

FOREIGN DIRECT INVESTMENT AND BANK PERFORMANCE IN KENYA

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DECLARATION

This research project is my original work and has not been submitted to any other institution for any academic award.

Declaration by Candidate:

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SUPERVISOR'S DECLARATION

This project work has been submitted by the candidate for examination with my approval as the university supervisor.

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DEDICATION

I dedicate this research project to each and every individual who contributed to the success of this work in one way or another. Thank you all.

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TABLE OF CONTENTS

DECLARATION.....	ii
DEDICATION	iii
ACKNOWLEDGEMENT	iv
LIST OF TABLES	ix
LIST OF FIGURES	x
ABBREVIATION AND ACRONYMS	xi
OPERATIONAL DEFINITION OF TERMS.....	xii
ABSTRACT.....	xiv
CHAPTER ONE	1
INTRODUCTION.....	1
1.1 Background of the Study	1
1.1.1 Foreign Direct Investment	3
1.1.2 Bank Performance	5
1.1.3 Banking Sector in Kenya	6
1.2 Statement of the Problem	7
1.3 Objectives of the Study	9
1.3.1 General Objective.....	9
1.3.2 Specific Objectives.....	9
1.4 Research Hypotheses.....	9
1.5 Significance of the Study.....	10
1.6 Scope of the Study.....	10
1.7 Limitations of the Study	10

1.8 Organization of the Study	11
CHAPTER TWO	12
LITERATURE REVIEW	12
2.1 Introduction.....	12
2.2 Theoretical Review	12
2.2.1 Profit Maximization Theory	12
2.2.2 Pecking Order Theory	13
2.4.2 Eclectic Paradigm of Dunning	14
2.3 Empirical Review	16
2.3.1 Bank Performance	16
2.3.2 Equity Capital and Bank Performance	17
2.3.3 Reinvested Earning and Bank Performance	18
2.3.4 Intra-company Loans and Bank Performance.....	19
2.4 Research Gaps.....	20
2.5 Conceptual Framework	22
CHAPTER THREE	23
RESEARCH METHODOLOGY	23
3.1 Introduction.....	23
3.2 Research Philosophy	23
3.3 Research Design.....	23
3.4 Target Population	24
3.5 Sample Size and Sampling Technique	24
3.6 Data Collection Instrument	25

3.7 Data Collection Procedure	25
3.8 Data Analysis and Presentation.....	26
3.8.1 Diagnostic tests	27
3.7.2.1 Normality test.....	27
3.7.2.2 Autocorrelation.....	28
3.7.2.3 Multicollinearity	28
3.7.3.4 Stationary test.....	28
3.9 Ethical Considerations	29
CHAPTER FOUR.....	30
DATA ANALYSIS, PRESENTATION AND INTERPRETATION	30
4.1 Introduction.....	30
4.2 Descriptive Analysis.....	30
4.3 Trend Analysis	31
4.3.1 Return on Assets.....	31
4.3.2 Return on Equity	32
4.3.3 Foreign Equity Capital.....	33
4.3.4 Intra Company Loans	34
4.3.5 Retained Foreign Earnings.....	35
4.4 Diagnostic Tests.....	36
4.4.1 Test for Normality	36
4.4.2 Heteroscedasticity Test.....	37
4.4.3 Multicollinearity Test	38
4.4.4 Autocorrelation Test.....	38

4.5 Unit Root Test.....	39
4.6 Regression Analysis	43
4.7 Hypothesis Testing	45
4.7.1 Effect of Foreign Equity Capital on the Bank Performance	45
4.7.2 Effect of Reinvested Foreign Earnings on the Bank Performance	46
4.7.3 Effect of Intra-Company Loans on the Bank Performance	46
CHAPTER FIVE.....	48
SUMMARY, CONCLUSIONS AND RECOMMENDATIONS	48
5.1 Introduction.....	48
5.2 Summary.....	48
5.3 Conclusions.....	49
5.4 Recommendations	50
5.5 Contribution of Knowledge	50
5.6 Suggestions for Further studies.....	51
REFERENCES.....	52
APPENDICES.....	59
Appendix I: Data Collection Tools (Banks)	59
Appendix II: Sampling Frame	60

LIST OF TABLES

Table 3. 1: Measurement of Variables	27
Table 4. 1: Descriptive statistics	31
Table 4. 2: Shapiro-Wilk Test	37
Table 4. 3: Breusch-Pagan/Cook-Weisberg Test for Heteroskedasticity.....	37
Table 4. 4: Variance Inflation Factor	38
Table 4. 5: Breusch-Godfrey Langrage Multiplier test.....	39
Table 4. 6: Im-Pesaran-Shin unit-root test for ROA.....	39
Table 4. 7: Im-Pesaran-Shin unit-root test for ROE	40
Table 4. 8: Im-Pesaran-Shin unit-root test for Foreign Equity Capital.....	41
Table 4. 9: Im-Pesaran-Shin unit-root test for Intra-Company Loans	42
Table 4. 10: Im-Pesaran-Shin unit-root test for Retained Foreign Earnings.....	43
Table 4. 13: R-squared and F-statistics for ROE as the Dependent Variable	44
Table 4. 14: Regression Coefficients for Independent Variables and ROE	45

LIST OF FIGURES

Figure 2. 1: Conceptual Framework	22
Figure 4. 1: Trend of Return on Assets	32
Figure 4. 2: Trend of Return on Equity	33
Figure 4. 3: Trend of Foreign Equity Capital	34
Figure 4. 4: Trend of Intra Company Loans	35
Figure 4. 5: Trend of Retained Foreign Earnings	36

ABBREVIATION AND ACRONYMS

CBK:	Central Bank of Kenya
EFT:	Electronic Funds Transfer
FDI:	Foreign Direct Investments
FMD:	Financial Market Development
IMF	International Monetary Fund
KNBS:	Kenya National Bureau of Statistics
KRA	Kenya Revenue Authority
SPSS:	Statistical Package for Social Sciences
UNCTAD:	United Nations Conference on Trade and Development
VAT:	Value Added Tax

OPERATIONAL DEFINITION OF TERMS

Bank performance: This refers to how well the bank is doing in terms of its capability to make use of its resources that are available to increase the shareholders' wealth and make sustainable profits to increase its capital base through retained earnings.

Equity Capital: This is capital such as surplus earning or stock that is void of debt more so the capital given to someone due to the interest one has on ownership to an enterprise. In this research, equity capital refers to the equity capital from foreign investors.

Financial performance: It is how an enterprise is doing in terms of its revenue and expenditure and the results can be shown by the annual financial statements. The measures of this performance can also be regarded in terms of the enterprise return on assets and return on equity.

Foreign Direct Investment: It is an investment from a firm or a person in one country with business interests in another country, in the form of either establishing business operations or acquiring business assets in the other country, such as ownership or controlling interest in a foreign company.

Intracompany loan: This is the amount of money borrowed by a subsidiary from the parent company usually containing a given loan repayment duration and also earns interest.

Reinvested earnings:

This is the net earnings percentages that has not been paid out as dividend but that which a firm retains so that it can use it for debt repayment or to use it in the operations of the enterprise. In the current research, reinvested earning refers to the earnings reinvested that ought to be paid as dividends to foreign investors.

ABSTRACT

Foreign direct investment (FDI) is an essential part of any economic system and it is an incentive that allows economies to grow. However the positive results of FDI are not accessed by all countries, communities or sectors. The performance of commercial banks in Kenya has been found wanting for the last five years with some banks reporting profit warnings and two banks being placed in receivership in the year 2015. Similarly, foreign direct investment in Kenya has been fluctuating. The research also sought to assess the effects of equity capital, reinvested earnings and intra-company loans on the Bank performance of Kenya. The research design used for this research is a descriptive research design and positivism research philosophy. The Target population of the study was all the 39 commercial banks in Kenya. Annual data for the period of 2005 to 2015 was used. This study used secondary cross-sectional time-series data, which was obtained from annual financial statements of commercial banks, KNBS, World Bank database and CBK. Two checklists were used for the collection of data. The analysis of the secondary data that was quantitative in nature was done using inferential and descriptive statistics. Descriptive statistics used include frequency distributions, mean, standard deviation and percentages. Inferential statistics included analysis of variance, correlation analysis and multivariate regression analysis. The inferential statistics was used to evaluate the relationship between the dependent and the independent variables. Data was analyzed by use of statistical software known as STATA (version 14) and the results presented in tables and line graphs. Before conducting regression analysis, diagnostic tests such as test for normality, heteroscedasticity test, multicollinearity test, autocorrelation test and unit root test were conducted. The results indicate that foreign equity capital had a significant effect on the Kenya commercial banks return on equity in a positive and significant manner. The study also found that reinvested foreign earnings have a positive and significant effect on return on equity in commercial banks in Kenya. In addition, the study found that intra-company loans affected the Kenyan banks performance in a positive and significant manner. In addition, intra-company loans positively affected the Kenyan commercial bank's return on equity. The study concludes that foreign direct investment in terms of foreign equity capital, reinvested foreign earnings and intra-company loans, has a significant influence on bank performance in Kenya. According to the recommendation of the research, bank performance in Kenya whose main offices were found in foreign nations should seek to increase their foreign equity capital so as to increase their performance in terms of return on equity and return on assets. The study also recommends that Kenyan commercial banks from foreign countries should ensure that they increase the percentage of their earnings that they reinvest as a way of increase performance in terms of return on equity and return on assets. Further, the study recommends that foreign commercial banks in Kenya should make use of intra-company loans so as to improve their performance in terms of return on equity.

CHAPTER ONE

INTRODUCTION

1.1 Background of the Study

Financial performance comprises of various methods of assessing how well a firm utilizes its resources in the generation of income. The most common examples of firms' financial performance include net asset value, operating income as well as earnings before taxes and interest (Adeniyi *et al.*, 2012). However, there is no single financial performance measure that should be used on its own. Instead, a comprehensive company's performance evaluation should consider various performance measures (Agbloyor *et al.*, 2014). Selecting a specific financial performance measure depends on how appropriately it meets the set objective. In a bank set up, financial performance is considered as the ability of a bank to generate a profitability that is sustainable (Alfaro & Charlton, 2013). Therefore, a bank financial performance is its capability to make use of its resources that are available to increase the shareholders' wealth and make sustainable profits to increase its capital base strength through retained earnings (Azman-Saini *et al.*, 2010).

FDI and activities of multinational banks in developing nations have significantly grown. The increased interest of foreign banks in developing nations has motivated scholars to conduct comprehensive studies in the banking sector. There was an increase in the provision of credit by international bank and their presence also increased in Kenya. Foreign banks role in the developing of the local banking sector in developing and developed nations has also been significant (Claessens *et al.*, 2008). Proponents of this kind of growth argue that foreign banks has positively impacted efficiency and competition, credit availability, capital ratio, innovation,

technology and management skills. However there are those who argue that foreign banks have affected the sector negatively arguing that these banks have led to the destabilization of the domestic banking sector. Empirical studies done on the subject show that the positive effect of foreign banks presence in the developing nations outdo the negative effects. This has led to many politicians in the developing countries to encourage the international banks to set camp in their countries. This trend started as early as the 1980s. The result is that scholars have also had a keen interest in studying the bank penetration into these countries. With time there have been an increase in the findings from the theoretical and empirical studies done on this area (Chan, Koh & Kim, 2016).

According to empirical research, the positive effects of the foreign banks on developing countries' economies are many (Cull & Martinez Peria, 2010). This has led politicians and governments to come up with strategies to encourage the penetration of foreign banks in the developing countries from as early as the 1980s. This has increased the research done on this sector and with years empirical and theoretical results have increased. Belloumi (2014) notes that a huge body of empirical literature exists that links FDI to the economic growth of countries.

FDI in Kenya has been observed to be higher compare to other countries in the East African region. This is because of the favorable investment climate observed in Kenya. Obrien and Ryan (2012) point out that that for many years the country has been an attractive option for investment for many foreigners. However something that discouraged some of the investors include the liberal repartition policies which saw most of the profits made leave the country to foreign nations. This made the government come up with strategies that could encourage investors to reinvest their profits into the Kenyan economy.

1.1.1 Foreign Direct Investment

Foreign direct investment is a phenomenon caused by globalization through integration of local or domestic markets with international markets. It is mainly accomplished through creation of conducive business environment to the locals as well as to the foreign investors so as to enhance rapid economic growth. The lasting interest among various states implies that a long lasting association between the direct and indirect investments as it normally direct investors an effective voice with regard to management of direct investment markets.

The lasting interest in direct investment business generally involves establishment of financial institutions, manufacturing companies, and warehouses as well as established of permanent or long term organizations in foreign countries. This would led to development of new investments such as Greenfield investments or acquisition of existing enterprises abroad through cross border mergers or acquisition. The investments would be incorporated through convention, land or property ownership among individuals. Direct investments comprises of initial transaction for the establishment of foreign direct relationship (FDI) between the investors and investment enterprises, but all subsequent transactions among the affiliated enterprises. Thus, the investment relationship tends to extend beyond the original direct investments through integration of foreign subsidiaries and affiliation of the direct investors who are regard as the members of the parent groups.

The last two decades has seen many developing nations governments encourage investors from foreign countries to come and invest in these countries to help them achieve their development objectives. Such investors are seen to provide technology, capital investment and better management skills spurring growth in the local industries. Governments in the developing

countries have had to come up with strategies to attract the foreign direct investment. A common measure used by many governments is the tax incentives. In some cases foreign investors have been observed to consider some types of investments so as to set up their businesses in given locations. Additionally, for governments they prefer to use tax incentives as they can easily modify, change or extend the tax restrictions contrary to other factors affecting investments that they might find difficult to control (Filippova & Sozdaeva, 2014).

In the last three decades the growth in FDI has been on a high rise. Before the global economic and financial crisis took place, FDI worldwide had reached an all-time high of \$1,833 billion in 2007 which was an increase from the 2000 all-time high (UNCTAD 2008). Multination organization production of goods and services was at an all-time high from 79,000 international firms and their 790,000 foreign affiliates. The stock from these firms was higher than \$15 trillion in 2007. In 2012 there was a slump in FDI flows but the flows rose again in 2013 by 9% to a total of \$1.45 trillion (Benz, Karl & Yalcin, 2014). In 2015, UNCTAD projected that the inflows would rise to \$1.75 trillion and increase further to \$1.8 trillion in 2016 and the largest increase would be in developed nations. However, due to fragile markets in the emerging countries and other risks that was due to uncertainty and instability in some regions, the increase in FDI was negatively affected. According to UNCTAD WIR (2014), the FDI stock increased by 9% to a total of \$25.5 trillion, globally.

FDI levels in Kenya are higher when compared to other nations in the East Africa region. This is due to the favorable investment conditions maintained by the country. According to O'Brien and Ryan (2002), Kenya has been an attractive location for many foreign investors. However, as Bradshaw (1988) notes concerns were pointed out by the government and academicians that the Kenyan repatriation policies that were liberal to say the least were affecting investments such

that more income from investment activities of foreign investors left the country as profit remittances rather than remaining in the country. Due to this observation, the Kenyan government came up with measure that would see investors reinvest their profits back to the country. As early as 1974, companies who had high repatriation rates could no longer borrow as their rights were restricted by the Kenyan central bank. The Kenyan government further tried to reduce the management remittances and the technical fees as they came up with a 14% withholding tax. These moves discouraged investments from foreign companies (Jemimah, 2017).

To date, Kenya is still trying to develop a favorable environment for foreign investors to invest in gas exploration, transportation, industrial production and business. Kenya further has plans to develop their energy and manufacturing sectors in coming years. Kenya's inflows grew by over 95pc to \$989 million from \$505 million in 2013 (UNCTAD WIR 2014). Just like other African nations, Kenya depends largely on FDI to create employment and provide capital with remittance being the biggest source of foreign funds. Central Bank of Kenya shows that Kenya's remittance totaled \$1,472 million in the world in 2015.

1.1.2 Bank Performance

Performance of financial institutions was rated as strongly rated as institutions achieved financial conditions which are satisfactory as well as improved operations results despite increase in market competition as the firms scramble for market shares (Dang, 2011). Introduction of new or foreign products in the market as a result of increase in competition as the system continue to remain more capitalized. Shareholders' funds, deposits and assets increased by 35.2%, 27.7% and 31.9% in their respective order. Foreign financial institutions in Kenya control 40.3% of the

entire market share with regard to assets, Stan Chart and Barclays banks controlling 30 percent (CBK, 2011).

Financial soundness is defined as a phenomenon where by the fund form the depositors are kept safely in a stable banking system. The financial soundness tends to vary in each financial institution and would be unsatisfactory or satisfactory depending on the test and preference of customers (Lin, Sun & Yu, 2018). The profit margin of an organization is a profitability measure obtained by calculating net profit as a percentage of the organization total revenue for a specified period of time, probably one year. This profitability ration indirectly measures how well an organization manages its expenses as compared to its revenue (Dang, 2011). Therefore all profit making organizations strive to achieve high values of profit margin ratio. Return on equity measures how a firm can generate profit from the shareholders fund invested in a firm. Return on assets shows how a firm makes profit from its assets. It measures how management is efficient in generating income from its assets (Deoras, 2013). Return on investment is used to measure the profits earned from an investment.

1.1.3 Banking Sector in Kenya

Commercial banking took root in Kenya at the turn of the 20th Century with the partitioning of Africa by the European Imperial Powers. The first bank to establish operations was National Bank of India, which started a branch in Mombasa in 1896. By 1972, there were a total of 12 Commercial Banks operating in the Kenyan – market. By December 2014, the Kenyan banking sector was made up of the Central Bank of Kenya which regulated the sector, 44 banks made up of 43 commercial banks and 1 mortgage finance firm. The sector also had 9 microfinance banks,

2 credit reference bureaus, 87 foreign exchange Bureaus, 13 money remittance firms and 8 foreign banks representatives (Central Bank Annual Report, 2014).

Commercial banks are an important aspect of the Kenyan economy. Their main role is that of mediation in the financial sector where they mobilize deposits from the economy's surplus and lend to the deficient units so that they can use them for investment. By acting as lenders to the different sectors in the economy, the banks are crucial in the development of the country's economy (World Bank, 2010). Governments recognize these roles and try to accelerate development in desired direction by influencing allocation of loanable funds through minimum lending (to specific sectors) guidelines. In Kenya, the structure of commercial banks portrays a cartel-like feature. Out of 43 commercial banks in the country, 6 banks own 48.8% of the total net assets of the industry (Bank Supervision Annual report, 2014), indicating that the industry is not competitive. Since banks are seeking for profits it is not unusual for them to diversify their portfolio such that they are able to get a minimum rate of return. To achieve the objective of profit maximization, banks make decisions to invest their money in varying investments that involve various amounts and securities. The decisions are often based on how much cash flow is expected and the risk that is associated with the investment.

1.2 Statement of the Problem

With the financial challenges developing countries are facing daily, it is not uncommon to see commercial banks failing in the provision of financial services needed by investors to spur economic growth (Campbell, 2017). The Kenyan financial sector has been resilient and stable more so due to the support provided by FDI in the past years. However, risks still exist for the country to go forward financially. Some of the risks include liquidity, corporate governance and

skewed distribution risks. These risks have resulted to two banks being placed in receivership in the year 2015 (CBK, The Kenya Financial Sector Stability, 2015). Developments in the global arena such as the increase in the U.S federal funds rate from zero to 0.25% in the year 2015 saw the external financial conditions become more rigid which had an effect on capital flows and affected the volatility of currencies in developing nations Kenya inclusive (CBK report, 2015). In addition the slow rebalancing of Chinas economy as well as the Brexit effects are expected to change the foreign inflows coming to Kenya.

In 2015, the banking sector experienced volatility in exchange and interest rates in Quarter 1 through Quarter 3 that negatively affected the credit market. This resulted to a decline in foreign investors' participation in the banking sector as well as other economic sectors (CBK, The Kenya Financial Sector Stability, 2015). As a result, credit to private sector decreased to 14 per cent of GDP in 2015 as bank mop up available funds to fortify themselves and avoid lending to one another (CBK report, 2015).

Worried by the level of unprecedented capital flight due to global developments such as zero lower bound to 0.25% by US Federal Funds, slowdown in China and Brexit which results to downward flow of capital and currencies to developing countries, the researcher in this work will examine and study the extent to which foreign direct investment (FDI) could impact on or affect an economy. This work will therefore, try to look at the extent to which such impact is; or should be, on the performance of the Kenyan banking sector, with a view to proffering possible recommendations.

Various studies have been conducted on foreign direct investment and organizational performance both globally and locally. Globally, Korna, Ajekwe and Idyu (2013) conducted a

study on the effect of Foreign Direct Investment on bank performance in Nigeria; and Amos (2016) carried out a study on the impact of foreign direct investment on the performance of the banking sector in Ghana. However, due to differences in legal frameworks governing foreign direct investment findings from these countries cannot be generalized to Kenya. In Kenya, Amondi (2017) examined the effect of foreign direct investment on real estate sector performance in Kenya. However, findings from real estate sector cannot be generalized to the banking sector. This study therefore seeks to determine the effects of foreign direct investment on the Bank performance in Kenya.

1.3 Objectives of the Study

1.3.1 General Objective

The general objective of the study was to determine the effects of foreign direct investment on the Bank performance in Kenya.

1.3.2 Specific Objectives

- i. To determine the effects of foreign equity capital on the banks performance in Kenya.
- ii. To look into the effects of reinvested foreign earnings on banks performance in Kenya.
- iii. To analyze the effects of intra-company loans on the banks performance in Kenya.

1.4 Research Hypotheses

This section presents the null hypotheses of the study;

H₀1: Foreign equity capital has no significant effect on banks performance in Kenya.

H₀2: Reinvested foreign earnings have no significant effect on banks performance in Kenya.

H₀3: Intra-company loans have no significant effect on banks performance in Kenya.

1.5 Significance of the Study

The research findings are of significance to the investment managers and policy makers in commercial banks in understanding the interaction between the level of foreign direct investment and the bank performance. This helps them identify factors which could help raise the performance of banks. The findings would also be important to policy makers and governments to come up with policies that can encourage growth in the banking system through utilizing the foreign direct investments. The research findings also act as a guide to academicians and researchers who seek reference materials and literature they can use for future studies related to the topics under study.

1.6 Scope of the Study

The study scope was limited contextually to a study of the foreign direct investments in Kenya and their effects on the performance of the banking industry in Kenya. The study scope was further limited geographically to a population of the commercial banks operating in Kenya. In addition, only the foreign owned banks were used as the study seeks to assess the effects of foreign direct investment on the Bank performance in Kenya. The study scope was also limited to a descriptive research design that was guided by positivism philosophy. The study used annual data for the period of 2005 to 2015.

1.7 Limitations of the Study

The study faced limitations in accessing information from the KNBS/CBK where historical data was not posted on the state agencies websites. The research further faced limitations due to bureaucracy tendencies within the state agencies. The study further faced limitations in financial errors arising in the data collected from the commercial banks at a time when the banking

industry in Kenya had been faced by numerous corporate governance failures and unethical practices in regard to manipulation of financial data. The study was conducted between the month of August and September 2017.

1.8 Organization of the Study

The research was organized in five main chapters. The first chapter gives the overview of the research and contextualize the research variables. The chapter further outlines the research problem, the objectives that guided the research, the significance of the research and the limitations the study anticipated. The second chapter of the research gives an overview of the literature review of the research. The chapter also outlined the theoretical underpinning of the research, the empirical review of the research, the research gaps and a graphical representation of the association of research variables in the form of a conceptual framework. The third chapter of the research outlined the research methodology that was adopted in seeking to test the research hypothesis. The chapter in details contained the research design, philosophy, the empirical model, the data collection instruments and procedure, the sampling design and the data analysis and presentation methods. The fourth chapter of this research highlighted the findings of the research. The chapter contained the findings of the research arranged in line with the research objectives. Lastly, the research contained the summary, conclusions, recommendations and suggestions for further research.

CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

The current chapter provides literature review on useful information that is relevant to the current study on the effects of foreign direct investment on the Bank performance of Kenya. The chapter contains the theoretical underpinnings of the research, an empirical review of previous studies, research gaps, a conceptual framework depicting the relationship between the research variables, as well as a summary of literature review.

2.2 Theoretical Review

This study was anchored on three theories related to the performance of commercial banks and components of FDI, that is, reinvested earnings, intra-company loans, and equity capital. These theories included profit maximization theory, pecking order theory and trade off theory.

2.2.1 Profit Maximization Theory

The profit maximization theory was founded by Marshall (1890). The theory is based on the argument that the key goal of enterprises is the maximization of profits. According to the theory every person who is part of the organization acts in his self-interest to make sure that the profits of the business are maximized. The theory is usually used in the economic perspective whereby organizations ensure their profits are maximized by equating marginal revenue to marginal costs.

As Day *et al.* (2013) points out, a firm achieves its goals when it gets ample profits and more so when its resources are used to come up with goods and services that can be sold to customers so as to get revenue. He adds that the survival of any firm is dependent on the profits got from its

sources of revenue. Today this theory can be used in various organizations especially in the banking sector. One of the key assumption is that banks seek to maximize their profits when providing services. The shareholders of the banks expect profits and thus banks have no choice but to conduct business in a way that maximizes the profits. This leads to a maximization of their investment and revenue and a minimization of cost (Wong, 2012). The market power of a bank in the output and input market allows it to decrease or increase the prices of input and output respectively. By use of the right management the firm can choose the best combination of outputs and inputs that can maximize profits (Dasgupta, 2009).

Players in the banking industry in Kenya have adopted various strategies to improve their performance. One of these ways is the use of foreign direct investment. Developing and developed nations alike seek for foreign investment as they have seen the importance of such investment in the economic growth of their countries. Consequently, FDI improves the management skills, technology and knowledge in the host nations while at the same time it benefits the countries as it creates job opportunities and positively affects the balance of payment.

2.2.2 Pecking Order Theory

Myers and Majluf (1984) came up with the pecking order theory. The theory argues that organizations are more inclined to accept internal funding rather than use external funding. If they must use external funding, many firms prefer to use debt over equity and they only choose to seek equity if all the other options are exhausted. Thus due to information asymmetry most of the organizations lack an optimum debt to equity ratio. The enterprises use a traditional approach for divided and to maximize their value they choose to seek for debt financing (Abhijit, 2013).

The theory further argues that in any profitable organizations prefer to seek internal funding rather than seek equity or debt funding. This is despite the fact that debt is seen as less expensive compared to equity. Myers and Majluf (1984) argue that the asymmetry of information disturbs the firm value and also affects the wealth of the firm's stakeholders. In this study, pecking order theory is used to explain the influence of equity capital and reinvested earnings as components of FDI on the performance of commercial banks.

Due to information asymmetries existing between financiers and the banking institutions, the cost of financing is not always the same among the choices of financing. The funds are given by the retained earnings of the organization, then more information is given compare to the case of equity. The equity holders in this case will expect their investment to attract a higher rate of return which leads the equity being more costly than the use of external funding (Qureshi, Sheikh & Khan, 2015). The argument holds when debt is used instead of retained earnings. Additionally, if the risk exposure due to information asymmetries is higher, the different financing choices will demand a higher capital in accordance to this risk (Abhijit, 2013). Therefore any organization will rather seek financing from the retained earnings over debt, would rather seek debt over equity and also prefer short term debt to long term debt.

2.4.2 Eclectic Paradigm of Dunning

Dunning (1980) by bringing together the structural market imperfections, transaction-cost market imperfections, and location theory, developed the eclectic paradigm of international production. The theory considers the nature of a country's involvement in international relations by analyzing two types of involvement. The first involvement is concerned with economic activities taking place within the boundaries, and thus using national resources, but concerning goods and

services directed to foreign market. The second involvement is concerned with activities of national economic agents using resources located in various countries to produce goods and services for foreign market. Dunning (1980) argues that the first involvement falls within the conventional international trade theory. The second involvement falls within the domain of international production and FDI. He further argues that the two are part of the same process. He asserts that in terms of a country's involvement, one has to explain why and when foreign markets are sourced through FDI and international production rather than production and exports. This approach is an attempt to analyze why and where decisions in terms of ownership, locational and internalization advantages (known as OLI advantages) (Kumar & Kavita, 2017).

The essence of electric approach is in considering those advantages altogether and in applying them to both international trade and production. Ownership advantages (O) are specific to a particular enterprise (such as technology, marketing and production skills). If this advantage is exploited optimally, a firm can overcome and can be compensated for additional costs of establishing production facilities abroad (Dunning, 2000). This advantage also gives the firm the ability for additional costs of establishing production facilities abroad. Locational advantages (L) are specific to countries likely to attract foreign investors. Under these factors such as large markets, government policies, the country's trade policy and tax incentives are included. Finally the firm gets greater benefits by exploiting both ownership and locational advantages by internalization (I). Firms do internalization due to the fact that markets for assets and product such as technology and knowledge are imperfect. The ownership and Internationalization are specific to a particular firm but the location advantages are specific to the host country and have a crucial influence on a host country's inflow of FDI. The advantages must occur jointly for FDI to occur (OlaREWaju, 2018).

Dunning's eclectic paradigm suggests that, when ownership, location and internalization advantages are high, firms will prefer an integrated entry mode for example FDI or joint ventures, versus export or licensing. Cyree and Morris (2018) argue that, in the former case strategic asset-seeking investments take place, in which FDI is used in mergers and acquisitions, seeking horizontal efficiency. In the second case, investments are characterized by the search for markets, and resources, thus being of vertical efficiency. The relevance of internalization advantages informs this research. Despite the criticism, the OLI paradigm is dynamic in understanding the importance of foreign direct investment and how it can be enhanced.

2.3 Empirical Review

2.3.1 Bank Performance

In United State of America, Cyree and Morris (2018) conducted a research on the role of market demographics in determination of performance of banks, by using a sample of single county bank. The study adopted descriptive research design. The study found that market demographics play a key role in determination of performance of financial institutions. Performance was measured in terms of return on equity, return on investment, return on assets.

Olarewaju (2018) conducted a study to determine the relationship between dividend policies and performance of commercial banks in Sub-Saharan countries. The study used two hundred and fifty financial institutions within the Sub-Saharan states during the as from 2006 and 2015 to conduct causality tests. The finding revealed that there was a positive and significance relationship between the dividend policies and organizational performance. Performance was measured in terms of totals assets, profitability, return on assets and return on equity.

Kumar and Kavita (2017) conducted a study to analyze the financial health of commercial banks in the state of India. Altam Z-score model was used during the study. The study found that there was a strong association between financial health and performance of commercial banks in the state of India. Financial health and financial performance were measured in terms of capital adequacy, liquidity ratio, return on assets, and return on equity.

In Kenya, Mwai (2018) investigated the relationship between capital requirement and performance of Central Banks in Kenya. Descriptive research design was adopted during the study. The findings indicated that there was a positive and significant association between minimum core capital and performance of Central Bank of Kenya. In addition, the finding revealed that there was a significant relationship between capital requirement and performance of financial banks which was measured in terms of return on assets and return on equity.

2.3.2 Equity Capital and Bank Performance

Salazar *et al.* (2012) did a study on the relationship that exists between capital structure and profitability of listed industrial firms on the main board of the Kuala Lumpur Stock Exchange (KLSE). Data analysis was done with the help of Ordinary Least Squares and Correlation Analysis. According to the findings of the study, a significant relationship did exist between market imperfections changes in capital structure and the firm's profitability. Another finding was that there was a negative relationship between equity size and the firm's financial performance.

In Kenya, Githire and Muturi (2015) conducted a research on the effect of equity financing on financial performance of firms listed at the Nairobi Securities Exchange. The research population was made up of the organizations listed at the Nairobi Securities Exchange and the study's

sample was made up of a census of all organizations listed at the Nairobi Securities Exchange between 2008 and 2013. The research used an explanatory non-experimental research. There was overwhelming evidence that showed that equity financing positively affected the financial performance of the organization. The reason behind this was because there was direct control from the equity holders who ensured to maximize the interest of the shareholders. In addition, Maina and Ishmail (2014) conducted a study on capital structure and financial performance in Nairobi Securities Exchange. The research population was the organizations quoted at the NSE, and the study sample was made up of a census of all organizations listed on the NSE between 2002 and 2011. The study found that equity was a major factor that determined the profitability of the organizations listed at the NSE.

Moreover, Mbangula (2009) researched on the association between financial institutions business models on performance of commercial banks in the state of Kenya. The study adopted descriptive survey design. The study found out that there was a positive and significant relationship between commercial banks business model and performance of financial institutions.

2.3.3 Reinvested Earning and Bank Performance

In India, Deoras (2013) found that almost one-fourth of the foreign direct investment in India is from foreign investors who reinvest their earnings which show the commitment to the operations in India. An analysis done on official data from the years 2008-09 and 2012-13 revealed that out of an FDI amounting to \$186 billion, \$45 billion was reinvested earnings.

In the United States, Edwards, Kravet and Wilson (2013) conducted a study on the relationship between reinvested earnings and foreign cash acquisitions' profitability. According to the US tax

laws, there is an incentive for the organization in the US meant to avoid foreign earnings repatriation as the government has put up more charges for any repatriated foreign earnings. As pointed out in ASC 740, taxes on foreign earnings are treated differently. Incentives are higher so that firms can designate foreign earnings in terms of permanently reinvested earnings and delay the recognition of the deferred tax liability that comes as a result of repatriation of the US tax which leads to a higher after tax income. Consistent with expectations, the study observed that organization that showed high earnings that were termed as PRE and which were held as cash did not make more acquisitions that were profitable by making use of their cash consideration compared to organizations that had high levels of PRE that were considered as cash.

2.3.4 Intra-company Loans and Bank Performance

In Malaysia, Saad (2014) studied on the effects of equity and debt financing on SMEs performance. The study was run based on of postal survey using cluster sampling method. The findings indicated that equity financing positively and significantly affected the profitability of the firm and the financing via debt was not significant. Among Romanian Listed Companies, Raisa and Cristian (2015) investigated on whether short term debt affects profitability. The data analyzed done by a fixed effect regression model was from 50 firms that were from various fields in the years 2003 to 2014. After control was subjected to the organizations liquidity, size, tangibility of results and growth, it was shown that short term debt had a negative effect on the profitability of the firm.

In Kenya, Muchugia (2013) investigated financing using debt affected the Bank performance in Kenya profitability. The research adopted a descriptive methods and a census was conducted on

the total 43 banks. The period of study was five years between 2008 and 2012. According to the results a positive relationship did exist between short term debt (SDA) and profitability. This was because short term debt was cheaper and an increase in it led to a minimal increase of the interest rate leading to higher profits and better performance. A negative relationship was observed between long term debt (LDA) and profitability.

In addition, Kajirwa (2015) carried out a study on the effects of debt on firm performance of commercial banks listed on Nairobi Securities Exchange. The study used a longitudinal research design in collection of data. According to the findings, there was a negative relationship between the profitability of the organization and debt. This effect was not statistically significant as it was quantified by ROA. The research concluded that debt negatively affects the Bank performance in Kenya profitability although this effect was not statistically significant. Among small and medium enterprises in Kenya, Githaiga and Kabiru (2015) conducted a study on debt financing and financial performance. The study targeted 4122 SMEs in Eldoret town. The findings showed that short term debts, and long term debts negatively affected SMEs financial performance.

2.4 Research Gaps

From studies mentioned, it is obvious that many researchers have studied the components of FDI and firm performance in many parts of the globe and also locally. This study is anchored on theories, namely, profit maximization theory, pecking order theory and trade off theory. Profit maximization theory indicates that the main aim of firms is to maximize profits. Pecking order theory explains the association between equity capital, debt and firm performance. Trade off theory is used in explaining the association between debt (intracompany loans) and performance. The literature also shows that there are mixed empirical results on the equity financing and firm

performance with some studies showing positive influence and other showing negative influence. In addition, the literature shows that reinvested earnings influence firms' performance in the host country positively. In relation to debt financing, the results displayed mixed results with some studies showing positive effect and other showing negative effect. This study therefore sought to determine how the three components of FDI influence the performance of the Bank performance in Kenya.

Although various studies have been conducted of foreign direct investment, these studies have been limited to specific countries, sectors and have focused on different dependent variables such as economic growth. Globally, Simona-Valeria (2012) conducted a study on the influence of foreign direct investment on firms' performance in Central and Eastern European Countries; Akulava and Vakhitova (2010) carried out a study on the impact of FDI on firm's performance across sectors in Ukraine; Korna *et al.* (2013) carried out a study on the Impact of Foreign Direct Investment on the Nigerian Banking Sector and Reddy (2016) conducted a study on the impact of FDI on Performance of Select Private Sector Banks in India. However, different countries have different macroeconomic factors that and are governed by different legal frameworks and hence the findings of one country cannot be generalized to another.

In Kenya, Maingi (2014) conducted a study on the effect of foreign direct investments on economic growth in Kenya; Saddimbah (2014) conducted a study on the effect of foreign direct investments inflow in Kenya on economic growth and Ngeny and Mutuku (2014) carried out a study on the impact of foreign direct investment volatility on economic growth in Kenya. The dependent variable in these studies was economic growth, which is different from the performance of commercial banks. In addition, studies conducted on FDI in Kenya do not show

the influence of the three FDI components such as intra-company, reinvested earnings and equity capital, and loans on the performance of commercial banks.

2.5 Conceptual Framework

A conceptual framework is a presentation that can be in visual form or written that explains in terms of graphic or narration means the variables, factors and concepts in the study and the relationship between the variables. This study sought to determine the effects of foreign direct investment on the Bank performance of Kenya. The independent variables of the study were the three components of FDI: reinvested earnings, equity capital, and intra-company loans. The dependent variable was the Bank performance of Kenya.

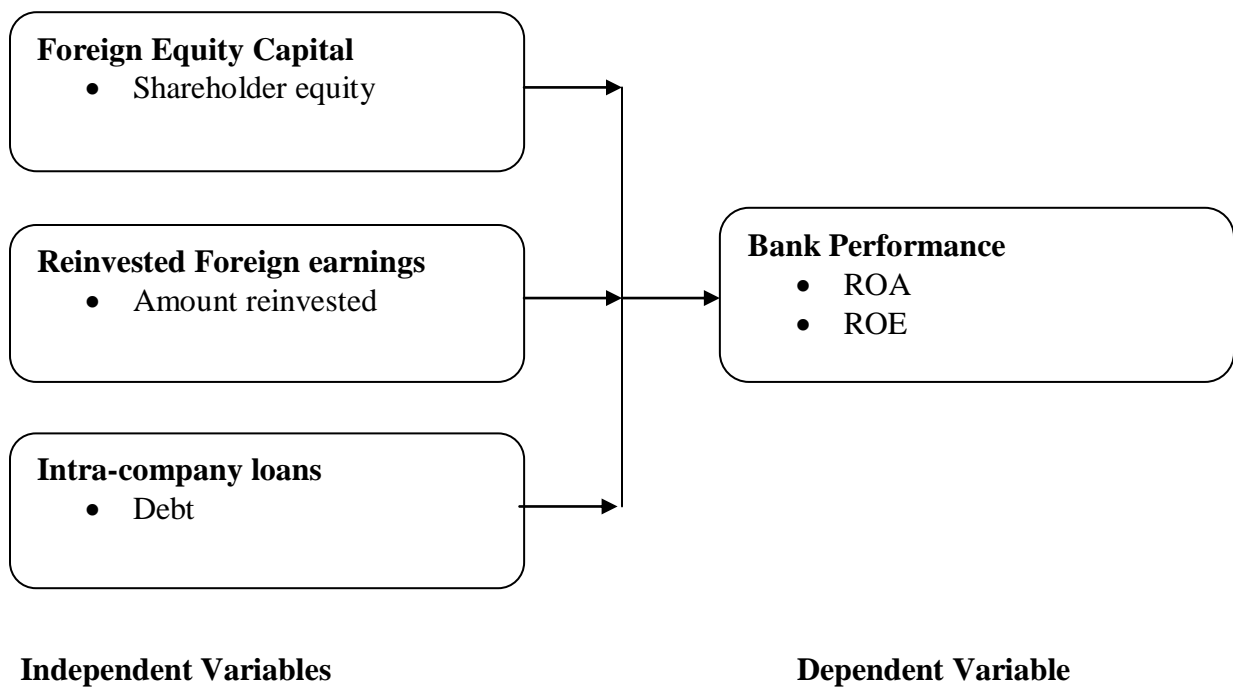


Figure 2. 1: Conceptual Framework

Source: Author (2018)

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Introduction

The third chapter of this research presents the overview of research methodology that was used in the study and gives procedures that was used to carry out the research work. The discourse in this chapter is structured around the research design, research philosophy, and sample size and sampling technique, data collection instruments, data analysis and presentation of findings.

3.2 Research Philosophy

Research paradigm explains how certain phenomenon data should be collected and analyzed (Saunders, Lewis & Thornhill, 2007). Research paradigm can be classified into three groups realism, interpretivism and positivism (Saunders *et al.*, 2007). According to positivists hypothesis gotten from theories can be tested if their observable social realities can be quantified positivism is gotten from the natural sciences. Thus positivism research as explained earlier is easy to make predictions. A hypothesis can be tested and the findings can be generalized. However hypothesis testing requires the translation of the underlying concepts to forms that can be measured (Saunders *et al.*, 2007). The principle of positivism was applied since the research built on existing theories and literature to develop hypotheses and have them tested by using a quantitative research design.

3.3 Research Design

According to Kothari (2004), a research design involves establishing and stating the strategy and the research approach used for the project. The research design should adhere to the research objectives. Bhattacharjee (2012) definition of research design is the specification of techniques

and methodologies for acquiring the information required. A descriptive research design of quantitative method of data was adopted in this study. Descriptive research is a statistical method that involves the use of surveys and fact finding enquiries of various kinds (Creswell, 2006). The key role of descriptive research is describing the current state of affairs through quantitatively synthesizing the empirical evidence of a specific field of research. Thus, this research design was adequate in determining how foreign direct investment affected the Bank performance in Kenya.

The study also adopted an explanatory research design. An explanatory research suggests that the research in question is intended to explain, rather than simply to describe, the phenomena studied. Explanatory studies are designed to test whether one event causes another. This study showed how foreign direct investment causes bank performance in Kenya.

3.4 Target Population

Target population refers to a group of items, objects or individuals which provide the sample for the study. The group must have a thing in common. Kothari (2004) also explains that a population is a set of objects, individuals or cases with similar observable traits. The research population was all the 39 commercial banks in Kenya. The study used annual data for the period of 2005 to 2015. This period was selected to increase the accuracy of the study results.

3.5 Sample Size and Sampling Technique

As Kothari (2004) explains, a study's sample size should be big enough to represent the total population. Creswell (2006) emphasizes that the sample size should give ample information on the population under study and the sample size should also be easy to analyze. The study used purposive sampling to select foreign owned commercial banks in Kenya. These banks were selected because they were playing a major role in foreign direct investment in Kenya through

equity bank, reinvested earnings and intra-company loans. This study selected annual data between 2005 and 2015. A larger sample size is associated with a lesser likelihood of errors hence a higher accuracy level and hence 10 years was selected instead of five. The sample size of this study was all the 14 foreign commercial banks in Kenya

3.6 Data Collection Instrument

This study used secondary cross-sectional time-series data. Data that is in terms of cross-sectional time-series is from observed entities across time. Secondary data is the data which is already available and collected (Greener, 2008). Secondary data was used in this study as it is abundant to provide an exhaustive analysis. Secondary data was obtained from the annual financial statements of commercial banks, KNBS, World Bank database and CBK. A checklist was used to collect the data.

3.7 Data Collection Procedure

The process of collecting data started with obtaining a letter of data collection from the school of business in Kenyatta University. This was followed by obtaining a research permit from National Commission for Science, Technology and Innovation. Thereafter, the researcher visited the headquarters of each of the 14 foreign commercial banks in Kenya to obtain data on equity capital, reinvested earnings and intra-company loans. In addition, the researcher visited the CBK website to obtain data on the return on equity and return on assets of each of the individual foreign commercial banks.

3.8 Data Analysis and Presentation

Data analysis involves use of logical analytical tools to examine data collected for research purposes to generate summaries, observe trends and or patterns with the aim of making inferences so as to draw informed conclusions (Greener, 2008). Secondary data was quantitative and its analysis was done by use of inferential and descriptive statistics. Descriptive statistics included mean, frequency distributions, standard deviation and percentages. Inferential statistics included analysis of variance, multivariate regression analysis and correlation analysis. The inferential statistics was used to evaluate the relationship between the dependent and the independent variables. Data was analyzed by use of statistical software known as STATA (version 14). The data which was already analyzed was presented in terms of tables and line graphs.

The regression model was expressed as follows;

$$Y_{it} = \beta_0 + \beta_1 X_{1it} + \beta_2 X_{2it} + \beta_3 X_{3it} + \varepsilon_{it}$$

Where

Y_{it} is the dependent variable (Bank performance),

B_0 is the y intercept (Constant),

β_1 - β_3 are coefficients of determination,

X_{1it} is the equity capital,

X_{2it} is the reinvested earnings,

X_{3it} is intra-company loans (debt).

i is the observations number,

t this is the time series data or observation number for a given bank;

ε_{it} is an error term.

Table 3. 1: Measurement of Variables

Variable	Type	Operationalization	Measurement
Bank Performance	Dependent Variable	ROA	Net-Income/Average Assets
		ROE	Net Income/Shareholders Equity
Foreign Equity Capital	Independent Variable	Shareholder equity	amount of foreign equity capital
Reinvested Foreign Earnings	Independent Variable	Amount reinvested	Amount of reinvested earnings
Intra company Loans	Independent Variable	Debt	Amount of intra company Loans

3.8.1 Diagnostic tests

The following diagnostic test was carried out to ensure that the time series data used fits the basic assumptions of the models used in linear regression.

3.7.2.1 Normality test

A normality test is essential in statistical data because the data is an underlying assumption in parametric testing (Creswell, 2006). Shapiro-Wilk Test was used in this study in the examination of the normality of data. The alternative hypothesis in Shapiro-Wilk Test is that data is not normally distributed. Therefore, when the p-value is smaller than the chosen alpha value, the null hypothesis is not accepted and hence this data will be treated as not normally distributed.

3.7.2.2 Autocorrelation

Autocorrelation results to bias and thus spurious estimates. Serial correlation usually shows that correlation exists between stochastic random error terms of the subsequent time periods (Cooper & Schindler, 2006). Breusch-Godfrey Lagrange Multiplier test was used to test for autocorrelation. The Lagrangian multiplier test assists to decide whether the regression is a random effects regression or a simple OLS regression. The null hypothesis in the test is that variances across entities are zero. This is no panel or significant effect across units.

3.7.2.3 Multicollinearity

Multicollinearity also termed as collinearity shows if two or more variables used in a multiple regression model are highly correlated which means that one can be linearly predictable with a higher degree of accuracy compared to the others. The researcher used variance inflation factor to test collinearity. This factor measures how high the multicollinearity is in a least squares regression analysis. It gives the index showing the magnitude of the increase of a variance if a regression coefficient is increased because of collinearity.

3.7.3.4 Stationary test

Im, Pesarian and Shin also noted as IPS gives a test to test the availability of unit roots in panels that combine information from the time series and cross section dimension. The IPS test is superior and thus, the researcher used it to analyze the panel data. The unit root can be found under the null hypothesis while the panel unit root was presented in the alternative hypothesis.

3.9 Ethical Considerations

According to Saunders *et al.* (2007), ethics refers to norms governing human conduct which have a significant impact on human welfare. Ethical issues were put into consideration by the researcher in this study to avoid the loss of credibility of the study. There was acknowledgement of all ideas that were borrowed from other authors in an effort to avoid plagiarism. In addition, strict confidentiality was adhered to, where no information was given to any person who is not authorized.

CHAPTER FOUR

DATA ANALYSIS, PRESENTATION AND INTERPRETATION

4.1 Introduction

This chapter covers the presentation and interpretation of the findings. The chapter begins with a descriptive analysis of the independent variables and the dependent variable. This was followed by trend analysis for all the variables of the study. Thereafter, the chapter presents diagnostic tests, which include all the five regression assumptions tests. This was later followed by unit root analysis, regression analysis and hypothesis testing.

4.2 Descriptive Analysis

From the findings, the average foreign equity capital over the study period (2006-2015) was Ksh. 6.3143 billion. The maximum foreign equity capital was Ksh. 37.98 billion and the minimum foreign equity capital was Ksh. 0.272 billion. This implies that foreign equity capital by foreign owned banks in Kenya was ranging from Ksh. 0.272 billion and Ksh. 6.3143 billion.

In addition, the average intra-company loans were Ksh. 0.6987 billion, the minimum figure was Ksh. 0.12 billion and the maximum was Ksh. 3.594 billion. Further, the average retained foreign earnings was Ksh. 50.6856 billion, the minimum figure was Ksh. 0.12 billion and the maximum figure was Ksh. 784.55 billion. These findings imply that the average intra-company loans between the year 2006 and 2015 in foreign owned commercial banks in Kenya was ranging from Ksh. 0.12 billion and Ksh. 3.594 billion.

The average return on assets for the 14 foreign banks over the study period was 3.6416 per cent, the minimum return on asset over the study period was 0.1 per cent and the maximum figure was

10.4 per cent. These findings imply that the return on assets among foreign banks in Kenya ranged from 0.1 per cent to 10.4 per cent.

In addition, the average return on equity over the study period for the 14 banks was 24.5505 per cent, the minimum figure was 1.25 per cent and the maximum figure was 46.99 per cent. These findings imply that the average return on equity among foreign banks in Kenya ranged from 1.25 per cent to 46.99 per cent.

Table 4. 1: Descriptive statistics

Variable	Obs	Mean	Std. Dev.	Min	Max
FEC	140	6.314314	8.534438	.272	37.98
ICL	140	.6987529	.7518653	.012	3.594
RFE	140	50.6856	127.0376	.12	784.55
ROA	140	3.641571	1.769434	.1	10.4
ROE	140	24.5505	10.9183	1.25	46.99

4.3 Trend Analysis

This section presents the trend analysis for the dependent variable, which was return on equity, and the independent variables (intra-company loans, foreign equity capital and reinvested earnings).

4.3.1 Return on Assets

From indicated findings in figure 4.1, return on assets for the 14 foreign banks has been fluctuating over the study period. The average return on assets increased from 2.03 per cent to 3.16 percent in 2008. The figure then decreased to 2.81 per cent before increasing steadily to 4.49 per cent in the year 2010. The figure then decreased to 3.68 per cent in the year 2013 and then increased to 5.52 in the year 2015. These findings imply that while return on assets among

foreign banks in Kenya had been increasing there were fluctuations in some years. The findings are in agreement with Central Bank of Kenya (2017) report that foreign the performance of commercial banks in Kenya has over the years been fluctuating.

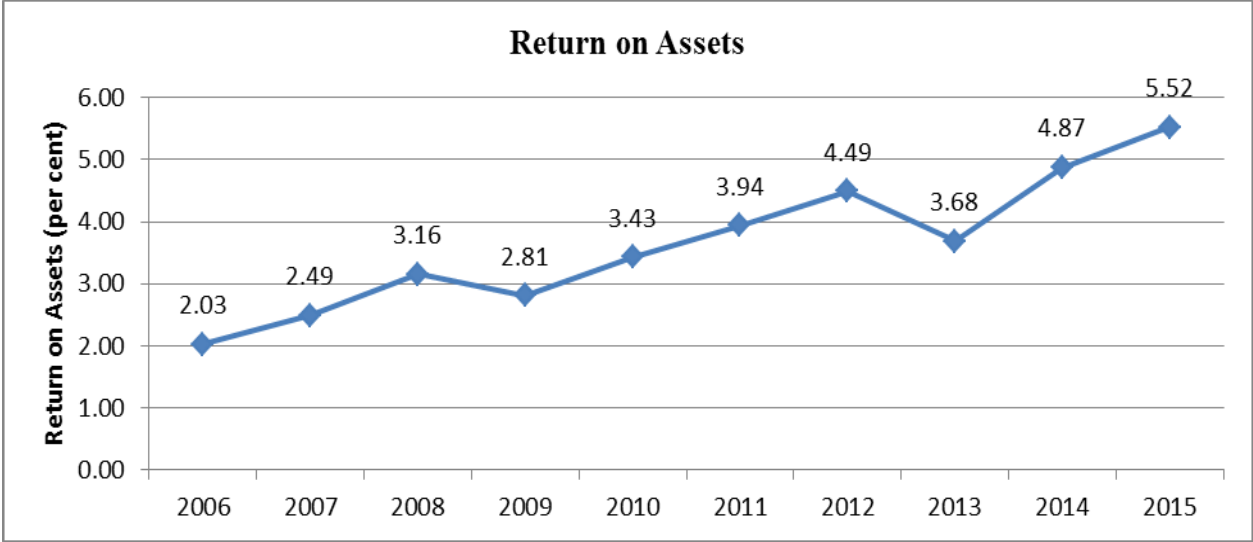


Figure 4. 1: Trend of Return on Assets

4.3.2 Return on Equity

As indicated in figure 4.2, the average return on equity increased from 14.28 per cent to 27.12 per cent in the year 2007. However, the figure decreased steadily to 20.49 per cent. Between the year 2009 and 2012, the average return on equity increased to 28.98 per cent from 20.49 per cent. In 2013, the average return on equity decreased to 18.70 per cent before increasing steadily to 34.93 per cent in the year 2015. These findings imply that return on equity among foreign banks in Kenya between the year 2006 and 2015 had been fluctuating. The findings are in agreement with Central Bank of Kenya (2017) report that foreign the performance of commercial banks in Kenya has over the years been fluctuating.

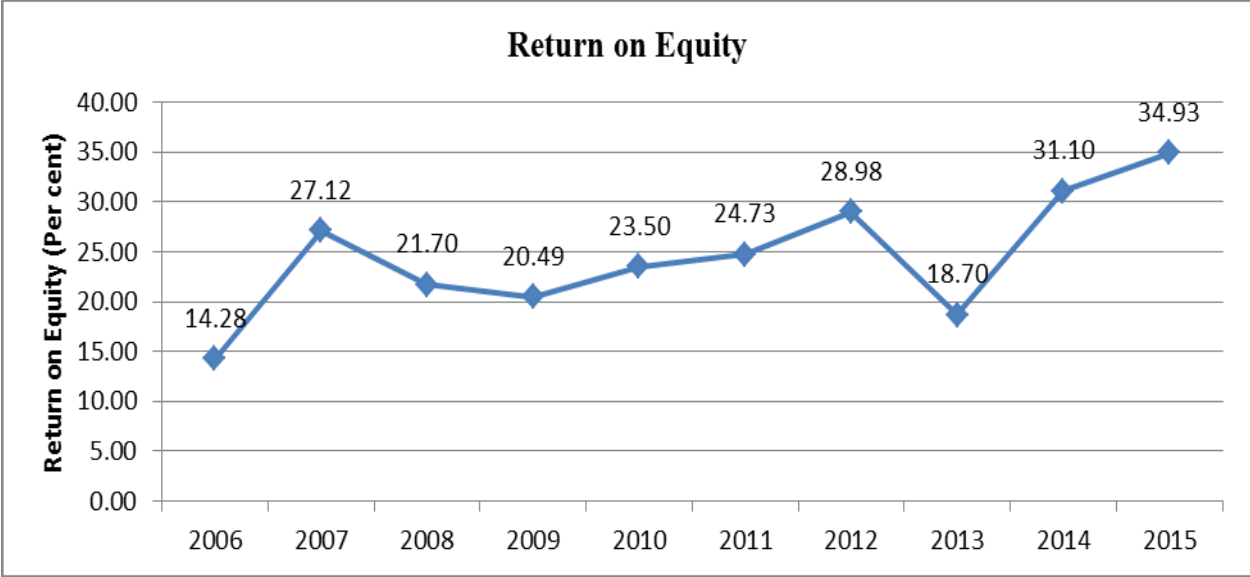


Figure 4. 2: Trend of Return on Equity

4.3.3 Foreign Equity Capital

According to the findings, as indicated in figure 4.3, the average foreign equity capital increased from Ksh. 2.61 billion in 2006 to Ksh. 5.36 billion in the year 2009. However, the figure decreased to Ksh. 4.40 billion in the year 2010. However, the increased steadily to 11.15 per cent in the year 2015. This implies that although the average foreign equity capital was slightly fluctuated over the study period, it generally increased. These findings are in agreement with Central Bank Annual Report (2014) findings that foreign equity capital in Kenya has generally been increasing.



Figure 4. 3: Trend of Foreign Equity Capital

4.3.4 Intra Company Loans

Figure 4.4 shows the trend of intra-company loans for the 14 foreign banks. For the findings, the average intra company loans increased from Ksh. 0.47 billion in the year 2006 to Ksh. 0.63 billion in the year 2008. The figure decreased slightly to Ksh. 0.57 billion in the year 2009, increased to Ksh. 0.75 billion in the year 2010 and decreased again to Ksh. 0.55 billion. This figure then increased steadily to Ksh. 1.05 billion in the year 2015. This implies that the average intra company loans during the study period (2006-2015) was fluctuating. These findings agree with Central Bank Annual Report (2014) findings that intra company loans have been fluctuating due to fluctuations in interest rates.

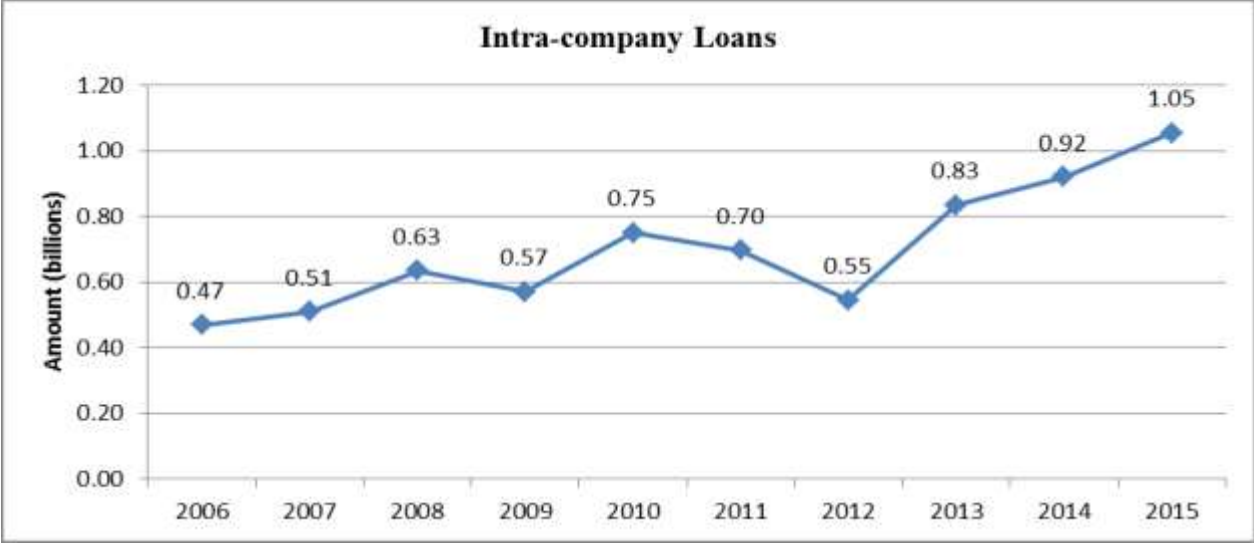


Figure 4. 4: Trend of Intra Company Loans

4.3.5 Retained Foreign Earnings

From the results, shown in figure 4.5, the average retained foreign earnings between the year 2006 to 2009 increased from Ksh. 25.80 billion to Ksh. 48.93 billion. The figure then decreased to Ksh. 43.62 billion before increasing steadily to Ksh. 75.41 billion in the year 2012. Further, average retained foreign earnings decreased to Ksh. 48.37 billion in 2013, increased to Ksh. 86.16 billion in 2014 and decreased to Ksh. 63.55 billion in the year 2015. These findings show that the average retained foreign earnings between the year 2006 to 2015 had been fluctuating. These findings concur with Central Bank Annual Report (2014) findings that both total warnings and retained earnings for foreign commercial banks in Kenya have been changing over time.



Figure 4. 5: Trend of Retained Foreign Earnings

4.4 Diagnostic Tests

Diagnostic tests included test for normality, heteroscedasticity test, multicollinearity test and autocorrelation test.

4.4.1 Test for Normality

The Shapiro–Wilk test was used to test normality. In line with the null hypothesis of the test, the study’s population is normally distributed. This means that if the value of p is less than the level of chosen alpha, the null hypothesis will not be accepted. The evidence will show that the data is abnormal as it will not be from a normally distributed population. Consequently, if the value of p is higher than the chosen alpha value, then the null hypothesis will be accepted and it will be concluded that the data collected was from a normally distributed population. From the results, return on assets (p-value=0.05508) and return on equity (value=0.08897) were normally distributed. However, foreign equity capital (p-value=0.000), reinvested foreign earnings (p-value=0.0000) and intra-company loans (p-value=0.000) were not normally distributed. These findings imply that return on assets and return on equity were normally distributed, but foreign

equity capital, reinvested foreign earnings and intra-company loans were not normally distributed.

Table 4. 2: Shapiro-Wilk Test

Shapiro-Wilk W test for normal data

Variable	Obs	W	V	z	Prob>z
FEC	140	0.69767	33.162	7.909	0.00000
ICL	140	0.79193	22.822	7.065	0.00000
RFE	140	0.44662	60.699	9.275	0.00000
ROA	140	0.98151	2.028	1.597	0.05508
ROE	140	0.98345	1.816	1.347	0.08897

4.4.2 Heteroscedasticity Test

The study used Breusch-Pagan/Cook-Weisberg test for heteroskedasticity. Heteroskedasticity exists if the variance of the error term varies across observations. According to the null hypothesis, a constant variance exists while the alternative hypothesis purports that heteroskedasticity does exist. The violation of homoscedasticity causes an increase as heteroskedasticity increases. From the findings, as shown in table 4.3, it was revealed that the p-value of 0.0031 was smaller compared to the significance level (0.05) implying that the study rejects the null hypothesis of homoscedasticity. These findings imply that there was homoscedasticity in the data.

Table 4. 3: Heteroskedasticity Test results

Breusch-Pagan / Cook-Weisberg test for heteroskedasticity
 Ho: Constant variance
 Variables: fitted values of ROE

chi2(1)	=	8.75
Prob > chi2	=	0.0031

4.4.3 Multicollinearity Test

Multicollinearity also termed as collinearity shows if two or more variables used in a multiple regression model are highly correlated which means that one can be linearly predictable with a higher degree of accuracy compared to the others. The researcher used variance inflation factor (VIF) to test collinearity. This factor measures how high the multicollinearity is in a least squares regression analysis. It gives the index showing the magnitude of the increase of a variance if a regression coefficient is increased because of collinearity. A variable whose VIF value is greater than 10 would merit further investigation. From the findings, the VIFs for the variables, foreign equity capital (0.334759), intra-company loans (0.339371) and retained foreign earnings (0.966237) were less than 10. This implies that there was no multicollinearity.

Table 4. 4: Variance Inflation Factor

Variable	VIF	1/VIF
FEC	2.99	0.334759
ICL	2.95	0.339371
RFE	1.03	0.966237
Mean VIF	2.32	

4.4.4 Autocorrelation Test

The Lagrangian multiplier test assists to decide whether the regression is a random effect regression or a simple OLS regression. The null hypothesis in the test states that variances across entities are equal to zero. This is, no panel or significant effect across units. Since the p-value (0.000) is less than the significance level (0.05), our conclusion is that the variances across the study entities are more than zero, meaning that panel effect does exist or there is significant difference across units. These findings imply that there were significant differences among

foreign banks in regard to the return on assets, return on equity, foreign equity capital, intra company loans and retained foreign earnings.

Table 4. 5: Breusch-Godfrey Langrage Multiplier test

Breusch and Pagan Lagrangian multiplier test for random effects

$$ROE[Bank,t] = Xb + u[Bank] + e[Bank,t]$$

Estimated results:

	Var	sd = sqrt(Var)
ROE	119.2092	10.9183
e	36.4119	6.034227
u	37.36991	6.113094

Test: Var(u) = 0

chibar2(01) = 107.34
 Prob > chibar2 = 0.0000

4.5 Unit Root Test

The IPS test is superior and thus, the researcher used it to analyze the panel data. The unit root can be found under the null hypothesis while the panel unit root was presented in the alternative hypothesis. The null hypothesis indicated that return on assets in all panels (banks) contain unit roots. Since the p-value (1.0000) was more than the significance level (0.05), the null hypothesis is acceptable. This implies that return on assets in all panels contains unit root.

Table 4. 6: Im-Pesaran-Shin unit-root test for ROA

From the findings, as shown in table 4.8, the null hypothesis indicated that foreign equity capital in all panels (banks) contain unit roots. Since the p-value (1.000) was more than the significance level (0.05), the null hypothesis is acceptable. This implies that foreign equity capital in all panels contains unit root.

Table 4. 8: Im-Pesaran-Shin unit-root test for Foreign Equity Capital

Ho: All panels contain unit roots	Number of panels = 14
Ha: Some panels are stationary	Number of periods = 10
AR parameter: Panel-specific	Asymptotics: T,N -> Infinity
Panel means: Included	sequentially
Time trend: Not included	
ADF regressions: No lags included	

	Statistic	p-value	Fixed-N exact critical values		
			1%	5%	10%
t-bar	1.3315		-2.140	-1.950	-1.850
t-tilde-bar	0.6489				
Z-t-tilde-bar	9.9678	1.0000			

According to the findings, as indicated in table 4.9, the null hypothesis indicated that intra-company loans in all panels (banks) contain unit roots. Since the p-value (1.000) was more than the significance level (0.05), the null hypothesis is acceptable. This implies that intra-company loans in all panels contains unit root.

Table 4. 10: Im-Pesaran-Shin unit-root test for Retained Foreign Earnings

Ho: All panels contain unit roots	Number of panels =	14
Ha: Some panels are stationary	Number of periods =	10
AR parameter: Panel-specific	Asymptotics: T,N -> Infinity	
Panel means: Included		sequentially
Time trend: Not included		

ADF regressions: No lags included

	Statistic	p-value	Fixed-N exact critical values		
			1%	5%	10%
t-bar	-0.7522		-2.140	-1.950	-1.850
t-tilde-bar	-0.6488				
Z-t-tilde-bar	3.2410	0.9994			

4.6 Regression Analysis

The regression model was expressed as follows;

$$Y_{it} = \beta_0 + \beta_1 X_{1it} + \beta_2 X_{2it} + \beta_3 X_{3it} + \varepsilon_{it}$$

Where; Y_{it} represents the dependent variable (return on equity); B_0 is the y intercept (Constant); β_1 - β_3 are coefficients of determination; X_{1it} is the equity capital; X_{2it} is the reinvested earnings; X_{3it} is intra-company loans (debt); i is the observations number; t is the number of observations for a given bank (time series data) and; ε_{it} is an error term.

The model involves return on equity as dependent variable and foreign equity capital, reinvested foreign earnings and intra-company loans as the independent variables. From the findings the overall r-squared was 0.4413. This implies that the independent variables (foreign equity capital,

reinvested foreign earnings and intra-company loans) explain 44.13% of the dependent variable (return on equity).

F-test is conducted to establish whether all the model coefficients are different than zero. In this study, the p-value for the F-test was 0.000, which is less than the significance level (0.05). This means that the model is a perfect fit for the data. The results also show that differences across units are uncorrelated with the regressors.

Table 4. 11: R-squared and F-statistics for ROE as the Dependent Variable

Random-effects GLS regression	Number of obs	=	140
Group variable: Bank	Number of groups	=	14
R-sq: within = 0.2686	Obs per group: min =		10
between = 0.5443	avg =		10.0
overall = 0.4413	max =		10
	Wald chi2(3)	=	59.45
corr(u_i, X) = 0 (assumed)	Prob > chi2	=	0.0000

From the findings, foreign equity capital has a positive and significant influence on return on equity as shown by a beta coefficient of 0.44733. This implies that a unit increase in foreign equity capital across time and foreign banks would lead to a 0.11979 increase in return on equity. There was a significance association since the p-value (0.000) was lower than the significance level (0.05).

The results show that intra company loans has a significant and positive effect on return on equity. This implies that a unit increase in intra company loans across time and foreign banks would lead to a 0.11979 increase in return on equity. There was a significance association as the p-value (0.016) was lower than the significance level (0.05).

The findings show that retained foreign earnings has a significant and positive effect on return on equity as indicated by a beta coefficient of 0.01432. This implies that a unit increase in retained foreign earnings across time and foreign banks would lead to a 0.01432 increase in return on equity. The association was significant as the p-value (0.000) was less than the significance level (0.05).

Table 4. 12: Regression Coefficients for Independent Variables and ROE

ROE	Coef.	Std. Err.	z	P> z	[95% Conf. Interval]	
FEC	.4473359	.1719766	2.60	0.009	.1102679	.7844039
ICL	5.707811	2.375873	2.40	0.016	1.051185	10.36444
RFE	.0143215	.0068977	2.08	0.038	.0008023	.0278407
_cons	17.01164	2.047785	8.31	0.000	12.99805	21.02522
sigma_u	6.1130935					
sigma_e	6.0342271					
rho	.50649222	(fraction of variance due to u_i)				

4.7 Hypothesis Testing

4.7.1 Effect of Foreign Equity Capital on the Bank Performance

H₀1: Foreign equity capital has no significant effect on banks performance in Kenya.

The study established that foreign equity capital had a significant effect on return on equity in bank performance in Kenya ($\beta=0.44733$, p-value=0.000). This shows that an increase in foreign equity capital across time and foreign banks would lead to a 0.44733 increase in return on equity. From these findings, we can reject the hypothesis that “foreign equity capital has no significant effect in bank performance in Kenya”.

These findings agree with Saddimbah (2014) findings that equity capital results in greater value for equity holders leading to better performance of the firm. These findings are also in line with

those of Salazar et al. (2012) findings that the use of equity capital improves the profitability of the firm. These findings also agree with Githire and Muturi (2015) argument that equity financing has a positive influence on firm financial performance. In addition, Ngeny and Mutuku (2014) explain that an organization that makes use of equity financing improves its performance due to the direct control and because the equity holders ensure that the resources are used efficiently so as to maximize their wealth.

4.7.2 Effect of Reinvested Foreign Earnings on the Bank Performance

H₀₂: Reinvested foreign earnings have no significant effect on banks performance in Kenya.

The study found that reinvested foreign earnings had a significant effect on return on equity in Bank performance in Kenya ($\beta=0.01432$, $p\text{-value}=0.000$). This is an indication that a unit increase in retained foreign earnings across time and foreign banks would lead to a 0.01432 increase in return on equity. From these findings, we can accept the alternative hypothesis that “retained foreign earnings have a significant effect on bank performance in Kenya”.

These findings agree with Edwards, Kravet and Wilson (2013) conducted a study on permanently reinvested earnings and the profitability of foreign cash acquisitions. These findings also agree with Deoras (2013) argument that reinvestment of earnings by overseas investors reflecting their long term commitment towards the operations in India had a significant influence on performance.

4.7.3 Effect of Intra-Company Loans on the Bank Performance

H₀₃: Intra-company loans have no significant effect on banks performance in Kenya.

The study revealed that reinvested foreign earnings had a significant effect on return on equity in Bank performance in Kenya ($\beta=0.11979$, $p\text{-value}=0.000$). This indicates that a unit increase in retained foreign earnings across time and foreign banks would lead to a 0.11979 increase in return on equity. From these findings, we can accept the alternative hypothesis that “intra-company loans have a significant effect on bank performance in Kenya”.

These findings agree with Saad (2014) findings that the use of intra company debt influences the performance of financial institutions positively. However, the findings are contrary to Muchugia (2013) argument that debt has a negative influence on the performance of commercial banks listed on Nairobi Securities Exchange. In addition, Githaiga and Kabiru (2015) find that short term loans, and long term debts negatively affected the profitability of the firms.

CHAPTER FIVE

SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

5.1 Introduction

This chapter presents the summary of the study, conclusions and recommendations. The chapter begins with summary of the study findings as per the objectives of the study followed by conclusions drawn from the findings. This was thereafter followed by recommendations and contribution to knowledge. The last section for this chapter was suggestions for further studies.

5.2 Summary

This part presents summary, conclusion as well as recommendations which are line with the study objectives. Specifically, the section covers the effect of foreign equity capital on the bank performance, the effect of reinvested foreign earnings on the bank performance and the effect of intra-company loans on the bank performance.

The study established that foreign equity capital has a significant effect on bank performance in Kenya. Specifically, the study revealed that foreign equity capital significantly and positively affect the Kenyans commercial banks return on equity. The capital also increases the equity holder's value thus positively impacting the firm profitability. Organizations that use equity financing can improve their profitability due to the direct control and due to the monitoring of how the resources are used by the equity holders in a bid to maximize their wealth.

The study found that reinvested foreign earnings have a significant effect of bank performance in Kenya. Specifically, the study found that reinvested foreign earnings have a positive and significant effect on return on equity in commercial banks in Kenya. Retentions are the profits that are not given out in the form of dividends but are left to the firm for the firm expansion. The

idea behind retention of these profits is that if the firm retains more profits it can grow better. Retained earnings are shown under shareholders equity on the balance sheet. Accumulated retained earnings which are related to the well-known company retained earnings are calculated by adding or subtracting the net income or net losses to the traditional retained earnings and subtracting dividends provided to the shareholders.

The study revealed that intra-company loans have a positive and significant effect on bank performance in Kenya. Specifically, the study found that intra-company loans had a positive effect on return on equity in commercial banks in Kenya. Multinational banks prefer to give capital to their foreign firms in terms of intercompany loans rather than increase their equity into the firm. However, the parent firm gives the funds as the owner of the other foreign firms. The loan provided usually has specifications on when the interest and principal should be repaid.

5.3 Conclusions

The study concludes that foreign equity capital has a significant effect on bank performance in Kenya. The study revealed that foreign equity capital has a significant and positive effect on return on equity of Bank performance in Kenya. The study also concludes that reinvested foreign earnings have a significant effect of bank performance in Kenya. Specifically, the study found that reinvested foreign earnings significantly and positively affected the Bank performance in Kenya return on equity. Also, the study concludes that intra-company loans have a positive and significant effect on Kenyan bank performance. The study found that intra-company loans had a positive effect on return on equity in commercial banks in Kenya.

5.4 Recommendations

The study found that an increase in foreign equity capital improves the performance of Kenyan banks. The study recommends that Kenya Commercial Banks should seek to increase their foreign equity capital so as to increase their performance in terms of return on equity and return on assets.

In addition, the study found that an increase in reinvested foreign earnings lead to an improvement in bank performance. The recommendation of the research is that foreign commercial banks based in Kenya should ensure that they increase the percentage of their earnings that they reinvest as a way of increase performance in terms of return on equity and return on assets.

The study also established that the use of intra company loans led to an increase in bank performance. Therefore the recommendation of the research is that foreign commercial banks based in Kenya should make use of intra-company loans so as to improve their performance in terms of return on equity.

5.5 Contribution of Knowledge

The study adds more information to the body of knowledge on the effect of foreign direct investment on bank performance. Specifically, the study provides information on the effect of foreign equity capital, reinvested earnings and intra-company loans on performance of foreign banks. In support of the profit maximization theory, the study findings show that increasing foreign direct investment leads to an improvement in bank performance in terms of return on assets and return on equity.

5.6 Suggestions for Further studies

The study found that foreign direct investment in terms of foreign equity capital, reinvested foreign earnings and intra-company loans could only explain 44.13% of return on equity in the foreign commercial banks in Kenya. The study therefore suggests further studies on other factors affecting the performance of foreign commercial banks in Kenya. Foreign direct investment depends significantly on macroeconomic factors of a country. The study therefore suggests further studies on the effect of macroeconomic factors on the performance of commercial banks need to be conducted in other foreign financial institutions. According to Eclectic Paradigm of Dunning the determinants of FDI include OLI (ownership, location and internationalization) advantages. The study therefore suggests further studies on the influence of OLI (ownership, location and internationalization) advantages on FDI inflows in Kenya.

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APPENDICES

Appendix I: Data Collection Tools (Banks)

Year	Foreign Equity Capital	Reinvested Foreign Earnings	Intracompany loans	ROA	ROE
2005					
2006					
2007					
2008					
2009					
2010					
2011					
2012					
2013					
2014					
2015					

Appendix II: Sampling Frame

1	Barclays
2	Bank of Africa
3	Bank of Baroda
4	Bank of India
5	Citibank
6	Credit bank
7	Diamond trust bank
8	Fidelity commercial bank
9	Habib Bank
10	Habib bank AG Zurich
11	Prime Bank
12	Standard Chartered
13	United bank of Africa
14	Transnational bank