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Foreign Direct Investment and Bank Performance in Kenya

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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 Kenyasn commercial banks from foreign countries should ensure that they increase the percentage of their earninsg 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 perfomance in terms of return on equity.*

Key Words: *Equity Capital, Bank performance, Intra-company Loan, Reinvested earnings*

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I. Introduction

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).

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.

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.

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.

Specifically, the study sought to test the following null hypotheses;

$H_0$1: Foreign equity capital has no significant effect on banks performance in Kenya.

$H_0$2: Reinvested foreign earnings have no significant effect on banks performance in Kenya.

$H_0$3: Intra-company loans have no significant effect on banks performance in Kenya.

II. 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.

Profit Maximization Theory

The profit maximization theory was founded by to 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. Buy 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.

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 m 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.

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 (0) 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.

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). The results indicated a significant relationship between market imperfections changes in capital structure and the firm's profitability. 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 and the results indicated that there was overwhelming evidence showing 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) found that equity was a major factor that determined the profitability of the organizations listed at the NSE. Moreover, Mbangula (2009) found out that there was a positive and significant relationship between commercial banks business model and performance of financial institutions.

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

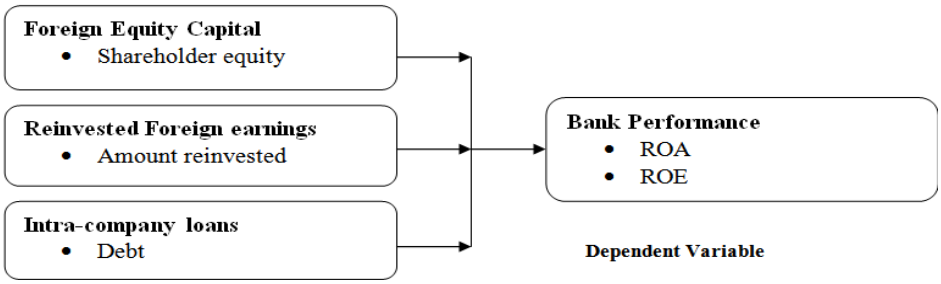
done on official data from the years 2008-09 and 2012-13 revealed that out of an FDI amounting to $186 billion, $45 billion was reinvested earnings. In the United States, Edwards, Kravet and Wilson (2013) conducted a study on the relationship between reinvested earnings and foreign cash acquisitions' 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 repartition 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.

Intra-company Loans and Bank Performance

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, sixe, 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 profitability and found that a positive relationship 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) found 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 and established that short term debts, and long term debts negatively affected SMEs financial performance.

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 in Kenya.



Independent Variables

Figure 1: Conceptual Framework

III. Research Methodology

The study adopted positivism research approach. This approach was applied since the research was built on existing theories and literature to develop hypotheses and have them tested by using a quantitative research design. A descriptive research design and explanatory research design were adopted. 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.

The target population was all the 39 commercial banks in Kenya. Purposive sampling was used 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.

This study used secondary cross- sectional time-series data, which was obtained from the annual financial statements of commercial banks, KNBS, World Bank database and CBK. A checklist was used to

collect the data. Data was quantitative and the 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. Before regression analysis, diagnostic tests were conducted and they included normality test, autocorrelation test, multicollinearity test and **s**tationary test. 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;

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

Where: $\mathbf{Y_{it}}$ is the dependent variable (Bank performance); $\mathbf{B_0}$ is the y intercept (Constant); $\boldsymbol{\beta_1}$- $\boldsymbol{\beta_3}$ are coefficients of determination; $\mathbf{X_{1it}}$is the equity capital; $\mathbf{X_{2it}}$is the reinvested earnings; $\mathbf{X_{3it}}$ is intra-company loans (debt); **i**is the observations number; **t** this is the time series data or observation number for a given bank;$\boldsymbol{\varepsilon_{it}}$ is an error term.

Table 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

IV. Results and Discussions

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 he maximum was Ks. 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 Ks. 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 2: 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

Diagnostic Tests

Diagnistic tests included test for normality, heteroscandicity test, multicolienarity test and autocorrelation test.

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 3: 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

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: 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
```

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 5: 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	

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 6: Breusch-Godfrey Langrage Multiplier test

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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
```

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 7: Unit Root Test for the Variables

Variable	t-bar	t-tilde-bar	Z-t-tilde-bar	p-value	Fixed-N exact critical values		
					1%	5%	10%
ROA	-0.2866	-0.1872	5.6339	1.0000	-2.140	-1.950	-1.850
ROE	-0.6621	-0.5749	3.6242	0.9999	-2.140	-1.950	-1.850
Foreign Equity Capital	1.3315	0.6489	9.9678	1.0000	-2.140	-1.950	-1.850
Intra-Company Loans	0.6893	0.5587	9.5004	1.0000	-2.140	-1.950	-1.850
Retained Foreign Earnings	-0.7522	-0.6488	3.2410	0.9994	-2.140	-1.950	-1.850

The null hypothesis indicated that return on equity in all panels (banks) contain unit roots. Since the p-value (0.9999) was more than the significance level (0.05), the null hypothesis is acceptable. This implies that return on equity in all panels contains unit root.

From the findings, 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.

According to the findings, 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.

The null hypothesis indicated that retained foreign earnings in all panels (banks) contain unit roots. Since the p-value (0.9994) was more than the significance level (0.05), the null hypothesis is acceptable. This implies that retained foreign earnings in all panels contains unit root.

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 8: R-squared and F-statistics for ROE as the Dependent Variable

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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 9: 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)				

Hypothesis Testing

$H_0$1: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(β=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.

$H_0$2: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 (β=0.01432, p-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 alternativel 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.

$H_0$3: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 (β=0.11979, p-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.

V. 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.

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 animprovement 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 earninsg that they reinvest as a way of increase perfoemance 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 perfomance in terms of return on equity.

Areas for Further Research

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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