THE SUFFICIENCY OF DEPOSIT PROTECTION FUND'S INVESTMENT OPTIONS TO GENERATE INSURANCE FUNDS FOR DEPOSITORS IN FINANCIAL INSTITUTIONS IN KENYA

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AUGUST 2008
DECLARATION

I hereby declare that this research project report is my original work and has not been presented for a degree in any other University.

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ABSTRACT

The principal objective of Deposit Protection Fund Board (DPFB) is to provide deposit insurance scheme for customers of member institutions, liquidate and wind up the operations of any institution in respect of which DPFB is appointed as a liquidator. DPFB as a department of the Central bank of Kenya undertakes to insure banks and other member institutions to compensate depositors of these institutions incase of liquidation. Thus the research intended to find out how sufficient the fund is to insure the institutions depositors in the event of liquidation. The sufficiency of the DPFB to insure all the depositors from the foregoing literature is that all the accumulated reserves are not enough to provide the necessary compensation to some of the member institutions whose deposits as a bank is much more than the total deposits at the DPFB. As at 30th June 2006, DPFB had fund reserves accumulated from premiums levied to the member institutions of Ksh. 13.82 billion against a liability exposure of Ksh. 88.36 billion during the same period (DPFB, 2006).

The study used conceptual framework to relate the dependent and independent variables. Both primary and secondary data were collected using the questionnaires administered to the respondents at the DPFB, the Ministries of Finance and Planning and National Development as well as the Nairobi Stock Exchange. The study used stratified random sampling techniques to select a sample from the target population and the data analyzed using both descriptive and inferential statistics. Presentation of the information was done using the pie charts, curves and bar graphs. From the analysis, it is has become evident that the DPFB’s fund may prove insufficient to insure all the depositors at the same time while the performance of the economy has an influence on the investment options that the DPFB has. The roles of the member institutions have no significant effect in the investment options available to the Board. The mandate that the Board has (through the Banking Act) is the key significant factor that determine the investment options and effectively the sufficiency of the fund to insure depositors. The study recommends that DPFB be de-linked from CBK, review rules and regulations about DPFB, review the banking act to enhance capacity of the board and urgently diversity the investment options for DPFB
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OPERATIONAL DEFINITION OF TERMS

Deposit Insurance Deposit Insurance is a guarantee that all or a limited amount of the principal (and in some cases interest accrued on deposit accounts) will be paid in the event that a bank fails (Gillian, 1996).

Implicit Deposit Protection System – This is a discretionary approach adopted by the monetary authorities for supporting some failing deposit taking institutions in the system (Garcia, 1999)

Explicit Deposit Insurance Scheme – This scheme is created by a legal instrument. The enabling statute usually states the objectives of the scheme and other operational guidelines relating to issues like ownership, funding, extent of deposit protection, membership and objectives (Garcia, 1999)

Bank Failure A bank that has failed to meet its obligations to its customers due to one reason or another and is placed under Central Bank of Kenya’s statutory management or liquidation by the Deposit Protection Fund (Banking Act, Cap 488).

A Financial Institution or Non Bank Financial Institution – A company, other than a bank which carries on, or proposes to carry on financial business and includes any other company which the minister may, by notice in the Kenya gazette declare to be a financial institution for the purpose of the Banking Act (Banking Act, Cap 488).

Portfolio A portfolio is a collection of investments held by an institution or a private individual. A portfolio is a group of securities put together to make an investment pool. Holding a portfolio is part of an investment and risk-limiting strategy called diversification. (Cull et al, 2005).

Risk Risk is the variability of returns from an investment. The impact of negative real returns on future contribution rates. Risk relates to the volatility of the market value of assets in relation to the settlement value of the transaction deal (Luc, 2002).
**Systematic Risk** This is risk which is common to an entire class of assets or liabilities. The value of investments may decline over a given time period simply because of economic changes or other events that impact large portions of the market (Luc, 2002).

**Unsystematic Risk** Unsystematic risk is risk attributable to facts unique to a security. It is also termed non-market risk or diversifiable risk. The risk that is unique to a company such as a strike, the outcome of unfavorable litigation, or a natural catastrophe that can be eliminated through diversification. Unsystematic risk can be reduced by holding a larger number of securities in that market (Luc, 2002).

**Independent Variable** A variable that is manipulated, measured, or selected by the researcher as an antecedent condition to an observed behavior. In a hypothesized cause-and-effect relationship, the independent variable is the cause and the dependent variable is the outcome or effect (Mugenda and Mugenda, 1999)

**Dependent Variable** A variable that is not under the experimenter's control. It is the variable that is observed and measured in response to the independent variable (Mugenda and Mugenda, 1999)

**Sufficiency** An adequate quantity, a quantity large enough to achieve a purpose; a quantity that can comfortably meet obligations (Webster Dictionary)

**Ex ante Deposit Insurance Scheme** Ex-ante DIS funding is a scheme where the regulator has decided to create up front a cash fund for the purpose of deposit insurance. The fund is created through different sources (Gillian, 1996)

**Ex Post Deposit Insurance Scheme** an ex-post DIS does not create any funds up front, but only when there is a need for a payout (Gillian, 1996)
LIST OF ABBREVIATIONS

AERC  African Economic Research Consortium
APM   Arbitrage Pricing Model
CAPM  Capital Asset Pricing Model
CBK   Central Bank of Kenya
DIF   Deposit Insurance Fund
DIS   Deposit Insurance Scheme
DPFB  Deposit Protection Fund Board
Ksh   Kenya Shillings
NBFI  Non Banking Financial Institutions
NYSE  New York Stock Exchange
SPSS  Statistical Package for Social Scientists
UNU   United Nations University
CHAPTER ONE
INTRODUCTION

1.1 Background of the Study
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 is a level of protection of deposits against bank failure established by regulation. The purpose of deposit insurance is not to resolve banking crises, nor should it arouse any such expectations. Deposit insurance may be publicly or privately managed, involve narrow or broad responsibilities and roles in the overall financial safety net. Level and scopes of insurance differ among countries. 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 insurances can be explicit or merely implicit. Explicit insurance coverage is contractual obligations whereas implicit coverage is only conjectural (Ross, 1997). Implicit insurance exists to the extent that they influence government’s reaction to large or widespread banking problems that make taxpayer bailouts of insolvent banks seem inevitable. The deposit insurance funds in many countries provide opportunities for commercial banks to have the much-needed safety nets whenever they fall short of their expectations (Armen et al, 2003).

Explicit Deposit insurance is a measure introduced by policy makers in many countries to protect deposits, in full or in part, in the event of a "run" on a bank or banks. The failure of a bank has the potential to trigger a much broader spectrum of harmful events. A deposit insurance system is one component of a financial system safety net that contributes to the promotion of financial stability. The purpose of deposit insurance varies from one country to another but in most cases they are designed to contribute to financial stability and to protect less financially sophisticated depositors.

1.1.1 Deposit Protection Fund Board
The post-independence period in Kenya was one of tremendous economic growth characterized by conscious Government Policy to transfer economic activity into the hands of indigenous Kenyans. The banking sector was no exception and given the large
number of new entrants and low levels of expertise and experience, disaster was bound to strike sooner or later.

Amendments to the Banking Act in 1985 were carried out to expand the safety net and improve the bank failure resolution mechanism. The DPFB was established as a deposit insurance scheme to provide cover for small depositors and act as liquidator to banks which could not be salvaged. The same amendments gave Central Bank of Kenya the responsibility of risk minimization through prudential regulation, supervision and surveillance. The function of curator and revival of ailing institutions was also entrusted to the Central Bank. Although operations commenced on 1st September, 1986, activities at the initial period to 1989 involved establishment of the necessary administrative and operational procedures as well as laying the foundation and building up seed capital to ably meet any future payments of protected deposits and its other objectives

The Deposit Protection Fund Board (DPFB) is a significant player in the financial safety net for the savings, banking and payments systems in the country (Armen et al, 2003). It protects the depositors especially small depositors, against loss of their deposits in case of a bank failure, by providing payments of insured deposits which provides the necessary confidence for the depositors to remain in the banking and payments system. The fund is considered as an important mechanism to provide stability within the financial market. It serves a number of important economic and social objectives, the principal being the provision of protection to small-unsophisticated depositors, the maintenance of confidence in and stability within the financial sector and the acceleration of the process of failure resolution strategies in cases where a bank fails.

1.1.2 Objectives of the Fund

The appointment of DPFB as a liquidator by the Central Bank has the same effect as the appointment of a liquidator under the Companies Act when liquidation is under the supervision of the High Court. The significance of this provision is the sign that it is not necessary for a creditor to petition for winding-up of a financially distressed institution before the Board is appointed as Liquidator. This effectively eliminates need for a court order declaring the institution insolvent prior to the appointment of a Liquidator.
The principal objectives of the Board are to provide a deposit insurance scheme for customers of member institutions and to wind up the operations of any institution in respect of which the Board is appointed as a liquidator. Complementary objectives are to hold, manage and apply funds levied as contributions from member institutions (The Banking Cap 488)

1.1.3 Membership of the Fund and Premiums
Membership is compulsory for all institutions licensed to carry on business as Commercial Banks, Financial Institutions, Mortgage Finance Companies and Building Societies. Currently there are 45 members composed of 42 commercial banks and 3 Non Banking Financial Institutions (NBFI) (Appendix III). Though membership of the financial institutions is compulsory, the fund can exclude such institution(s) perceived to conduct its business in a manner that is detrimental to the interests of the fund and the interests of its depositors.

Determination of the size of the Fund, which is premised on the need to sufficiently protect the interests of depositors, is largely guided by information compiled from the mandatory returns member institutions file with both the Board and the Central Bank of Kenya. At the moment, the Act limits premiums to a maximum of 0.4 per cent of the average of a members total deposit liabilities in a twelve-month period prior to assessment. Currently, the annual premium is assessed at 0.15% of the average total deposit liabilities or Ksh.300,000 per member, whichever is higher. It is applied uniformly and assessments are carried out in July and premium payments are expected by August of each year. Late payments attract penalties

1.1.4 Deposit Coverage and Options of Investment
The Board is mandated to provide deposit insurance coverage of up to Kshs.100,000 to each depositor of an institution licensed to carry on banking or finance business in Kenya. The insurance covers all types of deposit accounts including Current; Savings; Time; Bankers Cheques; Money Orders; Drafts etc for which a protected institution is liable. However, payment is restricted to one depositor per institution i.e. all accounts of a
depositor with more than one account in an institution are first consolidated before settlement as one claim to the maximum protected limit of Ksh.100,000.

According to Honohan and Daniela (2003), however, the volatility of these security returns is not of primary importance as some of the risk can be eliminated when the security is brought into the portfolio of risky assets. Attention therefore should focus on the securities non-diversifiable risk and its impact on the risk of the investors overall portfolio, which in the introduction stage, has been observed, depends on the covariance of its return with the return on the other securities held in the portfolio. The central bank as a regulator of financial institutions should not shy away from participating in the capital market to build efficient portfolios that will increase the DPF liquidity in order to be able to sufficiently compensate depositors in case of liquidation of a financial institution. Also by the government participation in the capital market the volumes of transactions will be high hence increasing the market liquidity and reducing the transaction costs. Many investors will have confidence in the listed companies and the government has the resources to employ qualified personnel to manage its investment portfolios.

1.2 Statement of the Problem

In most jurisdictions, deposit protection funds either for financial institutions or credit unions are required to operate in a prudent manner by complying with statutory legislation and standards of sound business practice (Luc, 2002). This may be the reason the Kenyan government has restricted the investment of DPFB to only government securities. However, in a world of risk and uncertainty any investor will be interested in both the expected return on the investment and the risk associated with this return which is to maximize the returns.

As at 30th June 2005, DPFB had fund reserves accumulated from premiums levied from the member institutions of Ksh. 12.20 billion against a liability exposure of Ksh. 67.843 billion during the same period whereas as at 30th June 2006, Ksh. 13.82 billion against a liability exposure of Ksh. 88.36 billion during the same period (DPFB, 2006). There is
therefore need to evaluate the alternative investment options as evidenced by the fact that the reserves in 2005 were only 17.98% of the exposure and reduced to 15.64% in 2006 (www.centralbank.go.ke, 2006).

As there are a large number of securities available at the Stock exchange and it is possible to vary the proportions of a portfolio allocated to each security, in principle it is feasible to construct an infinite number of different portfolios. In choosing between the various portfolio possibilities a rational and risk adverse investor would limit the choice to an efficient portfolio. This is a portfolio that minimizes risk for a given return; or maximizes return for a given risk.

From the foregoing background, the study sought to investigate the sufficiency of the Deposit Protection Fund’s investment options to generate insurance funds for depositors in financial institutions.

1.3 Objectives of the Study

1.3.1 General Objective
The general objective of the study was to find out if the Deposit Protection Fund’s investment options are sufficient to generate insurance funds for depositors in financial institutions.

1.3.2 Specific Objectives
The study however sought specifically to:

1. Establish the extent to which the performance of the economy influences the sufficiency of the board’s insurance of the depositors.
2. Determine if the mandate of the DPF Board as envisaged in the legislation and the Government policies is a factor that influences the sufficiency of the Fund to insure depositors against loss
3. Find out whether the availability of diverse investment options influences the sufficiency of the board’s fund to cover the depositors
4. Establish whether the member institution have an influence on the sufficiency of the insurance cover that the DPFB has for the deposits.
1.4 Research Questions

The study sought answers to the following questions:

1. To what extent does the performance of the economy influences the sufficiency of the fund?
2. Does the mandate of the DPF Board as envisaged in the legislation and the Government policies a factor that influences the options that the Fund has to invest in?
3. How does the availability or non availability of diverse investment options influences the sufficiency of the board’s fund to cover the depositors?
4. Does the member institutions have an influence on the investment options that the DPF have?

1.5 Significance of the Study

According to the DPFB’s annual report of 2006, the fund reserves are below 20% of the total exposures as shown in the statement of the problem and this poses a great risk to the financial institutions, depositors and the central bank incase of liquidation of its members. The depositors’ stand to loose a great deal given that the fund only provides deposits insurance coverage of up to Ksh. 100,000 to each depositor of the member institution who has invested funds. DPFB would also have difficulties paying the depositors incase a number of its member institutions were liquidated during the same period. The study recommends reviewing of the banking act to ensure that an efficient deposit protection fund is established for the benefit of the depositor, institution, the regulator, (i.e. Central bank). Lastly the study was also expected to stimulate further research, which would add to the body of knowledge on deposit protection funds management. Such knowledge may ultimately bring solutions to the current inadequacy of the fund in Kenya.

The management of the DPFB and other stakeholders are the primary recipients of the study results as it provides conclusions about the prevailing scenario at the fund and consequently suggest and recommend the steps that the fund may take to diversify their investment options and spread their risks. The study also is important to the Ministry of
Finance in that the research provides the basis upon which to review the legislation and expand the mandate of the DPFB. It is also important to the Government in general as it is able to understand the risks that the DPFB is imminently facing and thus see the need to diversify the portfolios of the fund essentially spreading the risks.

1.6 The Scope and Limitations of the Study
The scope of the study was the Deposit Protection Fund (DPFB) at the Central Bank of Kenya, the Ministry of Finance from where the banking act and other legislation governing banking lies on as well as the Ministry of Planning and National Development from where the national income statistics were obtained. Since the Nairobi Stock Exchange is a major player in the economy, it was also covered in the study.

However accessing the required information was a problem in that some of the staff were not willing to provide information appropriately. Some of the respondents did not duly respond to the questions in the questionnaire which made the questionnaire unreliable. Due to their busy schedule as per the nature of the work, some of the respondents were reluctant to fill the questionnaire. Biasness of the respondents was another limiting factor when answering the questionnaire which made some of the data to be unreliable. To minimize on these limitations, the respondents were assisted in filling the questionnaires by research assistants and were requested to apportion part of their time to fill the questionnaires. They were also given the assurance that the data collected were to be used strictly for the purpose of the study only. They were also briefed on the importance of the study to the DPFB and the Central Bank as a whole and respondents were encouraged to give their own opinion when answering the questions.

There were also the limitations of time and finances. The researcher centered the research in the DPFB and the ministries of Finance and that of Planning and National Development as well as the member institutions and the Nairobi Stock Exchange. This ensured that the time that the researcher could have used to travel to other places for the research, will be utilized in the development and maximum output in the ministries and DPFB.
 CHAPTER TWO
LITERATURE REVIEW

2.1 Introduction
This chapter deals with the overview of deposit protection fund management and portfolio management techniques used to minimize the risk exposures in an investment. In the Kenyan scenario, the literature review highlights the developments in the DPFB and its subsequent importance in providing a deposit insurance scheme to depositors, which will facilitate the development of savings, from the perspective of the performance of the economy, the mandate of DPFB, the investment options of DPFB, the role of the member institutions and the conceptual framework.

2.2 Review of Past Studies
The literature reviewed covers the role the performance of the economy influences the sufficiency of the fund to cover the insurance taken for the depositors, the role of the government policies, legislation and the mandate of the DPFB, the investment options that the DPFB has as well as the role and needs of the depositors in the financial institutions.

2.2.1 The Performance of the Economy
Differences in the constraints imposed on funds have prompted many writers to suggest that the use of most common share index numbers is inappropriate (Calomiris, 1996). Three areas of concern are often adduced; the methods of sampling, weighting, and averaging used in constructing the indices. Stock market indices portray the experience of particular groups of investors or collections of shares. They are a compromise between different objective including representation and ease of calculation. Broad market indices, for example which cover all securities in the market, are unsuitable for use in performance comparison of deposit protection funds, which are restricted to large, easily marketable and non-risky government securities since the return behavior of companies may be quite different from that of government securities. Difficulties also arise with the
weighting of stocks within an index. The weights reflect the relative importance of each stock. The particular weighting scheme adopted will depend on the aims and objectives of the index. A broad market index intended to portray the movement of all stocks in the market, as a whole would include each security in equal amounts. An index intended to reflect the experience of holding a portfolio of major stocks according to its market value. Equally weighted indices are unlikely to be useful for the majority of portfolios performance comparisons (ibid)

Haber (2006) cites the case of Mexico since they initiated the deposit insurance policy. Until 1982, Mexico did not have the deposit insurance scheme. During the 1991 – 2004, Mexico introduced the deposit insurance but because the scheme countenanced minimal bank regulation and weak governance, it led to reckless lending, high borrower default rates, and a taxpayer – financed bailout of various bank stakeholders. Comparison between the performances of any two portfolios can be done through two averages. Geometric averaging is like a policy of constantly selling off stocks that have gone up in price and reinvesting the proceeds in stocks that have down in price. Arithmetic averaging is equivalent to a policy of letting gains run so that successful companies become a larger and larger proportion of the portfolio and the unsuccessful companies become a smaller proportion. In the extreme, when the constituents of an index undergo no change, arithmetic averaging is a kin to buy and hold policy in which investment are simply held without trading. The result may be inadequate diversification and index portfolio that cannot be replicated by actual funds because of legal and self imposed constraints on the proportion of funds that may be invested in any one security.

These problems with index numbers have led to a number of suggestions for the creation of notional fund as performance standards. The fund is invested in various investment sectors such as government securities (Treasury bills and bonds), equity or securities at the stock markets and in proper proportions that accord to the constraints imposed on the actual portfolio within each sector, performance is measured with the appropriate index so that comparisons of the actual portfolio with the notional fund provide a clear picture of how the fund has performed relative to the average given the particular set of
restrictions imposed on the fund manager. In effect, the notional fund isolates the
decisions of the fund manager from the decisions of trustees. However this notional fund
concept doesn’t solve the problem by deposit protection fund boards completely. Hager
(1980) noted that changes in asset prices would result in changes in asset allocation and a
consequent need for portfolio rebalancing.

If the notional fund is rebalanced periodically it is acting in an artificial way since fund
managers rebalance continuously, but if rebalancing is not carried out then the notional
fund will become unrepresentative of the portfolio it is intended to shadow. The notional
fund can, in principle, be constructed according to whatever objectives the trustees see fit
with an emphasis on long or short run performance according to their needs. The other
problem is that since notional funds are easily charged particular expenses, depending on
the purpose of the comparison expenses may or may not be charged. Practical difficulties
may arise with receipt of new money or payments out of funds. The manager should not
be penalized by the charging of expenses on the receipt of new money or for the cost of
portfolio changes brought about by changes in the constraints imposed by the trustees
although difficulties arise when the funds receive large cash flows so that changes could
be affected without the sale of any existing securities.

Despite these problems several improvements have been suggested. Mossevar-Rahmani
(1987) provide a procedure for customizing performance benchmarks which involves
four steps; translating objective into concrete goals and risk parameters; determining a
maturity and sector distributions for the benchmark to best meet the funds objectives;
advising the sponsor of the expected performance of the benchmark under alternative
scenarios and finally monitoring the benchmark once in use. Surz on the other hand
suggests the use of simulations to determine the distribution of notional portfolio so that
one can determine whether deviations of the actual portfolio performance from the
notional fund are due to the manager’s skill or simply to chance.
2.2.2 The Mandate of Deposit Protection Fund Board

DPFB is mandated to collect assessed premiums from all member institutions and invest the funds in Government Paper. It is also mandated to receive funds from other sources including grants and borrowings from Central Bank. The other mandate of the fund is to liquidate institutions whereby it is appointed as liquidator and apply liquidation proceeds in paying depositors and other creditors.

Internationally, Deposit protection funds are built up and maintained at required levels primarily by premiums or assessments levied on individual institutions. The amount of the contribution is set as a proportion of shares and deposits; or shares, deposits and liabilities; or deposits and borrowings; or gross revenues or interest income; or total assets. Most deposit protection organizations have powers beyond the collection of premiums and the payout of funds, giving priority to stabilization and prevention roles aimed at averting the potential payout of claims. These organizations monitor financial performance closely, in addition to the independent audits or inspections by government or deposit protection organizations. They can intervene at the early stages of any potential difficulty. Powers of the insuring organization extend to taking over management, supervision, and ordering amalgamation or dissolution of a financial institution that is judged to be unable to achieve regulated performance results (Banking Act, Cap 488).

Management of deposit protection funds are complicated by differences in the objectives of funds as well as by the impact of differing constraints imposed on the participants in the fund management process (Gillian, 1999). Deposit protection investment is a tripartite process involving the depositors as the customer of the member institutions, the trustees (Bank) as the holders and administrators of the deposits and the investment managers (DPFB) as the investors of the funds. All these members have their set of objectives that do not necessarily coincide. The problems of persuading agents (fund managers who are DPFB) to act in the best interest of principals (trustees) is the subject of a large and growing literature and whilst relevant to determination how fund managers should be selected and remunerated with consequent effects on fund performance, is ignored mostly.
as of peripheral concern to the measurement process/trustee may be assumed to want to minimize its contributions to the funds so as to maximize its current profits suggesting that the depositor/customer objectives is the most efficient and profitable investment of funds (Gillian, 1999). The trustees, usually representatives of the managers and workers are required to act prudently and although interested in maximizing returns the trustees may do so only subject constraints. In consequence, important differences between the depositor and the trustee may arise with respect to risk aversion and decision horizons since the depositor maybe less risk averse and more interested in short term performances than the trustees. Such differences may have important consequences for the constraints imposed on deposit protection fund managers and hence their performance (ibid).

Holbrook (1976) states that the performance cannot be taken as a direct measure of the competence of a manager, except in those areas where he has complete freedom of action. Performance is the result of the joint efforts of trustees, managers and advisers working within the constraints imposed by the terms of the trust deed and by the preference of the trustees and the employer. The powers of investment are set out in the trust deed and may be widely drawn or restricted to investment in securities authorized by law for deposit protection funds investment (the Trustee Act 1925 and the trustee investment Act 1961 UK). The trustee may decide on an active or passive policy of investment and on more or less delegation of investment decision-making. The important consideration is that the manager’s performance should be measured by reference to all decisions within the manager’s discretion.

Deposit insurance denotes a class of public or private arrangements aimed at the prevention or ex-post resolution of problems that emerge due to the instability and opaqueness of banking firms. As a form of public intervention in the financial system, guaranteeing bank deposits, be it explicit or implicit, is typically justified on the ground that, given the importance of an effective and stable banking system for the national economic development and prosperity, the intrinsic instability of banking firms may impose large costs on the society and thus should be properly addressed. Since the 1980s, a worldwide wave of financial deregulation has drastically changed the financial
environment making it more competitive and yet riskier. This has become a stimulus to national regulators to abandon their past practices of implicit protection and move to the institutionalization of the policy in the form of an explicit deposit insurance system (DIS) (Mikhail, 2004).

Deposit insurance can bring about its own social costs. The experience of the boom-and-bust banking crises of the 1990s has shown that if improperly structured the policy can amplify the perverse incentive to excessive risk-taking and turn into a destabilizing factor (Demirgüç-Kunt and Huizinga, 1999). Deposit insurance was not solely responsible for the crises, and there were many other factors to blame. Nevertheless, the severity of problems surfaced in the national banking systems and the heavy price borne by taxpayers to resolve the problems well explain why policymakers have become strongly concerned about finding the optimal design for their national DISs.

Periodic premium contribution is usually aimed at building up a deposit insurance fund that could be relied upon to meet obligations under the scheme. However, under this option, a premium assessment policy has to be determined. This would involve determining the assessment base and rate, and whether the rate should be risk-based or flat rate for all insured institutions.

There are two basic types of DIS related to funding i.e. ex-ante and ex-post. Ex-ante DIS funding is a scheme where the regulator has decided to create up front a cash fund for the purpose of deposit insurance. The fund is created through different sources, for example from (i) initial capital at the time of the establishment of the Fund and membership fees by member institutions, (ii) regular and additional premiums paid by member institutions, (iii) additional resources like borrowing from the market and/or budget, as lender of last resort. Contrary, an ex-post DIS does not create any funds up front, but only when there is a need for a payout. There are many pros and cons for each funding model. Roy (2000) provides an overview of the characteristics of the two different funding schemes and a relative evaluation of the effectiveness and efficiency of each. He argues that ex ante schemes are more effective but less efficient than ex-post deposit insurance schemes.
When financial resources for deposit insurance are collected continually, a DIS is more liquid and ready for payouts when needed. Members pay premiums constantly at a time of prosperity as well as in times of recession. Premiums are paid by all member institutions not only those that have survived (which is the case of an ex-post DIS where resources are collected from surviving institutions in order to repay the deposits of a bankrupted institution). The existence of an ex-ante fund enhances depositor confidence. But, at the same time, the ex-ante fund must be managed, which increases operating costs compared to an ex-post DIS. Ex-post schemes do not impose an unnecessary burden on member institutions during periods without bankruptcies, because they do not have to make payments to the fund and money may be used more efficiently. Traditionally, the main regular resource of any ex-ante DIS is the premium.

Nevertheless, substantial amounts of resources may be ensured by establisher of the scheme at the beginning, as well as in exceptional circumstances such as banking crises. Premiums may be linear or differential. Premiums may be explicitly set in legislation as a percentage of some base such as total deposits, insured deposits, risk-weighted assets and similar, but some countries set only ceilings or ranges of annual premium in the national legislation, allowing in this way some flexibility in premium determination. Galac (2005) in his paper explains the economic and financial theory of the premium, as well as providing empirical evidence on the application of a risk-based premium. One of the main prerequisites for the success of any DIS is liquid and adequate financial resources (if an ex-ante fund has been developed) or fast access to raise the funds (ability to collect ex-post premiums, additional funding from government or on the market i.e. back-up funding). In both cases, funds are needed on time. The only way to achieve liquid and adequate funding in practice is through careful financial planning.

Under ex post funding method, an amount equal to whatever is required for a bail out or other resolution options in the event of a crisis is levied on the participating institutions. Under periodic recapitalization, the approach entails injecting additional equity in the deposit insurance scheme. This is usually undertaken to meet the desired capital
standards. Such standards are set to ensure reasonable adequacy of the Deposit insurance funding for its insurance obligations.

Most DIS have supplementary funding provisions that grant them access to potentially large financial resources. Usually for publicly or jointly owned DIS, some form of access to the national treasury is provided for. This could be in the form of borrowing from the central bank or the financial market with Central Bank guarantee (Banking Act Cap 488). Another important aspect of funding is whether a separate Deposit Insurance Fund (DIF) is set up for different subsets of insured institutions or a single DIF is used for all types of insured institutions. The difference in the two arrangements is substantially reduced where the separate funds are administered by the same agency. The avoidance of cross subsidization for the different types of insured institutions is always advanced as the reason for the separate funds approach. But this can be resolved by either charging different premium rates to reflect the different risk of the various types of insured depository institutions or by implementing different capital standards for them (Talley and Mas, 1989).

Initial capitalization is usually provided either in the form of paid up share capital by the owners in the case of public/joint ownership schemes or as an initial start up levy contributed by members in the case of privately owned schemes. The ex-ante funding option is likely to be chosen where the required return on investments is equal to or smaller than the return on government papers; while the ex-post funding is preferable where the required investment return is larger than the return on liquid and safe assets but the DIS’s borrowing costs are still lower than the required return. A mixed funding arrangement may be employed where the borrowing costs are higher even than the required return. Therefore, in the restricted case one could again expect that the choice between the ex-post vs. ex-ante funding schemes will vary depending on whose discounting factor is applied. If it is the return required on the banks’ investments, the DIS funding is likely to be ex-post (or mixed). If the factor is the investment return available, for example, to the depositors, then the funding probably becomes ex-ante. Garcia (2000) finds that ex-post assessments tend to be chosen by privately financed and
privately operated deposit insurance schemes, solutions because in this case the problem of uncertainty in the timing and size of losses is irrelevant.

2.2.3 Deposit Protection Fund Board Investment Options

A portfolio is a group of securities put together to make an investment pool. In their study, Wagner and Lau (1971) took 200 securities traded on the New York stock exchange and constructed a portfolio consisting of between 1 and 20 random chosen securities. The risk of each of these portfolios was calculated on the basis of the standard deviation of their past returns. It was found that the risk of a portfolio continued to fall, albeit at a decreasing rate, until the portfolio consisted of 15 or so securities. After that, adding more securities was found to contribute very little to further risk reduction. Evans and Archer (1968) studied the effects on risk of randomly selected portfolios. They considered the risk of a series of portfolios drawn from 470 securities quoted on the New York Stock Exchange. Return data was available for these securities on a semi annual basis for the 10 years between 1958 and 1967, where twenty observations for each security. Individual securities were drawn at random for inclusion in equally weighted portfolios. The average standard deviation for sixty securities drawn at random was found to be 0.2094. Next sixty portfolios of two securities each were selected at random, and the standard deviation of returns for these portfolios was calculated, and the average value was found to be 0.161. This constitutes almost a twenty five per cent reduction in risk in relation to an investment in single security.

Investment activities are typical of ex-ante systems as well as of combines systems (Gillian, 1999). Characterized by preliminary accumulation of funds to some extent investments is considered to be of a secondary importance and is even underestimated by some ex-ante systems, consistent with the legal requirement for security and liquidity of accumulated funds. Security and liquidity of funds proves a top priority, and therefore income on invested funds occupies a subordinate place. Commonly, investment options are legally formulated leaving little room for maneuvers of the deposit insurer. The status of the deposit insurer as a financial institution is not always explicitly defined law, although it actually acts as such institution. Provided no bank bankruptcies occur for a
long period of time significant funds may be accumulated in the ax-ante system. Investment alternatives and solutions are also impacted by the amount of premiums and investable funds. Internationally, there is a trend towards reducing or even eliminating required reserves.

Johnson and Shannon (1974) considered the incremental benefits from developing portfolios using Markowitz’s analysis in relation to naïve diversification. Quarterly returns over the period 1965 to 1972 were considered for 50 NYSE shares (data and computing constraints limited the scope of such studies in the early’ 1970s!) First equally weighted portfolios were selected along the lines as those employed by Archer and Evans (1968), and the impact on the risk of portfolios of increasing the number of shares held in the portfolio observed. Secondly, portfolios were formed, on the basis of Markowitz’s analysis, using the full covariance matrix and quadratic programming, to minimize risk. The Markowitz approach resulted in portfolios with fewer shares, as some shares were allocated a zero weight, but could be risk levels were lower than those produced by naïve diversification. This suggests that Markowitz diversification may save on transaction costs. It also has another benefit in that it appears to be able to generate portfolios with higher returns. If the data is available, and the computations can be undertaken, it is therefore worthwhile employing the Markowitz approach rather than relying on random selection to form portfolios. But this conclusion does not invalidate the finding that naïve diversification can substantially reduce risk exposure.

The expected returns and risks of any investment are assumed to be determined by the nature of the assets available for investment, and the interaction of supply and demand in capital markets for these assets (Gillian, 1999). Much of modern portfolio theory is based on the assumptions that asset returns are normally distributed. This is a highly convenient assumption as it implies that the return distribution can be described simply in terms of its mean and variance. However, the distribution of returns cannot be strictly described as being normally distributed. As a result of limited liability the lowest possible return is 100%, the value of the share going to zero, whereas a normal distribution incorporates the possibility of infinitely large positive and negative values. Whether the return distribution
is sufficiently close to normal for it to be reasonable approximation to returns experienced in a particular capital market is another matter, and this depends on the empirical evidence. Fortunately, the empirical evidence tends to support this assumption for portfolios if not for single shares. Whilst departures from normality for returns on individual shares are quite reasonable, the evidence usually quoted on this issue is taken from the study undertaken by Fisher and Lorie (1970).

Whereas the expected return on a portfolio is simply the weighted average of the returns on the constituent securities, the risk of a portfolio is unlikely to be equal to the weighted average of the risk of these securities. The risk will only be a weighted average of the risks of the individual securities in the special case, where the correlation coefficients for the returns between all pairs of assets included in the portfolio are all equal to plus one (Kane and Berry, 1998).

The disadvantage of the time weighted return method is that it requires the valuation of the fund each time there is a cash inflow and outflow. In general, the smaller the cash flow in relation to the funds the less will be the difference between the time and money weighted returns. The need to value the portfolio at frequent intervals has led to a number of approximations to reduce the burden of valuations. The use of quarterly or annual figures instead of monthly regression of the change in market value of the fund against the change in value of the market in order to derive adjustment coefficients; and the calculations of return on similarly constrained index fund which when adjusted for changes in new money entering the fund can be used to approximate the time weighted return (Society of Investment Analysis 1979).

2.2.4 Role of Member Institutions

In the course of the last fifteen years, more than three-fourths of the member countries of the International Monetary Fund have been faced with the task of resolving financial crises and bank failures in their own countries (Cull et al, 2005). In the majority of countries, this scope of problems in the banking sector has led to the consideration of the
establishment of a deposit protection system for banks as one of the means to the protection of a financial system from pressures of bank failures.

Currently the fund has 45 members composed as 42 commercial banks and 3 Non Banking Financial Institutions (NBFI). Membership for the financial institutions is compulsory but the fund can exclude such institution (s) if it perceives to conduct its business in a manner that is detrimental to the interests of the fund and the interests of its depositors. The majority of countries view the deposit protection system as one of the many means of protection available on the financial market, which protect depositors against the risk of loss of bank deposits, or at least reduce the risk thereof. Among the several of protection tools, the most important include: banking supervision, the bank licensing policy, the supervision of financial institutions, a regulatory commission for the capital market, and last but not least bank shareholder supervision over the activities of bank management. A specific role in the financial protection system is played by the central bank and the state institutions providing financial support as lenders of last resort to failing banks. In Kenya also a number of commercial banks have closed over the last five years. Daima Bank among others is an example of such banks, which has lead to huge losses by both individual and corporate institutions. This has illuminated debate on the adequacy and efficiency of the Deposit Protection Fund Board.

An example of a foreign deposit protection system is in the Slovak Republic, which is based on the provision of compensation payments for un-collectible deposits if a bank, due to its own financial situation, is unable to pay the demand deposits to its depositors. The maximum limit set on compensation payments and the extents of products included in the deposit protection system are determined by the Act. Protection covers only non-anonymous deposits of private persons up to 30 times (and in the case of building societies 60 times) the average monthly income per capita for the previous calendar year. The deposit protection system in operation in the Slovak Republic protects depositors of all banks and branches of foreign banks equally in order to encompass the widest range of so-called average depositors. The system does not include the deposits of entrepreneurs, publicly traded securities, and various types of bearer bank certificates of deposit. An important case in the system’s operation was the termination of the state
guarantee of deposits in three banks (Slovenská sporiteľňa, a. s., VÚB, a. s., and IRB, a. s.) as of 31 December 1997, which brought about balanced and equal conditions in deposit protection for clients of all banks operating in the Slovak banking sector. When the financial resources of the Fund are insufficient to cover payments. Should a shortage arise in the Fund’s own financial sources, the Fund may borrow from the NBS or other banks subject to NBS approval. Another important source of financing for the Fund is interest from investments in government securities.

The Fund’s bodies have adopted a strategy of gradual Fund repletion to the maximum limit allowed by law. The annual contribution has been set at 0.3% of the average level of non-anonymous deposits for the years 1996, 1997, and 1998 in accordance with the strategy of Fund repletion. The repletion of the Fund is aided by its financial policy, which seeks to maximize its legally permissible revenues on the financial market of the Fund’s financial assets. The share of deposits subject to protection under the law out of the total volume of deposits held by private persons stood at 70.4% as of 31 March 1998, while the share of deposits held by private persons out of the total volume of deposits in the banking sector was approximately 62%. This means that out of the total volume of deposits in the banking sector, approximately 43% of all deposits are protected. The share of deposits held by private persons as a function of total deposits has been stabilized at 57-60% over recent years, this is quiet high as compared to the 20 and 18% in year 2005 and 2006 respectively in Kenya. A United Nations university (UNU) conference on deposit protection fund observed that economic growth coupled with a rise in the volume of deposits subject to deposit protection raises the question of determining the volume of financial resources needed in the deposit protection system to guarantee the satisfactory protection of depositors from any possible bank failures.

In countries with a developed and well-functioning banking system, the 1-1.5% deposit protection coverage is considered to be satisfactory. Therefore, countries undergoing the restructuring of their banking systems as part of their socio-economic transformation should work towards higher coverage. The measurement of any investment returns poses particular problems when there are considerable inflows during the evaluation period and although wholly without difficulties, the time weighted returns is seen as the most
appropriate technique. This is because; the measurement on a security investment is dividends plus capital gains over a period. This is generally extended in the pension fund and deposit protection funds environment to take account of the outflows to and from a fund hence the money-weighted rate of return is the most commonly used measures of return in this case. The problem though is that the first makes no allowance for the impact of intermediate cash flows on performance so as to provide a more realistic assessment of fund performance.

2.3 Summary and Gaps filled by the Study
There seems to be minimal empirical literature on comparison of deposit protection fund returns and returns from other investment options. The call for tenders by the Ministry of Finance (2007) to review the Kenya Banking Act also indicates a shortage of research work on various departments of which the DPFB falls. There has also been an increasing need to accept the fact that while the need for financial services in Kenya is high, some Micro-finance institutions with their services are helping to bridge the demand. However, with the introduction of the micro-finance bill, more members are joining the fund as the guarantee of survival of the micro finance institutions is not secured. The board’s decision to invest in marketable securities and even at the stock exchange is inhibited by the Banking Act Cap 488. The board is limited in the options that it can invest its fund in order to generate funds that can suffice for insurance for the member institutions. Thus the challenge of understanding whether the fund at the DPF is sufficient to insure the member institutions was the basis of this research.

2.4 Conceptual Framework
Variables are measurable characteristics, attributes or properties of an individual population unit (Bell and Opic, 2002). The sufficiency of the DPFB fund to insure depositors is dependent on independent variables including the level of economic performance, the legislation, government policies and the mandate of the Board, the available investment options as well as the role and needs by the member institutions. When the performance of the economy is high, less risks DPFB will face because a well performing economy enables most of the depositors to perform well which minimizes the
chance of these banks going under. The Gross Domestic Product (GDP) of a country also helps to define the economic status of the country. The higher the GDP, the better the performance of the economy. The cost of living index is also another indicator of the performance of the economy. The per capita income helps to explain how the cost of living is being maintained. The inflation rate and the level of unemployment is also another factor that helps to explain the level of the economy. When the rate of inflation is low the better the economy whereas if the rate of unemployment is low, it means that more people in the economy are earning incomes which raise their standard of living. It is therefore an indication that the economy is performing better as the purchasing power of the population has improved.

The legislation and government policies also determine the mandate and the investments options of the board. The availability or otherwise of investment options in the market also could determine how the board invest its deposits. The alternative of investing the deposits in the stock exchange both in the local and foreign markets is available and the DPFB could invest in them. The Board can also invest in unit trusts with mutual or invest offshore in other governments securities where comparatively, the returns are higher. However, the mandate of the Board as defined by the Banking Act limits the investment of the Board. The role and the policies of the member institutions may also determine how the fund invests their deposits so that they become sufficient to insure the depositors when they are liquidated. The intervening government policies and regulations relates to the demographic factors, the economic conditions, the climatic conditions as well as political settings and their influence on the sufficiency of the DPFB’s funds to insure the depositors. Thus the sufficiency or non-sufficiency of the fund depends on them (Figure 2.1)
Figure 2.1: Conceptual Framework

Performance of the Economy
- Inflation rates
- Gross Domestic Product
- Employment levels
- Cost of Living Index

Mandate of DPFB
- Adequacy
- Regulations and Legislation

Investment options
- Local Stock Exchange market
- Foreign Stock Exchange
- Unit Trusts
- Offshore investments

Member institutions
- Role and influence
- Organizational Policies
- Level of Risks
- Deposit Levels

Government Policy and legislation
- Economic Environment
- Political Environment and influence
- Demographic and Climatic conditions
- Sociocultural

Sufficiency of Deposit Protection fund board in Kenya
- Level of Deposits
- Reserves by Member Institutions
- Legislation and policies

Independent Variables
Source: Researcher (2007)
CHAPTER THREE
RESEARCH METHODOLOGY

3.1 Introduction
This chapter focused on research methodology that was used in the study. It gives detailed descriptions of the research design, target population, sampling techniques and sample size, research instruments, data sources and collection as well as the methods that were used in data analysis are presented in the subsequent sections. The aim of the study was to assess the efficiency of investment options the Deposit Protection Fund Board (DPFB) has in generating sufficient funds to provide deposit insurance to member institutions and depositors.

3.2 Research Design
This study employed descriptive research. According to Schindler and Coopers (2004) descriptive studies are more formalized and typically structured with clearly stated questions to investigative. It served a variety of research objectives such as descriptions of phenomenon or characteristics associated with a subject population, estimates of proportions of a population that have these characteristics and discovery of associations among different variables. It describes the process of collecting data in order to test hypothesis or to answer questions concerning the current status of subjects under study. A descriptive research determines and reports the way things are. This research attempted to describe such things as alternative options, values and adequacy of policies. The study therefore utilized a descriptive survey design. This involved paying of visits to the Ministry of Finance, Central bank, Nairobi Stock Exchange and financial institutions who are members of the fund. It also involved formulating objectives of the study, designing the methods of data collection, selecting the sample, data collection and analyzing the results.

3.3 Target Population
This is the entire group of people; events or things of interest that the researcher investigated. Under this study, the target population was two hundred and nineteen (219)
comprising of all the staff of Deposit Protection Fund Board (DPFB) based at the Central Bank of Kenya, five (5) at the Nairobi Stock Exchange, one hundred and forty two (142) from the member institutions, and six (6) each from the Ministry of Finance and that of Planning and National Development.

3.4 Sample Design

From the DPFB, a census of all staff was taken, 5 heads of departments at the Nairobi Stock Exchange and 6 heads of sections each from the ministries of Finance and Planning and National Development. Since the target population was small enough, the study carried out a census for the DPFB, the two ministries and the Stock Exchange. According to Mugenda and Mugenda (1999), any meaningful study, a sample size of 10-20% of the accessible population is adequate. Thus the study used stratified random sampling technique for the member institutions that the study covered. A total of 117 respondents were studied. The researcher sampled the respondents as shown from the tables 3.1 and 3.2 below.

Table 3.1: Sample Design

<table>
<thead>
<tr>
<th>Strata</th>
<th>Target Population</th>
<th>%</th>
<th>Sample</th>
</tr>
</thead>
<tbody>
<tr>
<td>DPFB</td>
<td>60</td>
<td>100</td>
<td>60</td>
</tr>
<tr>
<td>Ministry of Finance</td>
<td>6</td>
<td>100</td>
<td>6</td>
</tr>
<tr>
<td>Planning &amp; ND</td>
<td>6</td>
<td>100</td>
<td>6</td>
</tr>
<tr>
<td>NSE</td>
<td>5</td>
<td>100</td>
<td>5</td>
</tr>
<tr>
<td>Member Institutions</td>
<td>142</td>
<td>20</td>
<td>30</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>219</strong></td>
<td></td>
<td><strong>117</strong></td>
</tr>
</tbody>
</table>

Source: Researcher (2007)

From the members institutions stratified sampling was done so that the institutions that have different levels of deposits were sampled differently (table 3.2). All the member institutions with deposits above 501 million were taken as they are few. For the institution with deposit levels below 500m, balloting was done so that a sample of 11 respondents was achieved.
Table 3.2: Sampling of Member Institutions

<table>
<thead>
<tr>
<th>Level of Deposits</th>
<th>Frequency</th>
<th>Sample Size</th>
</tr>
</thead>
<tbody>
<tr>
<td>Kshs 0 – 500 Million</td>
<td>26</td>
<td>11</td>
</tr>
<tr>
<td>Kshs 501 – 2 billion</td>
<td>11</td>
<td>11</td>
</tr>
<tr>
<td>Over 2 Billion</td>
<td>8</td>
<td>8</td>
</tr>
</tbody>
</table>

Source: Researcher (2007)

3.5 Data Collection Procedure

The research used both primary and secondary sources to collect data from the sample population. The researcher obtained an introduction letter from the University (appendix I) seeking authority to carry out the research. Primary data was collected using structured questionnaires (appendix IV) that were distributed to the sampled respondents. The questionnaires were administered to the respondents who then filled the questions and collected for analysis. The questionnaire had both open ended and closed ended questions to enable the research guide the respondent through the filling of the questionnaire as well as probe them for more information. An assurance was given to the respondents that the information they gave was specifically for academic purposes only increased the response rate and more information was obtained.

3.6 Data Analysis Procedure

Once the data had been collected, the researcher checked all of the collected data for completeness, the information coded and tabulated. Descriptive as well as inferential statistics was used to analyze the data. This is because, descriptive statistics are used to summarize, describe and present pictures of data quantitatively through the use of tables, graphs, charts and central tendencies of mean, mode and median (Mutai, 2000). Correlation analysis was also done to derive the relationship between the dependent and independent variables of the study. Inferential statistics on the other hand was used to draw conclusions from sample data to the target population as well as to analyze qualitative data. Statistical Package for Social Scientists (SPSS) was used to analyze any correlation between the various variables in the study. The analyzed data was presented using graphs, tables and curves.
CHAPTER FOUR

DATA PRESENTATION, ANALYSIS AND INTERPRETATION

4.0 Introduction

This chapter deals with the presentation, analysis and interpretation of findings of the study. It presents findings of the study on the sufficiency of Deposit Protection Fund’s investment options to generate insurance funds for depositors in financial institutions and interprets using a statistical package for social sciences (SPSS) for the analysis.

Data presentation in this chapter is mainly by use of frequency tables (f) and factor analysis. The findings are presented in a format that reflects the objectives of the study which was stated earlier on as seeking to investigate whether the Deposit Protection Funds investment options are sufficient to generate insurance funds for depositors in financial institutions. Specifically, the study was aimed at:

1. Establishing the extent to which the performance of the economy influences the sufficiency of the Board’s insurance of the depositors.
2. Determining whether the mandate of the DPF Board as envisaged in the legislation and the Government policies is a factor that influences the sufficiency of the fund to insure depositors against loss
3. Finding out whether the availability or non availability of diverse investment options influences the sufficiency of the board’s fund to cover the depositors
4. Establishing whether the member institution had an influence on the sufficiency of the insurance cover that DPFB has for the depositors.

To conclude, make suggestions and recommendations to the management of DPFB and other stakeholders about the sufficiency of the funds at the Board to insure the depositors upon liquidation.
4.1 Data Processing

The major purpose of data processing was to arrange the data so collected into an organized, integrated and meaningful whole. After collecting the questionnaires from the respondents the questionnaires were edited for completeness, accuracy and uniformity. Completeness was to ensure that there was an answer to every question on the questionnaire. Questionnaires with any missing responses were noted.

Uniformity gives an opportunity for checking that the respondents interpreted both the instructions and questions uniformly and in the same manner. Editing of the questionnaires was to help the researcher to detect and as far as possible to eliminate errors in the completed questionnaires.

4.2 Data analysis

After the data was coded and reviewed for accuracy and consistency it was then entered into the computer for further descriptive analysis using SPSS computer package for windows throughout the analysis of the primary data. The coded data was categorized and tabulation was obtained for the questions that were intended to measure descriptive characteristics of the study sample. The key method for analysis was quantitative though qualitative data was also collected and used to supplement understanding of the interrelationships of the construct variables that were generated by the quantitative methods. Factor analysis was done to itemize the various study variables in the questionnaire so as to establish record of their variances. A T-test was run to establish how significant the various study variables used to investigate the sufficiency of Deposit Protection Funds investment options.

4.2.1 Response Rate

A total of 90 questionnaires were received from the respondents out of the total number of 117 questionnaires circulated. This formed 78% of the targeted population for the study. This was a good response rate considering that the respondents did not want to respond owing to the confidentiality of the information that the study sought.
The characteristics of the respondents who participated in the study related to gender, the length the respondent has been with the organization among others as represented in the following analysis.

4.2.2 Characteristics of the Sample (Demographic Variables)

From the questionnaires distributed to the respondents 72 were received from the male respondents duly completed while the remaining 18 questionnaires issued were received from the female respondents. The data demonstrates that of the total of questionnaires returned correctly filled in, the larger proportion of respondents (80%) was male, and the remaining 20% were female as indicated in the figure shown below (Figure 4.1). This implies that majority of the employees in the institutions under study were male and is an indication of the gender imbalance in the staffing of the institutions and the DPFB.

Figure 4.1: Gender of the respondents

![Gender of the respondents](image)

Source: Research Data (2008)

4.2.3 Length of service at the organization

The largest proportion of respondents stated they had worked for the financial institution
for duration of 11 - 15 years and above 16 years total of 64 employees comprising 71.2% of employees. This was closely followed by those who stated that they had served the financial institution for a period of between 6 – 10 years, comprising 17.7%. This indicates that the majority of the employees, 89% had been in their financial institution for a period of more than five years of continuous service.

It is also evident that 72.2% of the male employees had worked at the financial institution for duration of over 10 years while 66.7% of the female employees had worked for a similar duration. This shows that most employees have worked in the organization for a relatively long duration of time, with over 35.6% having worked for over 16 years of continuous service to the financial institution. The sum total of the years of experience of the respondents indicates that they had quite sufficient experience in the job and they had vast knowledge on the goings in their institutions regarding DPFB. Thus their responses are dependable and can be used to form an opinion about the study.

Table 4:1: Duration as an employee

<table>
<thead>
<tr>
<th>DURATION</th>
<th>Male</th>
<th>Female</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>f</td>
<td>%</td>
<td>f</td>
</tr>
<tr>
<td>Below 5 years</td>
<td>6</td>
<td>8.3</td>
<td>4</td>
</tr>
<tr>
<td>6 - 10 years</td>
<td>14</td>
<td>19.5</td>
<td>2</td>
</tr>
<tr>
<td>11 – 15 years</td>
<td>28</td>
<td>38.9</td>
<td>4</td>
</tr>
<tr>
<td>Above 16 years</td>
<td>24</td>
<td>33.3</td>
<td>8</td>
</tr>
<tr>
<td>Total</td>
<td>72</td>
<td>100</td>
<td>18</td>
</tr>
</tbody>
</table>

Source: Research Data (2008)
4.3 Sufficiency of Investment Options for DPFB

The data in this section analyses some of the investment options available for the Deposit Protection Fund Board (DPFB). The analysis includes the use of frequency tables that show characteristics of the available investments options to DPFB in insuring the deposits of the member institutions.

4.3.1 Investment of the deposits

The respondents were asked to indicate from the list of options how DPFB invests the premiums received from the member institutions. The result from the table below (table 4.2) indicates that 84.4% of the respondents interviewed indicated that the DPFB invests the premium from the member institutions through the use of Treasury bill and bonds while only 15.6% of the deposits are invested in shares with the Nairobi Stock Exchange (NSE). This is a clear indication that the investments are not highly diversified and the dependence on these two may prove insufficient incase of emergencies and poor
economic performance. Furthermore, the 85% of the funds invested in one investment, may be disastrous during hard times when needed most and thus the DPFB needs to identify other options that they can invest their funds in.

Table 4.2: How DPFB invests the deposits

<table>
<thead>
<tr>
<th>Investment options</th>
<th>frequency</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Treasury bills and bonds</td>
<td>76</td>
<td>84.4</td>
</tr>
<tr>
<td>Shares at the NSE</td>
<td>14</td>
<td>15.6</td>
</tr>
<tr>
<td>Property</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Others</td>
<td>0</td>
<td>0</td>
</tr>
</tbody>
</table>

Source: Research Data (2008)

4.3.2 Sufficiency of the fund to insure the depositors

The researcher in this section asked the respondents to state what in their opinion was the level of sufficiency of the deposits to insure any member institution liquidating. From the table below (table 4.3) it is evident that the majority of the respondents, 55% stated that the deposits were slightly insufficient to insure the member institutions upon liquidation. The table also indicates that 20% of the respondents stated that the amount of the deposits with the DPFB was just sufficient to insure the member institutions while the other 7% stated that the amount of the deposits were insufficient. According to majority of the respondents, the funds are slightly insufficient to insure depositors implying that there is need for the Board to develop other ways of making the funds sufficient. It is an indication that the depositors may be facing an imminent danger in case of liquidation.
### Table 4.3: Sufficiency of reserves to insure larger member institutions (Depositors)

<table>
<thead>
<tr>
<th>Level of sufficiency</th>
<th>frequency</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Quite sufficient</td>
<td>16</td>
<td>18%</td>
</tr>
<tr>
<td>Just sufficient</td>
<td>18</td>
<td>20%</td>
</tr>
<tr>
<td>Slightly insufficient</td>
<td>50</td>
<td>55%</td>
</tr>
<tr>
<td>Quite insufficient</td>
<td>6</td>
<td>7%</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>90</strong></td>
<td><strong>100%</strong></td>
</tr>
</tbody>
</table>

Source: Research Data (2008)

### 4.4 The Need to Diversify the Investment Options

The respondents were asked to indicate whether in their opinion they thought there was need to diversify the investment options that the DPFB currently had. The figure below (figure 4.3) presents the opinions of the respondents on the need to diversify the investment options that the DPFB have. A total of 64 respondents, representing 71% of the respondents stated that there is the need to diversify the investment options that the DPFB has while 29% indicated that there was no need to diversify the investment options. It is clear from these responses that the board needs to diversity so as to maintain a comfortable liquidity which in turn provides a confidence for the employees and the depositors themselves.
4.4.1 Other viable investment avenues

The respondents were asked to suggest some viable investment avenues other than the approved government securities that could be available and used by the DPFB to invest the levied premiums of member institutions. From the table below (table 4.4) 48.9% of the respondents suggested that the DPFB should be allowed to participate and deal in secondary trading in the government securities at the NSE. 15.6% of the respondents suggested the Housing Development bonds to be set up as it would yield reasonable returns and complement government efforts to providing housing to its citizens. 13.2% of the respondents stated the participation in offshore investments by the DPFB. The other viable avenues suggested included; mutual funds 8.9%, Deposit insurance in other countries 8.9% and Equity with trusts 4.5%.

Source: Research Data (2008)
### Table 4:4: Other viable Investment avenues

<table>
<thead>
<tr>
<th>Other investment avenues</th>
<th>Frequency</th>
<th>%</th>
<th>Ranking</th>
</tr>
</thead>
<tbody>
<tr>
<td>Housing development bonds</td>
<td>14</td>
<td>15.6</td>
<td>2</td>
</tr>
<tr>
<td>Mutual funds</td>
<td>8</td>
<td>8.9</td>
<td>4</td>
</tr>
<tr>
<td>Direct participation in secondary trading at NSE</td>
<td>44</td>
<td>48.9</td>
<td>1</td>
</tr>
<tr>
<td>Equity with trusts</td>
<td>4</td>
<td>4.5</td>
<td>5</td>
</tr>
<tr>
<td>Offshore investments</td>
<td>12</td>
<td>13.2</td>
<td>3</td>
</tr>
<tr>
<td>Deposit insurance in other countries</td>
<td>8</td>
<td>8.9</td>
<td>4</td>
</tr>
</tbody>
</table>

Source: Research Data (2008)

### 4.5 Legal Provisions Governing DPFB

The respondents were asked to indicate whether they were satisfied with the current legal provisions governing the DPFB. From the figure below (figure 4.4) the majority of the respondents stated that they were dissatisfied with the legal provisions currently governing the DPFB. 18% of the respondents stated that they are currently satisfied with the current legal provisions governing the DPFB, while 82% of the respondents stated they were not satisfied with the current level of legal provisions governing the DPFB. This implies that there is need to restructure and develop new laws and legislation which will be conducive for the board to operate and provide sufficient backing for their investment and depositors.
4.6 Factors Influencing the Sufficiency of Funds at DPFB

The respondents used in the study were further asked to state the extent to which these factors influenced the sufficiency of the funds at DPFB to insure depositors.

4.6.1 Investment options available

The respondents were asked to state what they thought in their opinion the extent of influence the availability of other investment options had on the sufficiency of the funds at DPFB to insure the depositors. The table below, (Table 4.5) indicates that the variety of investment options available to DPFB would greatly influence the sufficiency of the funds at DPFB to insure depositors. In total 88.9% of respondents stated that the investment options available greatly and to some extent had some influence to the sufficiency of funds.

From the table, 11.1% of the respondents stated that the availability of other investment options had to a lesser extent and had no influence at all to the sufficiency of the funds the DPFB had to insure the depositors. This means that if there were more investment
options available for the board, more returns will be generated that will in effect enhance growth of the fund to insure the depositors.

Table 4:5: Investment options

<table>
<thead>
<tr>
<th>Level of influence</th>
<th>frequency</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Great influence</td>
<td>62</td>
<td>68.9</td>
</tr>
<tr>
<td>Some extent of influence</td>
<td>18</td>
<td>20</td>
</tr>
<tr>
<td>Less extent of influence</td>
<td>4</td>
<td>4.4</td>
</tr>
<tr>
<td>No influence at all</td>
<td>6</td>
<td>6.7</td>
</tr>
</tbody>
</table>

Source: Research Data (2008)

4.6.2 The Mandate of the DPFB

The respondents were asked to state, what in their opinion, was the level of influence the mandate of the DPFB had on the sufficiency of the funds at DPFB to insure depositors. From the study the majority of respondents, 77.8% stated that the mandate that DPFB had greatly and to some extent influenced the sufficiency of the funds at DPFB to insure depositors as indicated in the table below (Table 4.6). There is need therefore to enhance the mandate of the board so as to be able to effectively operate.

Table 4:6: Mandate of the DPFB

<table>
<thead>
<tr>
<th>Level of influence</th>
<th>frequency</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Great influence</td>
<td>46</td>
<td>51.1</td>
</tr>
<tr>
<td>Some extent of influence</td>
<td>24</td>
<td>26.7</td>
</tr>
<tr>
<td>Less extent of influence</td>
<td>8</td>
<td>8.9</td>
</tr>
<tr>
<td>No influence at all</td>
<td>12</td>
<td>13.3</td>
</tr>
</tbody>
</table>

Source: Research Data (2008)
4.6.3 Legislations and policies

The researcher asked the respondents to state, what in their opinion, was the level of influence they thought legislation and policies had on the sufficiency of funds at DPFB to insure the depositors. 86.7% stated that government legislations and policies set up to run the DPFB greatly and to some greater extent influenced the sufficiency of the funds at DPFB to insure depositors as indicated in the table below (Table 4.7). It is only 13.3% of respondent who stated that the legislations and policies had no influence at all and to a lesser extent had some influence on the sufficiency of the funds at DPFB to insure depositors. As indicated earlier, the government requires repealing and amending the legislation governing the board so as to provide an enabling environment for the board to diversity and operate effectively.

<table>
<thead>
<tr>
<th>Level of influence</th>
<th>frequency</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Great influence</td>
<td>52</td>
<td>57.8</td>
</tr>
<tr>
<td>Some extent of influence</td>
<td>26</td>
<td>28.9</td>
</tr>
<tr>
<td>Less extent of influence</td>
<td>10</td>
<td>11.1</td>
</tr>
<tr>
<td>No influence at all</td>
<td>2</td>
<td>2.2</td>
</tr>
</tbody>
</table>

Source: Research Data (2008)

4.6.4 Roles of the member institutions

The researcher asked the respondents to state, what in their opinion, was the level of influence they thought the roles of the member institution had on the sufficiency of funds at DPFB to insure the depositors. The figure below (Figure 4.5) indicates that only 31% of the respondents stated that roles of the member organizations to the DPFB greatly and to some extent influenced the sufficiency of the funds at DPFB to insure the depositors. 69% of respondents stated the roles of the member institutions had no influence at all and
to a lesser extent had some influence on the sufficiency of the funds at DPFB to insure the depositors. This is a clear indication that the board's activities are not in any way influenced by the member institutions. This is because of the regulatory role the board plays on these institutions.

Figure 4.5: Role of member institutions

Source: Research Data (2008)

4.6.5 Performance of the economy

The table below (Table 4.8) indicates the opinions of the respondents concerning the level of influence the performance of the economy had on the sufficiency of funds at DPFB to insure the depositors. 86.7% of the respondents stated that the performance of the economy greatly and to some extent influenced the sufficiency of the funds at DPFB to insure depositors. From the table also it is evident that only 13.3% of respondent stated that the performance of the economy had to a lesser extent some influence on the sufficiency of the funds at DPFB to insure depositors. Since the board invests in bonds, and bills, the performance of the economy is a great factor that influences the functions and ability of the board.
Table 4.8: Performance of the economy

<table>
<thead>
<tr>
<th>Level of influence</th>
<th>Frequency</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Great influence</td>
<td>58</td>
<td>64.5</td>
</tr>
<tr>
<td>Some extent of influence</td>
<td>20</td>
<td>22.2</td>
</tr>
<tr>
<td>Less extent of influence</td>
<td>12</td>
<td>13.3</td>
</tr>
<tr>
<td>No influence at all</td>
<td>0</td>
<td>0</td>
</tr>
</tbody>
</table>

Source: Research Data (2008)

4.7 Correlation Tests Using the Chi Square Tests

Chi Square is a test of statistical significance that is used to determine the degree of confidence one can have in accepting or rejecting a hypothesis. This is whether or not two samples are different enough in some characteristics to generalize. A chi square probability of 0.05 or less is interpreted as a justification for rejecting the null hypothesis. This section looks at the tests that were made in determining the degree of relationships between the dependent and independent variables under study. The Spearman’s correlation coefficient method was used to measure the relationships in the variables. The relationships measured were between the sufficiencies of the deposit protection funds investment options to generate insurance funds for the depositors in the financial institutions.

4.7.1 Relationship between investment options and performance of economy

The researcher in this section wanted to determine the association between the investment options and the performance of the economy. The null hypothesis that there is no association between the two was the starting point.
Table 4:9: Significance of correlation coefficient

<table>
<thead>
<tr>
<th>Method</th>
<th>Value</th>
<th>Significance</th>
</tr>
</thead>
<tbody>
<tr>
<td>Spearman’s correlation coefficient</td>
<td>0.742</td>
<td>0.000</td>
</tr>
</tbody>
</table>

Source: Research Data (2008)

There is a relationship between the investment options available and the performance of the economy. The relationship is significant with Spearman’s correlation coefficient of 0.742 and a significance of P=0.000. This indicates there is a strong correlation between the various investment options DPFB can have and the performance of the economy at any time.

4.7.2 Relationship between investment options and the mandate of DPFB

Table 4:10: Significance of correlation coefficients

<table>
<thead>
<tr>
<th>Method</th>
<th>Value</th>
<th>Significance</th>
</tr>
</thead>
<tbody>
<tr>
<td>Spearman’s correlation coefficient</td>
<td>0.572</td>
<td>0.000</td>
</tr>
</tbody>
</table>

Source: Research Data (2008)

There is a positive relationship between investment options available to DPFB and the mandate of the DPFB. This is indicated in the table above (table 4.10) by Spearman’s coefficient of 0.572 and a high significance of P=0.000. There is therefore a strong relationship between the investment options that can be availed to the DPFB and the mandate given to DPFB in its powers in insuring the depositors.

4.7.3 Relationship between investment options and legislation and policies

Table 4:11: Significance of correlation coefficients

<table>
<thead>
<tr>
<th>Method</th>
<th>Value</th>
<th>Significance</th>
</tr>
</thead>
<tbody>
<tr>
<td>Spearman’s correlation coefficient</td>
<td>0.840</td>
<td>0.000</td>
</tr>
</tbody>
</table>
From the table above (Table 4.11) there is a significant relationship between investment options available to DPFB and the government legislations and policies. The relationship is significant with Spearman’s coefficient of 0.840 and a significance of $P=0.000$. This is an indication of the existence of a correlation between the investment options that DPFB can be allowed to use and the legislations and policies set by the government concerning the investment options they can use. This would influence the sufficiency of the funds at DPFB to insure the depositors.

4.7.4 Relationship between investment options and roles of members

Table 4.12: Significance of correlation coefficients

<table>
<thead>
<tr>
<th>Method</th>
<th>Value</th>
<th>Significance</th>
</tr>
</thead>
<tbody>
<tr>
<td>Spearman’s correlation coefficient</td>
<td>0.382</td>
<td>0.070</td>
</tr>
</tbody>
</table>

From the table above (Table 4.12) there is an insignificant relationship between investment options that DPFB can utilize and the roles of member institutions. The relationship is also insignificant with Spearman’s coefficient of 0.382 and a significance of $P=0.070$. This indicates that there is no correlation between the investment options that DPFB can be allowed to use and how the roles of member institutions affect the choice of those options. This would not influence the sufficiency of the funds at DPFB to insure the depositors.

4.8 T-Tests

This test was carried out to examine the differences between the means of the DPFB member institutions on the investment options, effects of the performance of the economy and the sufficiency of the Fund to insure depositors and to examine whether the two means are significantly different from one another by testing the difference of means.
The significance value is the probability that the t-value would be simply by chance if the null hypothesis were true. The critical value is the value of a given level of significance (e.g. the 0.0005 level) and since this value is so small (less than 5 in 10,000) we will reject the null hypothesis and conclude that there is a difference between the DPFB and the member institutions in terms of the variables. The results are presented in the following tables.

4.8.1 Differences on investment of deposits from member institutions

Table 4.13: Differences on investment of deposits (one sample test)

<table>
<thead>
<tr>
<th>Variables</th>
<th>T values = 0</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>t</td>
</tr>
<tr>
<td>The use of Treasury Bills or Bonds</td>
<td>5.0270</td>
</tr>
<tr>
<td>Purchasing of shares at the NSE</td>
<td>7.416</td>
</tr>
<tr>
<td>Investing in properties</td>
<td>4.000</td>
</tr>
<tr>
<td>Investments in other areas</td>
<td>13.175</td>
</tr>
</tbody>
</table>

Source: Research Data (2008)

The above results show that there was a significant difference between the views of member institutions on the investment options that DPFB has for deposits received. The use of the treasury bills or bonds (t=5.027, p=0.003), the purchasing of shares at the Nairobi Stock Exchange – NSE (t=7.416, p=0.001), the others investing the members deposits in properties (t=4.000, p=0.010), and the investments in other areas (t=13.175, p=0.000), With a mean difference of 3.167 the variable of using the treasury bills or bonds and the investment of the members deposits through the purchase of shares at the Nairobi Stock Exchange were fairly significant as it indicated a positive significance to the investment options of the deposits.
4.8.2 Differences on effects of the economy on investment options

Table 4:14: Differences on economy on investment options

<table>
<thead>
<tr>
<th>Variables</th>
<th>T values = 0</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>t</td>
</tr>
<tr>
<td>The Gross Domestic Product (GDP)</td>
<td>4.000</td>
</tr>
<tr>
<td>The cost of Living Index</td>
<td>4.183</td>
</tr>
<tr>
<td>The Employment Levels</td>
<td>4.540</td>
</tr>
<tr>
<td>The Inflation Rates</td>
<td>3.264</td>
</tr>
</tbody>
</table>

Source: Research Data (2008)

The above results show that there was a significant difference between the variables on the effects of the country’s economy on the investment options available. In this respect the effects of the country’s Employment levels on the economy of the country had influence on the investment options (t=4.540, p=0.006), and the cost of living index (t=4.183, p=0.009), and the GDP of the country (t=4.000, p=0.0000).
4.8.3 Differences on influences on the sufficiency of funds at DPFB to insure Deposits

Table 4.15: Differences on influence of DPFB reserve funds

<table>
<thead>
<tr>
<th>Variables</th>
<th>T values = 0</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>t</td>
</tr>
<tr>
<td>Investment options available</td>
<td>5.190</td>
</tr>
<tr>
<td>The Mandate of the DPFB</td>
<td>5.836</td>
</tr>
<tr>
<td>Legislations and policies</td>
<td>11.000</td>
</tr>
<tr>
<td>Roles of member institutions</td>
<td>1.796</td>
</tr>
<tr>
<td>Performance of the economy</td>
<td>5.534</td>
</tr>
</tbody>
</table>

Source: Research Data (2008)

The above results (table 4.15) show that there was a significant difference between the influences of constructs being studied on the sufficiency of funds at DPFB to insure the depositors. All the above four variables are positively significant in influencing the sufficiency of funds at the DPFB to insure depositors except for the role of member institutions. Any significance level of 0.05 (95%) and above indicates a strong positive significance. In this respect the DPFB’s ability to invest the funds of the depositors is influenced by the legislations and policies of the Government of DPFB activities (t=11.000, p=0.000), the investment options available (t=5.190, p=0.003), the mandate of the DPFB (t=5.836, p=0.002), and the performance of the economy (t=5.534, p=0.003).

4.9 Summary of Findings

The study found out that the investment options of the board were not diverse with only two (2) major options being employed – the treasury bills and treasury bonds. Essentially,
it was also determined that the options were slightly insufficient to insure the investors and member institutions liquidating and there is an urgent need to diversify more options of the board. Indeed 71% of the respondents indicated that they supported the need to diversify investment options for the board. Eighty two percent (82%) of the respondents indicated they were not satisfied with the legal provisions governing the operations of the board and thus they recommended the development and amendment of the Banking Act.

The respondents indicated that the investment options available for the board (88.9%) influenced the sufficiency of the funds of the board to insure the depositors. Another 77.8% indicated that the sufficiency of the fund also is influenced by the mandate that the board has while another 86.7% said that the legislation and polices influenced the sufficiency of the fund. 69% of the respondents said that the member institutions' influence on the decisions by the board was quite minimal.
CHAPTER FIVE

SUMMARY, CONCLUSION AND RECOMMENDATIONS

5.0 Introduction

This research set out to study the sufficiency of the DPFB’s funds to insure depositors. The chapter discusses the findings as indicated in chapter four, concludes the findings and also gives the recommendations of the study.

In chapter 1, the background and problems of the study were given and the study variables indicated. Research questions were posed as a way of determining the impact of the variables under study. In chapter 2, a detailed review of literature on the topic of the research was done. In this chapter the relevant academic journals highlighting the various aspects of the study especially the variables used in the study were used to shed more light to the study. Chapter 3 presented the methodology of the study while Chapter 4 presented the analysis of the findings and interpretation of the study.

In this chapter, the results of the study as presented in chapter 4 are discussed and conclusions are drawn upon which recommendations and areas thought necessary for further research will be identified. This chapter is divided into four parts. Section 5.1 of this chapter deals with the summary, section 5.2 deals with the conclusions while section 5.3 highlights the recommendations and section 5.4 finally looks at areas of further research on this topic.

5.1 Summary of Findings

The discussions in this section are on the findings of the study in relation to the research questions. The research was intended to achieve the main objective of establishing the sufficiency of the DPFB’s funds to insure depositors. The research study was then further designed to accomplish the following objectives.

1. To establish the extent to which the performance of the economy influences the sufficiency of the board’s insurance of the depositors.
2 To determine whether the mandate of the DPFB as envisaged in the legislation and the Government policies is a factor that influences the sufficiency of the Fund to insure the depositors

3 To find out if the availability or non-availability of diverse investment options influences the sufficiency of the Board’s to insure the depositors

4 To establish whether the member institution have an influence on the sufficiency of the insurance cover that the DPFB has on the deposits.

5 To conclude, make suggestions and recommendations to the management of DPFB and other stakeholders about the sufficiency of the funds at the Board to insure the depositors’ upon liquidation.

5.1.1 Influence of Performance of the economy on the sufficiency of DPFB

The first objective was achieved through establishing that to many respondents the health of the country’s economy had a high influence on the sufficiency of the DPFB’s ability to insure the depositors’ funds. A number of factors indicating the performance of the economy had a positive effect on the investment returns of the DPFB. Among the many factors that affect the performance of the economy of a nation and the ones that were indicated by the respondents in their ranking included; the cost of living index, the employment levels, the GDP and the rate of inflation in the country.

5.1.2 Mandate of the DPFB versus the sufficiency of the Fund to insure the depositors

Based on the study, the respondents used in the study stated that the mandate of DPFB as stated out in the legislations and policies’ governing the operations of their organization (DPFB) is a major factor that has influenced the performance of the Board and has influenced the sufficiency of the fund to insure the depositors. The mandate of the DPFB is not broad enough to allow the Board to invest in a variety of options and as such has very limited investment portfolios. 82% of the respondents when asked whether they were satisfied with the current legal provisions governing the operations of the DPFB
stated that they were not at all satisfied indicating that the legislations and policies affected the sufficiency of the fund to effectively insure the depositors.

The respondents further stated that other than the Banking Act currently governing the operations of the DPFB they would recommend other additional legal provisions to govern the DPFB such as; strengthening the DPFB legal capacity to build a deposit insurance which can adequately meet the challenges in executing the mandate. The main areas in this case would be the rate of premium and the extent of the cover, with high risk institutions generating high rate of premium and vice versa.

There is the need to have an autonomous DPFB through a DPFB Act in order to de-link it from the CBK. The Act should state out the structural, organizational and mandate of the Board. Others stated the need to have the Government allow DPFB to inspect banks; the need to reduce the statutory period to a maximum of three (3) months; the institutions to pay protected deposits during the statutory period and to allow DPFB to take over the failed banks. Others are of the opinion that there is an urgent need for a separate court to deal with financial institutions especially to hasten the disposal of securities.

5.1.3 Investment Options influence on the sufficiency of DPFB to insure the depositor.

In respect to the availability or non availability of diverse investment options influences on the sufficiency of the board’s funds to cover the members’ deposits, majority of the respondents’ stated that the reserves were insufficient to insure member institution deposits with only 18% of the respondents stating that the investment options were quite sufficient.

The respondents were further asked whether they thought there was need to diversify the investment options the DPFB had. From the responses indicated in figure 5 71.1% of the respondents stated that there is need to diversify the investment options and the following were suggested as investment options the DPFB could participate in; direct participation in secondary trading in government securities at the NSE, housing development bonds,
mutual funds, offshore investments, having deposits in stable banks and have deposit insurance corporations in other foreign countries among others.

5.1.4 The influence of member institutions on the sufficiency of the insurance cover of DPFB

This was aimed at finding out the influence of the member institutions on the sufficiency of the insurance cover the DPFB had on the deposits. Majority of the respondents, 69% stated that the roles of the member institutions had no influence to the performance of the Deposit Protection Fund. A number of factors were identified as having influence on the sufficiency of the insurance cover the DPFB has for the members deposits namely; the financial stability of the member institutions, timely deposits remitted by the members, the volume of deposits by the respective member institutions to the DPFB.

Other aspects include the performance of the financial institution dealing in borrowing and lending and if this reduces then the DPFB receives less in premium from the member institution, mismanagement of the institution will also greatly affect the generation of deposits and the premium remitted to DPFB. This will affect the performance of the financial institution thereby reducing the amounts the DPFB will have access to be used to insure against the deposits.

5.2 Conclusions

This study examines the sufficiency of Deposit Protection Fund’s investment options to generate insurance funds for depositors in financial institutions. The study investigated the various investment options currently available to the DPFB in their role of investing the deposits from the member institutions and the possible constraints the fund experiences in investing the levied premiums.

As per the findings of the study most respondents stated that DPFB invests the deposits from the member institutions mainly in treasury bills and in shares at the Nairobi Stock
Exchange (NSE). The reason here is mainly because of the working regulations and the policies that restrict the mandate of the operations of DPFB. The study further found out that majority of the respondents proposed the need for the current Act to be amended to allow DPFB to invest in wide range of investment avenues with a large number further stating the need to have an autonomous DPFB Act to set the Board separate from the CBK to improve its effectiveness.

In a majority of cases the performance of the economy of the country plays a crucial part in the available investment options that the DPFB can have. When there is adverse or decline in the elements affecting the performance of the economy such as; the GDP, cost of living index, employment levels and the rate of inflation, the overall performance and success of the DPFB will grossly decline. The mandate given DPFB to carry out its activities is also not adequate enough thus making the legal provisions governing DPFB not satisfactory.

5.3 Recommendations
This part of the report brings forward recommendations that according to the researcher would help improve the cases that have been observed under this study. Based on the results of the study, these recommendations are expected to improve on the situations that have been observed. However, these recommendations do not only apply to the DPFB in Kenya but also to other developing countries that would want to improve on the performance of their financial institutions through improving the sufficiency of the deposit protection funds investment options to generate insurance funds for depositors in financial institutions.

The fund is considered an important mechanism to providing financial stability within the national economy so as to have an efficient financial market. It serves a number of important economic and social objectives, the principal being the provision of protection to depositors, the maintenance of confidence in and stability within the financial sector.
and the acceleration of the process of failure resolution strategies in cases where a bank fails. The fund should then be given the necessary legal and functional mandate that gives provisions to ensuring their effectiveness. The study recommends that:

i. The banking Act should be reviewed to ensure that an efficient deposit protection fund is established.

ii. There is an urgent need to diversify the investment options to enhance growth.

iii. Legislations and regulations should be reviewed to expand the mandate of the board to include surveillance.

iv. There is need to de-link DPFB from the Central Bank of Kenya so as to operate independently.

5.4 Area for Further Research

This study by its nature has not been able to exhaustively investigate all the variables that explain all the aspects of the sufficiency of the deposit protection fund’s investment options to generate insurance funds for depositors in financial institutions. The following area is therefore recommended to be carried out for further investigations or study in deposit protection fund investment options.

1. The other area of study in which further research is needed is on the impact of individual member success as a financial institution on the effectiveness of the DPFB.

2. The impact of economic factors on the stability and success of financial institutions and options available to DPFB’s investment options in generating insurance funds.
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*The Banking Act, Chapter 488, Laws of Kenya. G.O.K*


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TO WHOM IT MAY CONCERN

Dear Sir/Madam

RE: RECOMMENDATION FOR SALOME K. MUREITHI
REG. NO. D53/OL/3633/04

This is to confirm that the above named is an MBA student, undertaking Finance Option, in Accounting & Finance Department, School of Business, Kenyatta University.

Miss Mureithi has successfully completed her coursework and is now embarking on research work which is a requirement for the award of the degree.

Any assistance accorded to her will be highly appreciated.

For more information about the student, please contact this office.

Thank you.

Yours faithfully,

Ms. Farida Abdul
MBA COORDINATOR

KENYATTA UNIVERSITY
SCHOOL OF BUSINESS
MBA COORDINATION OFFICE

P.O. Box 43844
NAIROBI, KENYA
Tel. 810901/811622
Ext. 57519

Website: ku.ac.ke
APPENDIX II: LETTER TO RESPONDENT

Dear Respondent,

RE: RESEARCH PROJECT

I am a Postgraduate student at Kenyatta University pursuing a Master of Business Administration. I am carrying out study on “The Sufficiency of the Deposit Protection Fund’s Investment Options to Generate Insurance Funds for Depositors in Financial Institutions”. The success of the research substantially depends on your cooperation. I hereby request you to respond to the questionnaire items as honestly as possible and to the best of your knowledge.

The questionnaire is designed for the purpose of this study only, therefore the responses will absolutely be confidential and anonymously given. No name will be required from any respondent.

Thanking you in advance.

Yours Faithfully,

SALOME K MUREITHI
### APPENDIX III  MEMBER INSTITUTIONS TO THE DPFB

#### Commercial Banks

<table>
<thead>
<tr>
<th>NAME OF INSTITUTION</th>
<th>NAME OF INSTITUTION</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. African Banking Corporation Ltd</td>
<td>22 Fidelity Commercial Bank Ltd</td>
</tr>
<tr>
<td>2. Akiba Bank Ltd</td>
<td>23 Fina Bank Ltd</td>
</tr>
<tr>
<td>4. Bank of Baroda(K) Ltd</td>
<td>25 Guardian bank Ltd</td>
</tr>
<tr>
<td>5. Bank of India Ltd</td>
<td>26 Habib Bank AG Zurich</td>
</tr>
<tr>
<td>7. CFC Bank Ltd</td>
<td>28 Imperial Bank</td>
</tr>
<tr>
<td>8. Chase Bank (K) Ltd</td>
<td>29 I &amp;M Bank Ltd</td>
</tr>
<tr>
<td>10. Citi Bank, N.A</td>
<td>31 Middle East Bank Ltd</td>
</tr>
<tr>
<td>11. City Finance Bank Ltd</td>
<td>32 National Bank of Kenya Ltd</td>
</tr>
<tr>
<td>12. Commercial Bank Africa Ltd</td>
<td>33 N.I.C. Bank Ltd</td>
</tr>
<tr>
<td>13. Consolidated Bank of Kenya Ltd</td>
<td>34 Oriental Commercial Bank Ltd</td>
</tr>
<tr>
<td>15. Credit Bank Ltd</td>
<td>36 Prime Bank Ltd</td>
</tr>
<tr>
<td>16. Development Bank of Kenya Ltd</td>
<td>37 Southern Credit Corp. Ltd</td>
</tr>
<tr>
<td>17. Diamond Trust Bank of Kenya Ltd</td>
<td>38 Stanbic Bank Kenya Ltd</td>
</tr>
<tr>
<td>18. Dubai Bank Ltd</td>
<td>39 Standard Ch. Bank (K)Ltd</td>
</tr>
<tr>
<td>19. Equatorial Commercial Bank Ltd</td>
<td>40 Trans-National Bank Ltd</td>
</tr>
<tr>
<td>20. Equity Bank Ltd</td>
<td>41 Victoria Comm. Bank Ltd</td>
</tr>
</tbody>
</table>

#### Non-Banking Financial Institutions

| 1 Housing Finance Co. of Kenya Ltd      | 3 Savings and Loan Kenya Ltd            |
| 2 Prime Capital and Credit Ltd          |                                          |
APPENDIX IV: QUESTIONNAIRE
The Sufficiency of DPFB’s funds to Insure Depositors
You are kindly requested to answer the following questions. Please tick the appropriate answer. Information provided will be used strictly for the purpose of this study and will be treated with confidentiality. There is no correct or wrong answer.

PART A: PERSONAL INFORMATION
1. Name: (optional) 

2. Gender
   - Male □
   - Female □

3. Organization / Ministry

4. Department

5. Length of service in the organization or Ministry?
   - i. Less than 5 years □
   - ii. 6-10 years □
   - iii. 11-15 years □
   - iv. Over 16 years □

PART B: SUFFICIENCY OF INVESTMENT OPTIONS FOR DPFB
6. What is the current amount of premium payable to DPFB by your institution?

7. How does the DPFB invest the deposits from the member institutions?
   - Treasury bills and bonds []
   - Shares at the NSE []
   - Property []
   - Other (s) []
8. Does the Fund experience constraints in investing the levied premiums?
   Yes [ ] No [ ]

9. If yes above, would you propose that the Act be amended to allow DPFB to invest in wide range of investment avenues?
   Yes [ ] No [ ]

10. Explain your answer in 8 above. .................................................................

11. How sufficient are the DPFB reserves to insure larger member institutions’ deposits?

<table>
<thead>
<tr>
<th>Sufficiency</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
</tr>
<tr>
<td></td>
</tr>
</tbody>
</table>

   Where 1 = Quite sufficient, 2 = Just sufficient, 3 = slightly insufficient and 4 = quite insufficient

12. According to you, do you think there is need to diversify the investment options that the DPFB have? Yes [ ] No [ ]

13. Please suggest some viable investment avenues other than approved government securities.................................................................

14. Indicate against each element of the economy, the effect that it has on the investment options that the DPFB have.
<table>
<thead>
<tr>
<th>Element</th>
<th>Positive Effect</th>
<th>Negative Effect</th>
<th>Neutral</th>
</tr>
</thead>
<tbody>
<tr>
<td>GDP</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cost of living index</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Employment levels</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Inflation rate</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

15. How adequate is the mandate of DPFB to carry out its activities and plans? ...

16. According to you, what are the factors that determine the mandate of the DPFB?
   i. ........................................
   ii. ........................................
   iii. ........................................
   iv. ........................................

17. Are you satisfied with the current legal provisions governing the DPFB?
   Yes [] No []

18. If no above, what additional legal provisions would you recommend to govern the DPFB other than the Banking Act?

19. Do the roles of the member institutions influence the performance of the Deposit Protection Fund? Yes [] (go to 20) No []

20. Explain your answer in 19 above........................................

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21. To what extent does each of the following factors influence the sufficiency of the funds at DPFB to insure against depositors?

<table>
<thead>
<tr>
<th>Factor</th>
<th>1</th>
<th>2</th>
<th>3</th>
<th>4</th>
</tr>
</thead>
<tbody>
<tr>
<td>Investment Options</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Mandate of DPFB</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Legislation and Policies</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Needs and role of members institutions</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Performance of the Economy</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Where 1 – Great Influence, 2 – Some Extent, 3 – Less Extent, 4 – No Influence

22. Rank the effects that the following elements of the government policies and regulations influence the investment options for the DPFB.

<table>
<thead>
<tr>
<th>Government Policy</th>
<th>1</th>
<th>2</th>
<th>3</th>
<th>4</th>
</tr>
</thead>
<tbody>
<tr>
<td>Economic Environment</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Demographic</td>
<td></td>
<td></td>
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</tr>
<tr>
<td>Socio cultural</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Political systems</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Where 1 = highly affect, 2 = Affects moderately, 3 = slightly affects and 4 = No affects

23. What other suggestion or recommendation do you have on how to grow the fund?

THANKS AND GOD BLESS FOR YOUR TIME AND ANSWERS