, the less pronounced the moral hazard problem becomes, as fixed prime deposits insurance may cause the bank to engage into excessively risky activities.

**Table Five: Correlation Analysis of independent variables**

		deposit rate	leverage ratio	operating cost	credit demand
deposit rate	Pearson Correlation	1	.331	-0.079	-0.155
	Sig.(2-tail)		0.049	0.646	0.367
	N	36	36	36	36
leverage ratio	Pearson Correlation	.331	1	-.396	-0.298
	Sig.(2-tail)	0.049		0.017	0.078
	N	36	36	36	36
operating cost	Pearson Correlation	-0.079	-.396	1	.331
	Sig.(2-tail)	0.646	0.017		0.049
	N	36	36	36	36
credit demand	Pearson Correlation	-0.155	-0.298	.331	1
	Sig.(2-tail)	0.367	0.078	0.049	
	N	36	36	36	36

From the above table, the model shows that there is no multicollinearity problem of the independent variables hence the variables are fit for the analysis

## **CHAPTER FIVE: SUMMARY, RECOMMENDATIONS AND CONCLUSIONS**

### **5.1 Summary**

From the analysis of the data collected and the test of the hypothesis the deposit interest rate has no significant effect on the performance of the commercial banks in terms of the deposit interest rate, deposit level and default rate.

The returns from the loans in form of high interest paid on the loan and returns from the investment contribute greatly to the profits made by a commercial bank as compared to the low interest paid on the deposits made. Banks take deposits from savers, paying interest on some of these accounts. They pass these funds on to borrowers, receiving interest on the loans.

Their profits are derived from the spread between the rate they pay for funds and the rate they receive from borrowers. This ability to pool deposits from many sources that can be lent to many different borrowers creates the flow of funds inherent in the banking system. By managing this flow of funds, banks generate profits, acting as the intermediary of interest paid and interest received and taking on the risks of offering credit.

Basically, when the interest that a bank earns from loans is greater than the interest it must pay on deposits, it generates a positive interest spread or net interest income. The size of this spread is a major determinant of the profit generated by a bank.

Although the deposit interest rate is supposed to act as an incentive to the customers, it seems to be having little effect on the customer's decision to save. According to CBK's 2007/08 annual report, the level of savings among Kenyans has been declining over the years especially with Government securities becoming a cheaper and safer investment. The average lending and deposit interest rates are currently fixed at 14.06 per cent, and 4.48 per cent respectively. This compares unfavorably with 91-days T-Bill rate and 182-days T-Bill rates that stood at an 8.557 per cent and 9 per cent respectively.

The default rate is greatly affected by non performing loans and not by the deposit interest rate paid. Credit risk is the potential that a bank borrower will fail to meet the obligations in accordance with agreed terms. When this happens, the bank will experience a loss of some or all of the credit it provided to its customer

Therefore customers may not be able to meet interest payments because of the increase in the size of the payment or a reduction in earnings. The result will be a higher level of non performing loans. An increase in interest rates exposes a bank with a significant concentration in adjustable rate loans to credit risk

## **5.2 Conclusions**

Deposit interest rates can be used to shape the kind of customers each bank serves. Changing the rates affect the spread between bank loan rates and deposit interest rates. Banks tend to rely heavily on loans as a source of their returns.

However the sources of these loans are the deposits that they make to create loan able funds. If customers direct their money to other types of investments where they can get better returns, it will constrain the pool of deposits for banks.

This may result to issuing of loans at very high interest rate thereby increasing the default rate. As banks focus on their profitability strategies they should also endeavor to attract and maintain customers which in turn influences the performance of the bank.

As financial institutions, banks assume two primary types of risk as they manage the flow of money through their business. Interest rate risk is the management of the spread between interest paid on deposits and received on loans over time. Credit risk is the likelihood that a borrower will default on its loan or lease, causing the bank to lose any potential interest earned as well as the principal that was loaned to the borrower.

### **5.3 Recommendations**

The researcher would like to recommend further study on interest rates applied on the different types of deposits such as customer deposit, government deposit, deposit due to other financial institutions and negotiable bearer deposit and how this impacts on the profitability of commercial banks.

The researcher would also like to recommend study on factors that contribute to the changes in deposit level and how these can be used not only to attract but retain customers. The researcher would also want to recommend and analysis of the effectiveness of the regulatory policies governing deposit requirements and how other

factors if varied will affect the profitability, deposit level and default rate of commercial banks.

The researcher would recommend an in-depth analysis of the financial indicators and measures and how they can affect the overall performance of a commercial bank.

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## APPENDIIX 1: INDEPENDENT VARIABLES

	X1	X2	X3	X4
	Deposit rate (%)	Leverage ratio (%)	Operating cost (%)	credit demand Ksh (000000)
a) Foreign owned				
Bank of Africa (K) Ltd.	0.89	85.54	72.87	3,184.40
Bank of Baroda (K) Ltd.	2.56	84.06	53.66	2,703.40
Bank of India	2.00	85.74	48.19	1,966.40
Barclays Bank of Kenya Ltd.	8.51	88.12	88.01	65,830.60
Citibank N.A. Kenya	2.51	84.79	73.29	10,745.40
Diamond Trust Bank Kenya Ltd.	3.32	85.64	62.93	8,118.60
Habib Bank A.G. Zurich	0.72	89.25	70.71	1,008.40
Habib Bank Ltd.	0.63	86.87	71.04	842.20
K-Rep Bank Ltd.	0.38	73.07	82.63	2,229.60
Standard Chartered Bank (K) Ltd.	7.16	89.21	78.07	27,162.40
b) Local owned				
African Banking Corporation Ltd.	1.16	88.47	66.99	2,273.80
Chase Bank (K) Ltd.	0.47	75.53	68.24	1,345.20
City Finance Bank Ltd.	0.02	34.50	94.21	369.40
Commercial Bank of Africa Ltd.	3.74	89.68	71.74	8,631.40
Consolidated Bank of Kenya Ltd.	0.44	77.04	90.73	2,068.20
Co-operative Bank of Kenya Ltd.	7.71	92.23	75.90	33,462.60
Credit Bank Ltd.	0.84	81.82	59.82	1,290.60
Development Bank of Kenya Ltd.	0.31	60.31	54.51	1,403.00
Dubai Bank Kenya Ltd	0.09	61.62	89.53	756.20
Equatorial Commercial Bank Ltd.	0.85	83.74	59.74	1,772.00
Cfc stanbic	1.15	88.72	83.68	10,689.20
Fidelity Commercial Bank Ltd.	19.99	82.49	52.94	1,093.20
Fina Bank Ltd.	2.68	89.01	54.70	3,801.20
Giro Commercial Bank Ltd.	2.00	90.49	52.51	3,151.00
Guardian Bank Ltd.	1.79	83.26	48.31	3,106.80
Imperial Bank Ltd.	4.80	84.55	42.35	4,065.80
Kenya Commercial Bank Ltd.	8.00	88.87	87.43	43,791.00
Middle East Bank (K) Ltd.	0.87	79.49	61.25	1,670.60
National Bank of Kenya Ltd.	5.08	90.99	72.09	41,451.00
NIC Bank Ltd.	3.90	81.75	63.99	11,465.00
Oriental Commercial Bank Ltd.	0.13	61.73	78.37	1,514.80
Paramount Universal Bank Ltd.	0.57	78.58	60.14	1,133.20
Prime Bank Ltd.	2.09	87.91	51.46	3,158.80
Southern Credit Banking Corp Ltd.	1.73	86.50	57.29	2,236.20
Trans-National Bank Ltd.	0.22	53.72	88.98	1,223.40
Victoria Commercial Bank Ltd.	1.22	85.78	47.61	1,842.40

## APPENDIX 2: DEPENDENT VARIABLES

	Y1	Y2	Y3
	Deposit level(ksh 000000)	Profit level(ksh 000000)	Default rate (%)
a) Foreign owned			
Bank of Africa (K) Ltd.	4,280.00	50.60	2.31
Bank of Baroda (K) Ltd.	7,406.00	213.80	10.37
Bank of India	5,377.60	152.80	5.92
Barclays Bank of Kenya Ltd.	81,598.80	4,955.60	14.43
Citibank N.A. Kenya	18,713.00	1,031.20	3.81
Diamond Trust Bank Kenya Ltd.	10,346.00	337.60	2.25
Habib Bank A.G. Zurich	3,792.20	105.40	5.31
Habib Bank Ltd.	2,652.40	64.80	6.76
K-Rep Bank Ltd.	1,774.00	103.20	3.45
Standard Chartered Bank (K) Ltd.	58,082.20	3,447.20	6.21
b) Local owned			
African Banking Corporation Ltd.	3,709.60	98.60	7.21
Chase Bank (K) Ltd.	1,686.60	38.00	3.83
City Finance Bank Ltd.	83.80	-5.40	52.11
Commercial Bank of Africa Ltd.	18,563.00	619.80	8.39
Consolidated Bank of Kenya Ltd.	2,002.60	0.60	40.19
Co-operative Bank of Kenya Ltd.	36,870.60	521.60	27.39
Credit Bank Ltd.	1,921.40	61.40	17.23
Development Bank of Kenya Ltd.	1,011.20	110.40	29.64
Dubai Bank Kenya Ltd	564.20	12.20	23.06
Equatorial Commercial Bank Ltd.	2,580.00	93.40	8.09
Cfc stanbic	11,945.00	279.80	4.11
Fidelity Commercial Bank Ltd.	1,301.00	16.00	19.34
Fina Bank Ltd.	6,537.20	77.20	13.23
Giro Commercial Bank Ltd.	4,073.80	26.60	21.70
Guardian Bank Ltd.	3,459.00	54.60	34.41
Imperial Bank Ltd.	5,228.00	280.20	8.42
Kenya Commercial Bank Ltd.	60,011.80	577.40	35.46
Middle East Bank (K) Ltd.	2,828.60	78.00	18.46
National Bank of Kenya Ltd.	25,081.80	683.60	43.21
NIC Bank Ltd.	13,320.00	430.40	8.90
Oriental Commercial Bank Ltd.	527.60	-200.40	71.30
Paramount Universal Bank Ltd.	1,157.40	15.60	23.49
Prime Bank Ltd.	5,332.60	114.40	11.16
Southern Credit Banking Corp Ltd.	3,120.60	37.40	28.70
Trans-National Bank Ltd.	952.20	109.60	26.42
Victoria Commercial Bank Ltd.	3,137.80	70.00	6.69

**DEPOSIT LEVEL Kshs("000000)**

a) Foreign owned	2006	2005	2004	2003	2002	Avg
Bank of Africa (K) Ltd.	5,344.00	4,511.00	3,994.00	3,912.00	3,639.00	4,280.00
Bank of Baroda (K) Ltd.	10,224.00	8,082.00	7,182.00	7,051.00	4,491.00	7,406.00
Bank of India	7,317.00	5,999.00	4,969.00	4,755.00	3,848.00	5,377.60
Barclays Bank of Kenya Ltd.	96,106.00	83,475.00	81,876.00	77,417.00	69,120.00	81,598.80
Citibank N.A. Kenya	2,998.00	22,697.00	20,118.00	22,951.00	24,801.00	18,713.00
Diamond Trust Bank Kenya Ltd.	16,952.00	13,846.00	9,304.00	6,862.00	4,766.00	10,346.00
Habib Bank A.G. Zurich	4,377.00	4,048.00	3,813.00	3,444.00	3,279.00	3,792.20
Habib Bank Ltd.	2,435.00	2,356.00	2,794.00	3,058.00	2,619.00	2,652.40
K-Rep Bank Ltd.	3,308.00	1,960.00	1,602.00	1,179.00	821.00	1,774.00
Standard Chartered Bank (K) Ltd.	67,468.00	59,683.00	56,785.00	54,357.00	52,118.00	58,082.20
b) Local owned						
African Banking Corporation Ltd.	4,452.00	4,433.00	3,475.00	3,277.00	2,911.00	3,709.60
Chase Bank (K) Ltd.	3,369.00	1,866.00	1,422.00	1,031.00	745.00	1,686.60
City Finance Bank Ltd.	126.00	94.00	74.00	73.00	52.00	83.80
Commercial Bank of Africa Ltd.	32,667.00	26,537.00	17,788.00	1,607.00	14,216.00	18,563.00
Consolidated Bank of Kenya Ltd.	2,534.00	1,950.00	1,968.00	1,617.00	1,944.00	2,002.60
Co-operative Bank of Kenya Ltd.	50,462.00	44,094.00	39,456.00	27,151.00	23,190.00	36,870.60
Credit Bank Ltd.	1,995.00	2,278.00	2,252.00	1,721.00	1,361.00	1,921.40
Development Bank of Kenya Ltd.	1,774.00	1,129.00	586.00	918.00	649.00	1,011.20
Dubai Bank Kenya Ltd	801.00	710.00	479.00	401.00	430.00	564.20
Equatorial Commercial Bank Ltd.	3,281.00	3,053.00	2,163.00	2,400.00	2,003.00	2,580.00
Cfc stanbic	22,290.00	12,662.00	9,177.00	8,633.00	6,963.00	11,945.00
Fidelity Commercial Bank Ltd.	1,977.00	1,384.00	1,286.00	961.00	897.00	1,301.00
Fina Bank Ltd.	8,276.00	7,359.00	7,305.00	5,106.00	4,640.00	6,537.20
Giro Commercial Bank Ltd.	4,511.00	4,353.00	4,185.00	3,762.00	3,558.00	4,073.80
Guardian Bank Ltd.	3,995.00	3,567.00	3,276.00	3,246.00	3,211.00	3,459.00
Imperial Bank Ltd.	7,734.00	6,441.00	4,680.00	3,903.00	3,382.00	5,228.00
Kenya Commercial Bank Ltd.	77,802.00	64,512.00	57,522.00	51,319.00	48,904.00	60,011.80
Middle East Bank (K) Ltd.	2,347.00	3,007.00	3,160.00	2,556.00	3,073.00	2,828.60
National Bank of Kenya Ltd.	29,688.00	26,878.00	25,448.00	21,599.00	21,796.00	25,081.80
NIC Bank Ltd.	22,143.00	17,104.00	12,856.00	8,004.00	6,493.00	13,320.00
Oriental Commercial Bank Ltd.	733.00	537.00	638.00	483.00	247.00	527.60
Paramount Universal Bank Ltd.	1,745.00	1,163.00	1,012.00	902.00	965.00	1,157.40
Prime Bank Ltd.	8,400.00	6,078.00	4,757.00	4,462.00	2,966.00	5,332.60
Southern Credit Banking Corp Ltd.	3,928.00	3,621.00	3,231.00	2,731.00	2,092.00	3,120.60
Trans-National Bank Ltd.	1,264.00	901.00	1,196.00	523.00	877.00	952.20
Victoria Commercial Bank Ltd.	3,654.00	3,585.00	3,057.00	2,805.00	2,588.00	3,137.80

**PROFIT LEVEL Kshs("000000)**

a) Foreign owned	2006	2005	2004	2003	2002	Avg
Bank of Africa (K) Ltd.	61.00	7.00	139.00	1.00	45.00	50.60
Bank of Baroda (K) Ltd.	373.00	238.00	274.00	143.00	41.00	213.80
Bank of India	278.00	124.00	123.00	176.00	63.00	152.80
Barclays Bank of Kenya Ltd.	6,475.00	5,401.00	5,591.00	4,761.00	2,550.00	4,955.60
Citibank N.A. Kenya	1,530.00	1,285.00	356.00	826.00	1,159.00	1,031.20
Diamond Trust Bank Kenya Ltd.	681.00	427.00	263.00	204.00	113.00	337.60
Habib Bank A.G. Zurich	165.00	147.00	56.00	77.00	82.00	105.40
Habib Bank Ltd.	6.00	21.00	92.00	95.00	110.00	64.80
K-Rep Bank Ltd.	152.00	53.00	110.00	115.00	86.00	103.20
Standard Chartered Bank (K) Ltd.	3,810.00	3,513.00	2,691.00	4,010.00	3,212.00	3,447.20
b) Local owned						0.00
African Banking Corporation Ltd.	140.00	124.00	119.00	66.00	44.00	98.60
Chase Bank (K) Ltd.	111.00	65.00	-92.00	59.00	47.00	38.00
City Finance Bank Ltd.	-17.00	-47.00	11.00	11.00	15.00	-5.40
Commercial Bank of Africa Ltd.	1,343.00	369.00	437.00	568.00	382.00	619.80
Consolidated Bank of Kenya Ltd.	16.00	-12.00	-90.00	12.00	77.00	0.60
Co-operative Bank of Kenya Ltd.	1,256.00	714.00	356.00	181.00	101.00	521.60
Credit Bank Ltd.	90.00	90.00	47.00	49.00	31.00	61.40
Development Bank of Kenya Ltd.	128.00	165.00	97.00	103.00	59.00	110.40
Dubai Bank Kenya Ltd	20.00	29.00	31.00	9.00	-28.00	12.20
Equatorial Commercial Bank Ltd.	94.00	109.00	103.00	96.00	65.00	93.40
Cfc stanbic	921.00	444.00	153.00	-151.00	32.00	279.80
Fidelity Commercial Bank Ltd.	26.00	13.00	1.00	18.00	22.00	16.00
Fina Bank Ltd.	151.00	107.00	-51.00	106.00	73.00	77.20
Giro Commercial Bank Ltd.	59.00	-6.00	14.00	33.00	33.00	26.60
Guardian Bank Ltd.	48.00	56.00	53.00	52.00	64.00	54.60
Imperial Bank Ltd.	387.00	305.00	268.00	254.00	187.00	280.20
Kenya Commercial Bank Ltd.	3,167.00	1,948.00	1,074.00	877.00	-4,179.00	577.40
Middle East Bank (K) Ltd.	100.00	115.00	36.00	79.00	60.00	78.00
National Bank of Kenya Ltd.	934.00	859.00	743.00	492.00	390.00	683.60
NIC Bank Ltd.	677.00	403.00	373.00	359.00	340.00	430.40
Oriental Commercial Bank Ltd.	-65.00	-86.00	-369.00	-230.00	-252.00	-200.40
Paramount Universal Bank Ltd.	31.00	15.00	12.00	11.00	9.00	15.60
Prime Bank Ltd.	191.00	125.00	103.00	82.00	71.00	114.40
Southern Credit Banking Corp Ltd.	32.00	31.00	61.00	49.00	14.00	37.40
Trans-National Bank Ltd.	46.00	59.00	200.00	121.00	122.00	109.60
Victoria Commercial Bank Ltd.	128.00	124.00	45.00	31.00	22.00	70.00

**DEFAULT RATE(%)**

a) Foreign owned	2006	2005	2004	2003	2002	Avg
Bank of Africa (K) Ltd.	0.71	0.90	0.99	0.90	8.05	2.31
Bank of Baroda (K) Ltd.	4.29	6.63	8.36	15.78	16.79	10.37
Bank of India	3.58	3.40	6.90	8.24	7.50	5.92
Barclays Bank of Kenya Ltd.	11.75	17.06	13.40	14.85	15.07	14.43
Citibank N.A. Kenya	2.68	4.13	3.93	5.30	3.01	3.81
Diamond Trust Bank Kenya Ltd.	1.10	0.80	1.54	2.44	5.35	2.25
Habib Bank A.G. Zurich	3.26	4.13	4.51	7.18	7.46	5.31
Habib Bank Ltd.	5.62	11.42	4.13	3.71	8.92	6.76
K-Rep Bank Ltd.	3.54	4.38	4.18	3.66	1.47	3.45
Standard Chartered Bank (K) Ltd.	5.07	4.78	6.03	6.96	8.21	6.21
b) Local owned						0.00
African Banking Corporation Ltd.	7.43	5.25	6.12	8.03	9.22	7.21
Chase Bank (K) Ltd.	4.57	5.16	9.14	0.14	0.12	3.83
City Finance Bank Ltd.	64.69	70.39	34.52	36.28	54.68	52.11
Commercial Bank of Africa Ltd.	5.11	7.37	8.58	10.86	10.04	8.39
Consolidated Bank of Kenya Ltd.	24.05	26.92	55.59	46.51	47.89	40.19
Co-operative Bank of Kenya Ltd.	21.61	21.87	26.23	33.25	33.98	27.39
Credit Bank Ltd.	22.37	14.08	11.93	17.72	20.05	17.23
Development Bank of Kenya Ltd.	12.24	16.87	38.58	39.63	40.90	29.64
Dubai Bank Kenya Ltd	26.28	21.67	30.37	18.98	18.00	23.06
Equatorial Commercial Bank Ltd.	9.40	5.90	4.01	7.73	13.43	8.09
Cfc stanbic	2.01	1.44	1.41	4.87	10.80	4.11
Fidelity Commercial Bank Ltd.	13.24	12.24	16.71	24.80	29.69	19.34
Fina Bank Ltd.	10.66	11.10	14.44	13.91	16.03	13.23
Giro Commercial Bank Ltd.	13.76	19.14	23.63	24.92	27.05	21.70
Guardian Bank Ltd.	36.17	25.47	28.63	33.40	48.37	34.41
Imperial Bank Ltd.	6.37	7.51	8.76	9.58	9.89	8.42
Kenya Commercial Bank Ltd.	18.59	23.07	35.81	45.90	53.92	35.46
Middle East Bank (K) Ltd.	2.54	13.87	23.49	21.58	30.83	18.46
National Bank of Kenya Ltd.	29.70	31.62	49.77	52.86	52.10	43.21
NIC Bank Ltd.	7.33	4.75	4.88	9.95	17.57	8.90
Oriental Commercial Bank Ltd.	59.41	70.42	83.24	76.76	66.65	71.30
Paramount Universal Bank Ltd.	10.77	18.61	21.26	16.65	50.15	23.49
Prime Bank Ltd.	7.86	11.19	14.18	12.99	9.56	11.16
Southern Credit Banking Corp Ltd.	20.40	28.47	30.12	33.56	30.97	28.70
Trans-National Bank Ltd.	22.31	23.14	20.67	25.76	40.22	26.42
Victoria Commercial Bank Ltd.	0.57	1.61	2.63	10.45	18.20	6.69

**DEPOSIT RATE(%)**

a) Foreign owned	2006	2005	2004	2003	2002	Avg
Bank of Africa (K) Ltd.	1.08	0.98	0.37	0.92	1.10	0.89
Bank of Baroda (K) Ltd.	2.89	2.40	2.70	3.10	1.73	2.56
Bank of India	2.19	1.91	2.13	2.46	1.29	2.00
Barclays Bank of Kenya Ltd.	8.32	6.50	6.50	10.24	11.01	8.51
Citibank N.A. Kenya	3.28	3.17	1.49	1.71	2.88	2.51
Diamond Trust Bank Kenya Ltd.	5.46	4.80	3.00	1.73	1.60	3.32
Habib Bank A.G. Zurich	0.57	0.69	0.47	0.81	1.04	0.72
Habib Bank Ltd.	0.38	0.47	0.49	0.82	1.01	0.63
K-Rep Bank Ltd.	0.44	0.42	0.53	0.37	0.14	0.38
Standard Chartered Bank (K) Ltd.	9.50	7.47	4.85	6.47	7.52	7.16
b) Local owned						0.00
African Banking Corporation Ltd.	1.00	1.08	1.30	1.23	1.17	1.16
Chase Bank (K) Ltd.	0.76	0.46	0.56	0.32	0.24	0.47
City Finance Bank Ltd.	0.02	0.02	0.03	0.04	0.01	0.02
Commercial Bank of Africa Ltd.	5.34	4.70	2.31	2.63	3.73	3.74
Consolidated Bank of Kenya Ltd.	0.21	0.25	0.68	0.51	0.57	0.44
Co-operative Bank of Kenya Ltd.	6.51	10.88	6.97	6.50	7.70	7.71
Credit Bank Ltd.	0.65	0.86	1.17	0.83	0.70	0.84
Development Bank of Kenya Ltd.	0.45	0.29	0.23	0.27	0.30	0.31
Dubai Bank Kenya Ltd	0.08	0.07	0.04	0.09	0.15	0.09
Equatorial Commercial Bank Ltd.	0.75	0.75	0.90	0.90	0.95	0.85
Cfc stanbic	1.06	0.72	0.74	1.32	1.90	1.15
Fidelity Commercial Bank Ltd.	0.77	0.77	97.00	0.70	0.73	19.99
Fina Bank Ltd.	2.00	2.33	2.97	3.24	2.85	2.68
Giro Commercial Bank Ltd.	1.50	1.54	2.51	2.33	2.13	2.00
Guardian Bank Ltd.	1.53	1.62	2.28	1.95	1.57	1.79
Imperial Bank Ltd.	4.96	4.53	7.41	4.51	2.60	4.80
Kenya Commercial Bank Ltd.	4.75	4.54	6.59	10.72	13.42	8.00
Middle East Bank (K) Ltd.	0.63	0.88	0.84	0.95	1.06	0.87
National Bank of Kenya Ltd.	5.02	5.59	6.61	3.77	4.39	5.08
NIC Bank Ltd.	5.68	5.71	3.21	2.56	2.33	3.90
Oriental Commercial Bank Ltd.	0.16	0.14	0.29	0.07	0.00	0.13
Paramount Universal Bank Ltd.	0.50	0.40	0.72	0.63	0.58	0.57
Prime Bank Ltd.	2.34	2.01	2.31	2.26	1.54	2.09
Southern Credit Banking Corp Ltd.	1.43	1.56	2.27	2.08	1.30	1.73
Trans-National Bank Ltd.	0.19	0.20	0.26	0.19	0.26	0.22
Victoria Commercial Bank Ltd.	1.07	1.16	1.35	1.37	1.17	1.22

**LEVERAGE RATIO(%)**

a) Foreign owned	2006	2005	2004	2003	2002	avg
Bank of Africa (K) Ltd.	84.92	87.42	86.87	84.58	83.89	85.54
Bank of Baroda (K) Ltd.	89.27	88.47	88.37	62.48	91.69	84.06
Bank of India	88.25	88.09	84.12	84.75	83.50	85.74
Barclays Bank of Kenya Ltd.	87.38	87.39	88.83	88.63	88.37	88.12
Citibank N.A. Kenya	83.45	82.69	86.02	85.27	86.52	84.79
Diamond Trust Bank Kenya Ltd.	86.81	89.92	87.14	84.58	79.77	85.64
Habib Bank A.G. Zurich	87.80	88.55	89.94	89.83	90.12	89.25
Habib Bank Ltd.	84.94	85.19	87.77	88.60	87.84	86.87
K-Rep Bank Ltd.	82.80	78.86	71.78	68.31	63.59	73.07
Standard Chartered Bank (K) Ltd.	87.50	86.84	90.97	89.95	90.77	89.21
<b>b Local owned</b>						
African Banking Corporation Ltd.	87.36	89.48	87.95	88.83	88.73	88.47
Chase Bank (K) Ltd.	84.57	78.03	74.37	72.34	68.34	75.53
City Finance Bank Ltd.	32.93	27.40	23.21	37.59	51.37	34.50
Commercial Bank of Africa Ltd.	90.07	90.28	89.35	89.75	88.96	89.68
Consolidated Bank of Kenya Ltd.	78.99	75.78	79.5	73.97	76.96	77.04
Co-operative Bank of Kenya Ltd.	91.01	92.15	92.69	93.41	91.90	92.23
Credit Bank Ltd.	80.47	83.42	84.53	81.26	79.40	81.82
Development Bank of Kenya Ltd.	67.17	61.16	56.11	59.73	57.38	60.31
Dubai Bank Kenya Ltd	68.15	66.50	59.48	54.62	59.33	61.62
Equatorial Commercial Bank Ltd.	84.43	84.24	82.33	84.34	83.36	83.74
Cfc stanbic	89.39	86.47	84.93	90.64	92.17	88.72
Fidelity Commercial Bank Ltd.	87.79	83.87	83.25	78.79	78.77	82.49
Fina Bank Ltd.	87.90	88.81	89.62	89.17	89.53	89.01
Giro Commercial Bank Ltd.	90.29	90.82	90.92	90.12	90.32	90.49
Guardian Bank Ltd.	83.97	83.01	82.61	83.25	83.48	83.26
Imperial Bank Ltd.	84.80	85.57	84.06	83.90	84.40	84.55
Kenya Commercial Bank Ltd.	87.44	87.13	87.67	90.77	91.35	88.87
Middle East Bank (K) Ltd.	75.24	80.41	81.58	78.55	81.69	79.49
National Bank of Kenya Ltd.	89.35	90.11	91.42	91.69	92.40	90.99
NIC Bank Ltd.	88.35	86.51	84.12	76.56	73.22	81.75
Oriental Commercial Bank Ltd.	53.57	47.50	76.2	68.63	62.74	61.73
Paramount Universal Bank Ltd.	80.63	79.64	78.01	76.53	78.08	78.58
Prime Bank Ltd.	87.39	89.91	88.25	88.44	85.56	87.91
Southern Credit Banking Corp Ltd.	88.02	87.70	87.28	85.83	83.65	86.50
Trans-National Bank Ltd.	65.76	56.26	47.93	57.40	41.23	53.72
Victoria Commercial Bank Ltd.	86.43	86.65	85.99	85.26	84.55	85.78

**OPERATING COST(%)**

a) Foreign owned	2006	2005	2004	2003	2002	Avg
Bank of Africa (K) Ltd.	65.93	66.67	84.44	79.90	67.43	72.87
Bank of Baroda (K) Ltd.	42.69	50.49	64.48	51.91	58.72	53.66
Bank of India	35.44	47.21	57.97	41.82	58.51	48.19
Barclays Bank of Kenya Ltd.	83.89	88.64	93.50	89.72	84.30	88.01
Citibank N.A. Kenya	66.70	68.22	81.76	77.36	72.40	73.29
Diamond Trust Bank Kenya Ltd.	47.53	53.62	75.66	74.44	63.36	62.93
Habib Bank A.G. Zurich	69.20	68.13	86.07	72.17	57.97	70.71
Habib Bank Ltd.	73.98	72.43	82.94	72.41	53.41	71.04
K-Rep Bank Ltd.	79.02	80.83	86.35	82.49	84.47	82.63
Standard Chartered Bank (K) Ltd.	69.74	77.87	87.61	85.59	69.55	78.07
b) Local owned						0.00
African Banking Corporation Ltd.	69.19	66.82	75.73	67.68	55.52	66.99
Chase Bank (K) Ltd.	60.36	62.67	74.05	74.38	69.72	68.24
City Finance Bank Ltd.	91.49	96.15	95.24	93.02	95.12	94.21
Commercial Bank of Africa Ltd.	61.99	65.87	86.54	80.30	64.02	71.74
Consolidated Bank of Kenya Ltd.	92.08	93.47	91.23	91.37	85.50	90.73
Co-operative Bank of Kenya Ltd.	79.70	69.53	83.97	78.26	68.01	75.90
Credit Bank Ltd.	60.47	56.69	65.31	62.07	54.55	59.82
Development Bank of Kenya Ltd.	64.29	27.03	78.82	65.71	36.68	54.51
Dubai Bank Kenya Ltd	88.98	92.00	96.15	90.12	80.39	89.53
Equatorial Commercial Bank Ltd.	58.36	58.97	71.11	60.67	49.55	59.74
Cfc stanbic	84.34	88.83	92.42	84.99	67.83	83.68
Fidelity Commercial Bank Ltd.	54.01	54.42	58.96	54.17	43.14	52.94
Fina Bank Ltd.	62.64	62.17	64.17	47.38	37.15	54.70
Giro Commercial Bank Ltd.	51.36	57.36	58.67	51.74	43.40	52.51
Guardian Bank Ltd.	43.90	43.94	56.15	52.06	45.53	48.31
Imperial Bank Ltd.	41.09	41.73	43.44	43.72	41.76	42.35
Kenya Commercial Bank Ltd.	91.26	92.02	93.45	84.41	76.03	87.43
Middle East Bank (K) Ltd.	60.42	56.49	72.69	64.29	52.35	61.25
National Bank of Kenya Ltd.	72.52	73.63	79.73	74.63	59.95	72.09
NIC Bank Ltd.	56.24	54.67	78.62	72.04	58.41	63.99
Oriental Commercial Bank Ltd.	78.95	72.67	70.37	73.33	96.55	78.37
Paramount Universal Bank Ltd.	56.18	64.79	65.25	63.08	51.39	60.14
Prime Bank Ltd.	48.16	51.98	63.07	47.90	46.19	51.46
Southern Credit Banking Corp Ltd.	58.36	56.80	64.50	54.34	52.44	57.29
Trans-National Bank Ltd.	88.36	89.08	93.04	90.91	83.49	88.98
Victoria Commercial Bank Ltd.	44.63	46.30	58.70	48.28	40.17	47.61

**CREDIT DEMAND Kshs("000000)**

a) Foreign owned	2006	2005	2004	2003	2002	Avg
Bank of Africa (K) Ltd.	4,069.00	3,245.00	3121	3,345.00	2,142.00	3,184.40
Bank of Baroda (K) Ltd.	4,554.00	2,747.00	2797	1,886.00	1,533.00	2,703.40
Bank of India	3,319.00	2,371.00	1609	1,452.00	1,081.00	1,966.40
Barclays Bank of Kenya Ltd.	78,411.00	69,619.00	67750	60,038.00	53,335.00	65,830.60
Citibank N.A. Kenya	12,644.00	10,920.00	9814	8,795.00	11,554.00	10,745.40
Diamond Trust Bank Kenya Ltd.	14,225.00	10,685.00	7425	5,238.00	3,020.00	8,118.60
Habib Bank A.G. Zurich	1,335.00	1,158.00	1082	726.00	741.00	1,008.40
Habib Bank Ltd.	854.00	763.00	886	890.00	818.00	842.20
K-Rep Bank Ltd.	3,768.00	2,520.00	2107	1,568.00	1,185.00	2,229.60
Standard Chartered Bank (K) Ltd.	37,253.00	35,118.00	27065	19,328.00	17,048.00	27,162.40
b Local owned						
African Banking Corporation Ltd.	3,031.00	2,768.00	2131	1,795.00	1,644.00	2,273.80
Chase Bank (K) Ltd.	2,072.00	1,739.00	1294	937.00	684.00	1,345.20
City Finance Bank Ltd.	316.00	366.00	334	347.00	484.00	369.40
Commercial Bank of Africa Ltd.	15,205.00	12,438.00	5654	4,631.00	5,229.00	8,631.40
Consolidated Bank of Kenya Ltd.	2,714.00	2,978.00	1572	1,590.00	1,487.00	2,068.20
Co-operative Bank of Kenya Ltd.	43,895.00	44,548.00	33024	23,250.00	22,596.00	33,462.60
Credit Bank Ltd.	1,585.00	1,867.00	1396	912.00	693.00	1,290.60
Development Bank of Kenya Ltd.	1,802.00	1,380.00	826	1,171.00	1,836.00	1,403.00
Dubai Bank Kenya Ltd	1,083.00	1,057.00	617	514.00	510.00	756.20
Equatorial Commercial Bank Ltd.	2,492.00	1,904.00	1823	1,537.00	1,104.00	1,772.00
Cfe stanbic	15,752.00	12,053.00	11229	8,080.00	6,332.00	10,689.20
Fidelity Commercial Bank Ltd.	1,545.00	1,154.00	1175	825.00	767.00	1,093.20
Fina Bank Ltd.	5,226.00	4,371.00	3798	2,854.00	2,757.00	3,801.20
Giro Commercial Bank Ltd.	3,181.00	3,534.00	3274	2,981.00	2,785.00	3,151.00
Guardian Bank Ltd.	3,579.00	3,549.00	3181	2,776.00	2,449.00	3,106.80
Imperial Bank Ltd.	5,708.00	4,501.00	4089	3,171.00	2,860.00	4,065.80
Kenya Commercial Bank Ltd.	53,376.00	45,663.00	45218	35,901.00	38,797.00	43,791.00
Middle East Bank (K) Ltd.	2,089.00	1,735.00	1701	1,512.00	1,316.00	1,670.60
National Bank of Kenya Ltd.	58,717.00	54,234.00	34627	31,085.00	28,592.00	41,451.00
NIC Bank Ltd.	17,347.00	14,871.00	12089	7,629.00	5,389.00	11,465.00
Oriental Commercial Bank Ltd.	953.00	1,418.00	1355	1,675.00	2,173.00	1,514.80
Paramount Universal Bank Ltd.	1,478.00	1,726.00	764	873.00	825.00	1,133.20
Prime Bank Ltd.	5,164.00	3,591.00	2783	2,223.00	2,033.00	3,158.80
Southern Credit Banking Corp Ltd.	2,943.00	2,439.00	2163	1,968.00	1,668.00	2,236.20
Trans-National Bank Ltd.	1,606.00	1,578.00	1053	841.00	1,039.00	1,223.40
Victoria Commercial Bank Ltd.	2,181.00	1,943.00	1926	1,746.00	1,416.00	1,842.40

**EGERTON UNIVERSITY LIBRARY**