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DETERMINING THE EFFECT OF INFORMATION AND COMMUNICATION ON FINANCIAL DISTRESS OF UNLISTED BANKS IN KENYA

[1]LYDIAH KULOBA[2]Kennedy B. Mwengei Ombaba
[1]MBA FINANCE[2]Lecturer, Jomo Kenyatta University of Agriculture & Technology. Kenya.

ABSTRACT

The banking sector in Kenya plays a significant role in the economy. Banks provide financial services to the ever-growingbusinesses and act as the mediator of risk. Financial distress is a cause of concern for banks to adhere to their role. Financial distress is one major challenge and if left unchecked more often than not it causes banks to collapse. This study intends to determine the effect of information and communicationon financial distress of unlisted banks in Kenya. The study employed the theory of Asymmetry Information theory. The study used both primary and secondary data. Primary data was collected by closed ended questionnaires and secondary data was extracted from audited financial reports of all the 30 unlisted banks using data collection schedule.The study targeted all the 30 unlisted banks in Kenya for analysis. The unit of analysis was the bank manager, credit officer and the risk manager in each bank. The study therefore involved 90 respondents. A pilot study was conducted inKenya Commercial Bank, Cooperative Bank, and Equity Bank. The banks were randomly selected and they form 10% of the population under study. The study was done before the main study was conducted in order to test the reliability and validity of the research instrument. Content validity test was used to determine the validity of the questionnaires. Reliability was tested using Cronbach's alpha coefficient. Data processing was enhanced by the use of Statistical Package for Social Science (SPSS). Data analysis included both descriptive statistics and inferential statistics. Descriptive statistics included mean, frequency and standard deviation. Inferential statistics used correlation and regression analysis. The study findings indicated that information and communication had a positive and significant effect on financial distress of unlisted banks (β= 0.265, $p< 0.05$. The study was useful to the government and policy makers in enabling them understand and include relevant policies governing banking industry that effectively deter financial distress in unlisted banks. The study provided literature toserve as source of reference material for future scholarsin conducting further studies on financial distress of banks. The study recommended that banks employ appropriate preventive internal controls to deter financial distress in the banks.

Key Words: Financial distress, information and communication, unlisted firms

1.1 Background to the Study

Banks play a significant role in the economy by collecting savings from individuals, keeping deposits safely, providing loans to enable investment and consumption andacting as intermediaries in financial transactions. Banks are financial institutions licensed by the central bank of Kenya to receive deposits from the public, give loans and provide financial services to customerssignificant in enabling economic growth. Financial distress is a condition where a company cannot meet, or has difficulty meeting financial obligations as and when they fall due. Financial distress occurs when promises to creditors of a company are broken or honored with difficulty (Saleem, Muhammad, & Umara, 2013).

Financial distress increases when a firm has high fixed costs and illiquid assets and if unchecked, may lead to bankruptcy. There are four forms of financial distress;a firm could

be technically insolvent, unable to pay its current debts temporally.The second form of financial distress is legal bankruptcy where the company files for liquidation under the Company Act (2010) Chapter 486 and the decision to liquidate is made by a board resolution. A firm can do voluntary bankruptcy/ debtors' petition or a creditor can make the firm bankrupt through court process known as creditors petition. The third form of financial distress is when a firm is experiencing economic failure and the revenues are insufficient to cover the cost of capital. The forth form of financial distress is business failure.

Once the signs of financial distress are evident, a proactive approach is taken in an attempt to turn around the business: engage an independent accountant, auditor and an insolvency advisor to give financial expert reports, monitor the health of the business by reviewing profit and loss accounts, manage tax affairs by paying off tax owing to the government and maintain positive business relationship. Jamieson (2014). These measures help alleviate the aggravations that come with financial distress of the bank and eminent failure of the bank. A firm may terminate its operations either partially or fully, (discontinued operations IAS 14).

Causes of financial distress are classified into internal and external causes. Internal causes are management incompetence, weak internal controls, heavy debt burden, lack of financial discipline, uneconomic plant size, over investment in fixed assets, excessive borrowing and lack of expenditure control system.Memba and Abuga (2013)study on causes of financial distress acknowledged that the most significant causes of distress were improper capital decision, inadequate capital, poor accounting records and poor internal management. External causes of financial distress are hugeborrowings, large legal costs, competition, large debts, government policies on taxation and import duties (Natalia, 2007).

The first models of financial distress prediction originated in the 1960's. First financial distress models were created by (Beaver, 1966; Altman, 1968). A range of other models like the Beaver (1966) univariate approach on a neural network model for bankruptcy, Blum Marcs failing company model was developed by Marc's Blum to assess probability of business failure and the inability to pay debts as and when they fall due, LC Gupta model attempted to distinguish sick and non- sick companies on the basis of financial ratios. The study used Altman Z Score to measure and evaluate the financial distress of the banks.

Internal controls are procedures to help achieve objectives of a firm. Good controls boost efficiency, compliance with laws, regulations and policies, and eliminate abuse and fraud. Internal controls may be preventive or detective. Preventive controls like separation of duties and management trainings are designed to bar irregularities from occurring. Detective controls are performed on routine basis to identify areas of potential risks to the firm. For a firm in financial distress, internal audit function, segregation of duties, adequate knowledge of policies and procedures for employees, asset register and safe custody of assets and company information helps protect confidential information and curb fraudulent actions (Qiang, Beng & Jae, 2014). This results in operational efficiency with reduced misappropriation of company resources and enhanced quality of internal reports which helps to salvage the firm under distress.

Mexico's banking system was shrinking over timewith slow economic performancedue to the small size of the financial system (Tornell&Martinez, 2004). Mexico's banks had weak incentives to engage in prudent lending and the directors and major stockholders had their own capital at risk. The government allowed them to buy the banks shares with funds borrowed from the banks (Mackey,2000). Poor monitoring resulted in expanded credit and

rampant growth of NPLs. As atDecember 1991, the ratio of NPLsto total loans was 14 percent which increased to 17 percent in the year 1994,36 percent by 1995, and 53 percent by the end of 1996 (Haber, 2005). Mexico's bankers found it impossible to repossess collateraldue to the high standards which Mexican banks determined a loan to be non-performing.

Japan banking financial distress crisis began in early nineties, when a small commercial bank, insured by the Japanese government's deposit insurance system went into bankruptcy. Japanlost a whole decade trying to recover from the systematic banking crisis it suffered in 1997-1998. It ended in 2005 when the NPL ratio of major banks declined to a level below the target set by the government (Kawai, 2005). The Japanese government's response to the financial crisis in the 1990s was late, unprepared and insufficient. It failed to recognize the severity of the crisis which developed slowly, faced no major domestic or external constraints and lacked adequate legal framework for bank resolution.

In Tanzania, according to theIMF some banks reported huge losses while others reported declined profits. In 1980s, there was a financial crisis and a Commission of Enquiry (Nyirabu Commission, 2001) was formed to address the problems facing the financial sector. According to BOT Governor, Prof Benno Ndulu, the turning point of Tanzania's financial sector development was in the 1990s, after the government decided to liberalize the financial sector as per recommendation of the commission. Thecrisis facing the banks today started several years back. The government reverted to BOT as its banker, rather than use commercial banks. According to Ernst and Young website (www.ey.com) Eastern Africa Banking Sector report indicated that Tanzanian banks faced a tough year in 2013.

In Uganda, Crane Bank was the fourth largest local bank in terms of assets, (Busulwa, 2016). Development Finance Company of Uganda Bank Limited currently the second largest bank in Uganda by asset size acquired Crane after it was placed under receivership in 2016. The failure was attributed to the general challenges facing the economy and what the Governor of Bank of Uganda termed as falling below capitalization prudential limits. In 2010 the central government revised the minimum capital requirement to UShs 25 Billion below which the banks could not be allowed to operate. Three commercial banks including National Bank of Commerce, Global Trust Bank and, Teffe Trust Bank were closed in the last 15 years for failing to adhere to required standards, (Brownbridge,2012).

Zimbabwean economy was distressed by hyperinflation in 1990s and this resulted in declined deposits forcing the bank to use other sources to fund lending, Mambondiani(2012). Roger Bokas United Merchant Bank was the first bank to collapse in1998, the next to collapse was Unibank in the year 2000. In 2003 ENG Capital and Century Discount House collapsed leading to panic, (Kupakuwana, 2012). A lot of bank distress over the past decade in Zimbabwe pointed to a financial crisis more prevalent in the locally owned banks than foreign owned (Eernisse,2012). Twenty banks were under financial distress at various magnitudes over the past decade, (Fowowe,2013). The twenty banks under distress included thirteen banks under receivership, five banks were under recuperative curatorship, while two were classified as 'troubled' by the central bank of Zimbabwe.

Nigerian banking sector experienced a number of bank failures in the year 1994-2003. The 2004 Banking Sector Reforms swept away 14 additional banks andit became a matter of utmost concern to the entire nation and to the practitioners (Anameje, 2007). Nigeria wasoperating in unsafe and unhealthy manner, exposing the fragile system to risk and further erosion of public confidence. The comprehensive reforms of 2004-2005 ushered in a new era of banking in Nigeria, especially in the area of improved capital base and shareholders' funds. The revelations from the sector in late 2009 confirmed thatthe

widespread crisis that ravaged this sector over the years had not been dealt with. Huge sums of non-performing loans indicate great danger to the system and required drastic approach to embark on by the current CBN governor (Anya, 2003).

The Banking industry in Kenya is governed by the Companies Act, the Banking Act and the Central Bank of Kenya Act. The banking sector was liberalized in 1995 and exchange controls lifted. The CBK, under the Minister for Finance responsible for formulating and implementing monetary policy and fostering the liquidity, solvency and proper functioning of the financial system. CBK 2017 recorded that, there were 40licensed commercial banks operating in the country, 25locally owned, 15 are foreign owned, 30 banks unlisted in (NSE) and 10 banks are listed in NSE, (CBK, 2017). There are also a number of challenges facing the industry. Financial distress is one of the challenges and if left unchecked it leads to bank failure and cripple the economy.

Financial distress in unlisted banks in Kenya is caused by insider lending, lending to high risk borrowers and macroeconomic instability. Insider lending contributed to un serviced loans, liquidity problems and failure of banks, (Bankelele, 2014).The Continental bank, Trade bank and Pan African bank in Kenya failed due to extensive insider lending. According to Waweru and Kalani (2009) study on Commercial Banking Crises in Kenya, the leading cause of collapsedfinancial institutions was non-performing loans.CBK 2017 reported that due to uncertainties during elections, banks experienced delayed payments from both public and private enterprises. This resulted to increased NPLs by 23.4 percent from Ksh.214.3 billion in 2016 to Ksh.264.6 billion in 2017.

Dubai Bank Kenya had a total asset valued of Kshs 2.92 Billion and was ranked last among the forty-two licensed commercial banks in Kenya (Bankelele, 2014). Dubai Bank wasthe first to collapse in the recent past and was placed under receivership by CBK on the 14th August 2015 for violating banking guidelines for years in line. CBK appointed KDICas a receiver manager in the interest of depositors, creditors, and general public (Olingo,2015). The bank experienced deteriorating cash reserves and failed to meet its financial obligations breaching its daily cash reserve ratio. KDICwas appointed the receiver manager for one year.KDIC's report to the CBK on August 24, 2015 showed that there was no way to salvage the troubled bank and recommended that the bank be liquidated, (*B. D Africa, 2015).*

On 13thOctober 2015, Imperial Bank Limited (IBL), was placed under the management of KDIC by CBK dueto unsafe and unsound business conditions at the Bank (*Okoth, 2015)*. Internal fraud scheme as a result of weak internal controls occasioned the distress, (CBK, 2015). At the time of closure, the bank had an asset base of KES43 billion and was ranked the 19th largest Kenyan commercial bank by assets, out of forty-two licensed banks in the country, (Okoth, *2015).*In June 2016, the Central Bank of Kenya appointed NICBank an asset and liabilities consultant for Imperial Bank under receivership, (*Juma, 2016).*Irregular loans by IBL's management werecontrary to the legal and regulatory requirements, and the internal controls of IBL. These irregular loans resulted into violation of the statutory limit of lending to a single borrower and overstating IBL's capital adequacy position.

Chase Bank Kenya was placed under receivership by CBK on 7th April,2016, making it the 3rd bank to be placed under receivership in a period of 12 months. This was mainly due to failure to report on insider loans and failure to meet their statutory banking ratios known as "unsafe financial conditions". Chase Bank re-opened 27th April 2016 after a closure of two weeks with KCB as the receiver Manager, (*Irungu, 2016). As per financial statements for the year ending 2015, the* profits dropped from Kshs 2.3 billion in 2014 to Kshs 742 million in 2015 and non-performing loans rose from Kshs 3 Million in 2014 to Kshs 11 billion in 2015, (Mwaniki, *2016).* The bank suffered panic withdrawals as aresult

of rumors which led to a cash crunch rendering the bank incapable of meeting its obligations as and when they fall due. Depositors ran the risk of losing Kshs 16.6 billion which was given out as unsecuredloans.

1.2 Statement of the Problem

Banks play an important role of being the financial intermediaries and offer efficient financial services ensuring there are investment opportunities that create strong and globally competitive financial services in Kenya (ROK, 2007).However, financial distress has been a great concern all over the world and cannot be ignored as it leads to bankruptcy and bank failure. Kenya has been worst hit as many unlisted banks collapsed due to financial distress. Twenty-two banks collapsed between 1993 to 2016 and the last three banks were put under receivership in a range of one-year (Robert,2017).Due to the high number of banks that collapsed in Kenya as a result of financial distress, there was need to find out how internal control system affects financial distress of the banks. There have been numerous studies on ways of predicting financial distress in listed banks, butnone on effect of internal control system on unlisted banks in Kenya. This study helps banks establish if they are in distress and if so, how their performance isaffected and how to rectify the situation. Bank failures have adverse effects on borrowers who experience credit constraint, customers lose their deposits and employees lose their jobs. Thespillover effectsspread very fast throughout the economy and result in failure of other banks that were solvent at the time of the closure.A lot of literature and scholars' research has concentrated on the prediction of financial distress on listed banks.Gathaiya, (2017) carried out a study on analysis of issues affecting collapsed banks in Kenya from year 2015 to 2016. Waweru and Kalani, (2009) did a study on commercial banking crises in Kenya: Causes and Remedies, Issa, (2016) did a study on the role of monitoring and evaluation in promoting strategic management and mitigating financial distress in Ghana. Attention was not been given to effect of internal controls on financial distress of unlisted banks in Kenya.This challenge remains unaddressed. This study therefore sought to bridge this research gap by determining the effect of internal control system on financial distress of unlisted banks inKenya.

Research Objectives

The general objective of this study was to assess the effect ofthe effect of information and communication on financial distress
of unlistedbanks in Kenya.

Hypotheses of the Study

H_{01}: There is no significant effectof information and communication on financial distress of unlisted banks inKenya.

CHAPTER TWO
LITERATURE REVIEW

Asymmetric Information Theory

The proponents of asymmetric information theory were Akerlof,Michael and Joseph (2001).The theory was developed in 1970s and 1980s and proposed that an imbalance of information between two transacting parties leads to inefficient outcomes in the markets. In contract theory and economics, information asymmetry also known as information failure deals with decisions in transactions where one party has more information than the

other. Asymmetry creates an imbalance of power in transactions, where one party to an economic transaction possess greater material knowledge than the other party. Information asymmetry is a cause of business failure where the bank management has more information than the customers and the investors. It amounts to hidden information and hidden action by one party with more information.

Information asymmetry model is based on the assumptions that measurement errors are random. Examples of methods to estimate reliability include test-retest reliability, internal consistency reliability, and parallel-test reliability. Asymmetry models assume that one party to the transaction has relevant information whereas the other does not. One party can enforce for breach of contract while the other cannot. The ignorant party lacks information at the time of negotiating a contract while other party has information on the performance of the agreed transaction. Restricted information network in the banks further contribute to asymmetry of information as the senior management have more information than the rest of employees and the investors.

A critique of the information asymmetry Dane and Tsang (2015) argued that the two major problems are that a signal has an effect on information asymmetry and the uniformed investors have no information. The information asymmetry argument derived from signaling theory is the most commonly used in theoretical framework. The disadvantages of asymmetric information are: it may have fraudulent consequences after contrarychoice,and a bank may experience loss due to risknot disclosed at the time of the transaction. The solution is for banks to embrace detailed scrutiny of data and follow laid down processes so that hidden or undisclosed information does not cause loss.

Information asymmetry deals with the study of decisions in transactions where one party has more information than the other. Asymmetry creates an imbalance of power in transactions, which sometimes fail in the worst cases. Information asymmetries are studied in the context of principal–agent problems where they are a major barrier to correct information and communication. The theory is relevant to the study because internal controls if fully implemented and communicated then the banks will not run the risk of loss and financial distress as a result of hidden informtion. The bank management will not take advantage of their privileged access to information to make decisions beneficial to them but which may be detrimental to the interests of investors (Giovanni, 2001).

Effect of Information and Communication on Financial Distress of Banks

Information and communication system are**other terms for information technology. This** stresses the role of unified information, communications and integration of telecommunications and computers as well as necessary enterprise software, middleware, storage, and audio-visual systems. This enable users to access, store, transmit, and manipulate information*(ICT 2008). This* improves the quality of human life in learning and in promoting and campaigning for important issues, such as the healthcare and social life. It provides wider knowledge and provides access to accurate information and reliable information.

*Damien (2014)*analyzed banks' communication policies in crisis times and the role of imperfect information in enhancing bank financial distress in Romania. If banks differ in exposure to assets, fragile banks may claim to be sound so as to manipulate investors' expectations.False information improved the situation of the low-risk banks but

deteriorated the situation of the high-risk banks. The study emphasized on the impact of a manager's communication policy on the financial distress of the bank and showed that uncertaintycan contributeto improve social welfare. It is criticized that when investors have only imperfect information about the banks' true exposure to risky assets, some fragile bank may claim to be strong only to manipulate investors' expectations. The study failed to cover the effects of internal controlsystem on financial distress of unlisted banks.

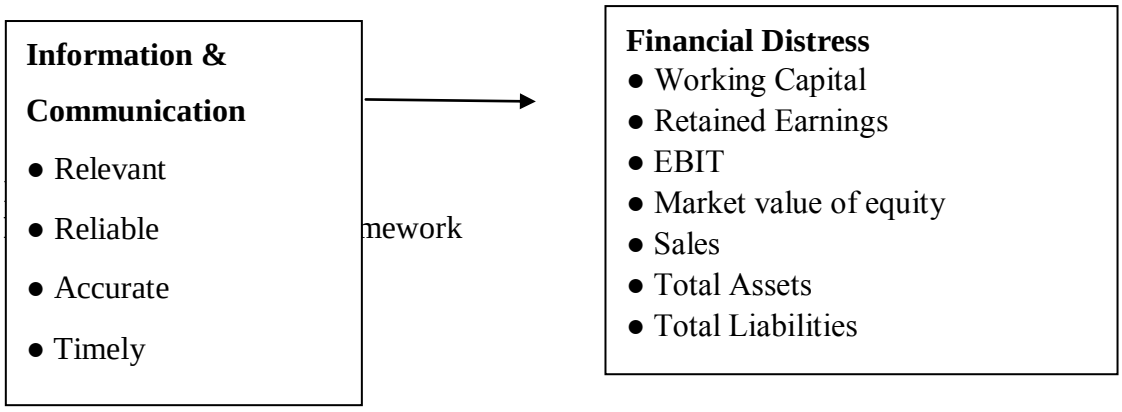
Mwangi (2012) study on effect of information technology on financial distress of commercial banks in Kenya. The findings of the study were that information and communication has tremendously improved the banking industry and the market share improved and the banks remain relatively competitive. The fast-evolving information and communication technology has resulted in high operational efficiencies and increased liquidity levels leading to improved earnings and returns. ICT enabled banks to offer a broad variety of services to customers and reduced on financial distress that may have occurred. The study failed to cover effects of internal controlsystem on financial distress of unlisted banks.

Gakure and Ngumi (2013) in the study on whether ICT innovation influence gains in commercial banks in Kenya, concluded that development of Information Technology in banks had influence on bank profits. Bank information and communication enabled banks to avert financial distress. The banks improved revenue and reduced costs were as a result of enhanced information, communication and technology. The study failed to cover effects of internal control system on financial distress of unlisted banks.

2.4 Conceptual Framework

A conceptual framework is a research tool intended to assist a researcher to develop awareness and understanding of the situation under scrutiny and to communicate it. When clearly articulated, a conceptual framework has potential usefulness as a tool to assist a researcher to make meaning of subsequent findings. It forms part of the agenda for negotiation to be scrutinized, tested, reviewed and reformed as a result of investigation and it explains the possible connections between the variables (Smith, 2004).

To guide the study, the inter relationship between variables discussed above were presented in the conceptual framework shown below:



RESEARCH METHODOLOGY

Research Design

Research design is used to combine the varied components of a study in a rational manner and ensure research problem is addressed effectively, (Kothari, 2014). The study useda descriptive research design to help demonstrate the relationship between internal controls and financial distress of unlisted banks.

Target Population

A population is a well-defined or specified group of people or a predetermined collection of individual elements (Lavrakas, 2014). The target population is the aggregate of all that conforms to a given specification and to which results are generalized. The target population for the study was90 bank officers, 3 from each of the 30 unlisted banks in Kenya comprising of bank manager, credit officer and the risk manager.

Research Instrument.

The study usedquestionnaires as the tool to collect data. Primary data was collected directly by the researcher for the first time. It was original in nature and was specific to the research problem under study. The study usedsemi-structured questionnaire as the tool for data collection. A questionnaire is a research instrument consisting of a series of questions used forgathering information from respondents (Mugenda& Mugenda, 2008).

Secondary data refers to data which is collected by someone else for the purpose other than the researcher's current project and may have already gone through statistical analysis. The secondary data was readily available from published financial statements and from business journals and it was cost effective, (Hui & Michael 2014). There are four steps in using secondary data: identifythe subject and where to acquire the information, gathered existing data, compare data from different sources and analyze the data. The data was obtained from the published financial reports for the banks from the year ending 2015, 2016 and 2017 and from the Banks website.

A pilot study is a research study conducted before the intended study. According to Polit and Beck (2003), a pilot study is a test on a smaller scale and is usually executed as planned for the intended study. Although a pilot study cannot eliminate all systematic errors, it reduces the likelihood of making type I or type II error. Pilot study is done in order to:test the effectiveness of research instruments, to assess the feasibility of the study, to assess if the research protocol is realistic, workable and to estimate the statistical parameters for later analysis. A pilotstudy is carried out on members of the relevant population but not on those who form part of the final sample. The study was conducted onKenya Commercial Bank, Corporative Bank, and Equity Bank before the main study was conducted. According to Connelly (2008),a pilot study sample should be 10% of the sample projected for the larger parent study.Conducting a pilot study does not guarantee success in the main study but it increases chances of success. The pilot study fulfilled the important function of providing valuable insights for other researchers. Therefore, one bank manager, one credit officer and one risk manager were chosen from each of the three banks to make a total of nine.

Validity Test

Validity test is the accurate results acquired from data collected (Mugenda & Mugenda, 2008). It refers to whether or not the test measures what it claims to measure. Content validity test was used as guided by my supervisor.

Reliability Test

Reliability test measures the degree of consistency of a measure (Kothari, 2014). The reliability of the questionnaires was tested using the Cronbach's alpha coefficient which refers to a measure of internal consistency. It measures the relationship of a set of items in a group. Cronbach's alpha coefficient ranges from 0.0 to 1.0.A Cronbach's alpha close to 1.0 indicates that the item is considered to have a higher internal consistency reliability, above 0.8 is considered good, 0.75 is considered acceptable and less than 0.6 is considered poor.

Data Collection Procedure

Jomo Kenyatta University of Agriculture & Technology provided an introduction letter to the researcher to visit different Banks. Questionnaires were distributed to the respondents at their point of operation. The data was collected using questionnaires with closed ended questions on a Likert scale, the material was collected and kept in a safe place for data analysis.

Data Processing and Analysis

The analysis was facilitated using Statistical Package for Social Sciences (SPSS) to aid the qualitative analysis. Dataprocessing involved a series of actions and steps performed on data which includedcleaning, editing, coding, classification, tabulating and storing before data wasanalyzed (Hall, 2010). The study used both descriptive and inferential statistics in data analysis. Descriptive statistics included means, frequencies, percentages and standard deviation while inferential statistics used correlation analysis, multiple linear regression analysis, Pearson's product moment correlation and hypothesis testing to ascertain the relationship that existed between the independent variables and the dependent variable.

The primary data was collected by use of a structured questionnaire. The data collected was coded, cleaned, analyzed, presented, discussed and inferences made in an attempt to address the specific objectives of the study. The secondary data was obtained from the published financial reports for the banks from the year ending 2015, 2016 and 2017 and from the Banks website.The research study involved document analysis of the financial reports by calculating financial ratios as per the ratios in the Altman Z score formula. Data was analyzed through a linear regression analysis on the basis of descriptive statistics and performance comparison done across time between the years 2015-2017.Financial distress of unlisted banks was analyzed and measured based on Altman's Z score model, (2006).

Multiple Regression Analysis Model

Multiple regressions are a statistical technique used when we want to understand the relationship between several independent variables and one dependent variable Hair, Anderson, Black and Totham (2010). It is used when predicting the value of a variable based on the value of the other variables. Multiple regression analysis was used to test the hypotheses on the effect of internal controlsystems on financial distress of unlisted banks in Kenya. Coefficient of determination, R^2 was used to determine the relationship between internal controlsystems and financial distress, the regression test was done at 5% significance level. In order to find out the effect of internal controls on financial distress of unlisted banks in Kenya, regression analysis using excel was done. Multiple regression equation used in the study was as below:

$Y=\alpha + \beta_1 X_1 + \varepsilon$ ……...……Equation 3.1

Where:α constant

ε is the error term

β Regression coefficient of independent variables

X_1 Information & communication

The Altman's Z- Score formula is used to forecast financial distress; Edward I. Altman was the one who first published, during that time, when he was a finance assistant professor of finance at the New York University in 1968.Altman, (2000) recorded that the model was found to be 80%- 90% accurate in predicting bankruptcy one year before the event with Type 11 error of between 15%- 20%(classifying the firm as bankrupt and it does not go bankrupt). This study adopted the Altman Z score formula.

Altman Z-score Formula: $\mathbf{Z=1.2X_1+1.4X_2+3.3X_3+0.6X_4+1.0X_5}$**……..…Equation 3.2**

Where X_1 Working capital/total assets

X_2 Retained earnings /total assets

X_3 Earnings before interest and taxes/total assets

X_4 Market value of equity/ total liabilities

X_5 Sales/total assets

Z score scale: Z >3.75 Safe zone, 1.75< Z < 3.75: Grey zone, Z <1.75: Distress zone.

RESEARCH FINDINGS AND DISCUSSIONS

Response Rate

The study targeted 90 respondents, 3 officers from each of the 30 banks. Out of the 90 questionnaires administered by the researcher, 78 filled questionnaires were collected translating to 86% response rate and 22 questionnaires were not returned forming 14%.Babbie (2013) stated that return rates of 50% are acceptable and adequate for analysis and therefore, the response rate of 86% is acceptable to analyze and publish. High response rates ensurethe survey results are representative of the target population and the number is sufficient to support requisite analysis of data, reliable to make accurate findings and conclusions. In Table 4.1, out of the 90 questionnaires administered, only 78 were completed, returned and used in the analysis representing 86% response rate and 22 questionnaires were not returned. Table 4.1 illustrates response rate of the targeted population.

Table 4.1 Response Rate

	Frequency	Percentage %
Questionnaires returned	78	86
Questionnaires not returned	22	14
Total	**90**	**100**

Reliability Test

Reliability is a measure of consistency of research instrument (Hair,Money, Somouel & Page, 2007). Reliability was tested using Cronbach's coefficient alpha which is a common method used in evaluating reliability (Bryman, 2011) for each variable.

Table 4.2: Reliability Test Results

Variable	Test Items	Cronbach's Alpha
Information and communication	4	0.768

The test findings were that overall Cronbach's alpha for effect of risk assessment on financial distress of unlisted banks is (0.852), effect of information andcommunication on financial distress of unlisted banks is (0.768) and effect of monitoring on financial distress of unlisted banks is (0.870) with an average of 0.830 as indicated in table 4.2 means the research instrument was reliable. In this study the Cronbach's alphas were > 0.7 signifying that the research instrument was reliable.

Background of the Respondents

The study sought to establish the background information of the respondents in regard to designation, work experience in the banks, and their level of education.

Designation of Respondents

Information on designation of respondents was sought. The results are indicated in the Table 4.3.

Table 4.3 Designation of Respondents

Designation	Frequency	% of Response
Bank Managers	19	24
Credit Officers	33	42
Risk Managers	26	34
Total	**78**	**100**

The majority of the respondents (33) who represent 42% of the sample were credit officers, (26) 34% were risk managers while (19) 24% were bank managers of the banks sampled for the study. This implies that the respondents had good knowledge of the banks internal controls as respondents are in senior management positions. Konya (2016) established that job type and hierarchical position have a substantial influence on the organization'sinternal structure and commitment.

Working Experience with Banks

The study sought to establish the number of years that the respondents spent working with the banks. Table 4.4 shows the results.

Table 4.4 Working Experience with Banks

Duration	Frequency	% of Response
Less than a year	10	12.8
Between 1 and 5 years	22	28.2
Between 6 and 10 years	30	38.5
Above 10 years	16	20.5
Total	**78**	**100**

The findings indicate that the majority of the respondents; 30 (38.5%) have been working with the banks for a period of 6-10 years. The second largest number of respondents 22 (28.2%) have worked for the banks between 1-5 years. The least experienced respondents are 10 (12.8%) having worked with banks for less than 1 year. The longest serving and most experienced respondents; 16 (20.5%) have worked for more than 10 years. This shows that Bank Managers, Credit Officers and Risk Managers at the Banks in Kenya have extensive work experience. The findings show that majority of the employees have work experience of between 6years and 10 years. This is important to the study since the employees have enough experience to answer questionnaires based on the experience with the firms.

Level of Education of Respondents

The study sought to establish the distribution of respondents in terms of their academic qualifications of the Bank Managers, Credit Officers and Risk Managers of the Banks that were involved in the study. Respondents with different levels of education have different responses. There are significant differences in opinion between respondents with a different educational level. Table 4.5 represents the findings.

Table 4.5 Level of Education

Level of Education	Frequency	% of Response
Diploma	2	2.6
Undergraduate level	16	20.5
Degree level	36	46.2
Masters	24	30.8
Total	**78**	**100**

The findings indicate that 2 respondents have Diploma as their highest level of education forming 2.6%, 16 respondents are doing their undergraduate programs which forms 20.5% and the majority of respondents 36 (46.2%) and 24 (30.8%) have first degrees and masters degrees respectively. This shows most respondents are graduates as their level of education. This implies that employees have the requisite skills in the firms which is necessary to perform.

Descriptive Findings and Discussions

This section demonstrates descriptive findings and discussions on the objectives of the study. The findings are presented in a 5-point Likert scale where 5 to 1 represent strongly Agree to strongly Disagree respectively.

Effect of Information and Communication on Financial Distress of Banks

The study investigated the respondents' views on effect of information and communication on financial distress of banks. The results of the study are illustrated in Table 4.6.

Table 4.6Information and Communication on Financial Distress

Statements		1	2	3	4	5	Mean	Std. Dev
i) Information system provides reports to management on financial distress	F	3	0	2	48	25	4.18	0.82
	%	3.8	0	2.6	61.5	32.1		
ii) The source of information and mode of communication is reliable.	F	5	2	6	32	33	4.10	1.09
	%	6.4	2.6	7.7	41	42.3		
iii) Procedures for verification of accuracy of management, financial reports are in place.	F	3	2	12	17	44	4.24	1.06
	%	3.8	2.6	15.4	21.8	56.4		
iv)Management communicates, promptly acts oncustomer issues on time.	F	2	1	5	37	33	4.26	0.84
	%	2.6	1.3	6.4	47.4	42.3		

The study findings indicate that 61 (78.2%) respondents agreed that procedures for verification of accuracy of management and financial reports are in place (mean = 4.24 std dev = 1.06). 70 (89.5%) respondents agreed that the management communicates and follows up action on customer issues on time (mean = 4.26 std dev = 0.84). 73 (93.6%) respondents also agreed that Information system provides reports to management on the banks financial distress (mean = 4.18 std dev = 0.82).65 (83.3%) respondents agreed that the source of informationand mode of communication is reliable and has effect on financial

distress in the banks (mean = 4.10 std dev = 1.09). The findings indicate that effective information and communication is at the work place.

Z- score values for Financial Distress of Unlisted Banks

The study sought to know the calculated Z values for the unlisted banks. The formula was used to predict financial distress possibility within 2 years. According to Altman (2000), Z score values of a firm are deemed under financial distress when the values fall below 1.75. the findings show that all firms under study are under financial distress since the z- score values are all below 1.75(distress zone). Z score scale: Z > 3.75 Safe zone, 1.75 < Z < 3.75: Grey zone, Z <1.75: Distress zone.All the calculated values for Z- score for the unlisted banks in Kenya range between 0.35- 0.81. All the values fall below 1.75 meaning that all the banks in the study fall under distress zone. Despite having internal control system in the banks, they had very low Z score values.The banks were under financial distress from the year 2015 to 2017.

Inferential Analysis

The study uses inferential analysis to determine the relationship between independent variables and the dependent variable. Pearson correlation coefficient is used to determine the strength and direction of the relationship. Regression model is also used to establish the association by predicting the variation of the dependent variable from independent variables. Regression analysis enables the researcher to establish whether there is a relationship exists between independent variables and the dependent variable (Murphy, 2010). The research problem in the study was to determine if there is a relationship between internal control system and financial distress of unlisted banks in Kenya. The study used multiple regression analysis to examine effect of risk analysis, information and communication;monitoring and evaluation on financial distress of unlisted banks in Kenya. Table 4.7 shows the results.

Table 4. 7: Correlation Analysis Results

		Financial Distress	**Information**
Financial Distress	Pearson Correlation	1	
	Sig. (2-Tailed)	0.000	
Information &Communication	Pearson Correlation	0.693**	1
	Sig. (2-Tailed)		

** Correlation is significant at 0.01 level (2 tailed).

The study conducted inferential analysis using Pearson's product moment correlation, coefficient and regression analysis. Correlation is a statistical technique which shows how variables are related. According to Orodho (2013), correlation coefficient ranges from-1.0 to +1.0. The value of -1.0 implies a perfect negative correlation, the correlation coefficient value of +0.001 to +1.0 shows a perfect positive correlation and a correlation coefficient value of 0.0 indicates that there is no relationship between the study variables.

The relationship between information and communication and financial distress of unlisted banks in Kenya was analyzed and findings shown in Table 4.7 implies that information and communication had a positive relationship with financial distress. This could have been a result of leaked information of the banks strength to the competitors who outwit them in operations. This indicates that changes in information and communication causes positive changes in financial distress of unlisted banks.This concurred with the study by *Damien*

*(2014),*analyzed banks' communication policies in crisis times and the role of imperfect information in enhancing bank financial distress in Romania. The study emphasized on the impact of a manager's communication policy on the financial distress of the bank and showed that information and communication with certainty can contribute to financial distress.This is contrary to the study on information and communication technology and bank distress by Akujuobi (2009). In this study, it was found that the introduction of information and communication impacted strongly on the bank performance as they noted great operational efficiencies.

Regression Analysis for the Model

The study looked at the combined effect of risk assessment, information and communication; Monitoring and evaluation on financial distress of unlisted banks. Table 4.8 illustrates the results of the multiple regression analysis.

Table 4.8Multiple Regression Model Summarized.

Model	R	R Square R^2	Adjusted R Square	Std Error of the Estimate	Durbin Watson
1	0. 927[a]	0.860	0.841	0.04863	1.938

Predictors: information and communication
Dependent Variable: Financial Distress on unlisted banks.

The findings in Table 4.8 show that the degree of the value of coefficient of correlation R was 0.927[a] indicating there was a positive relationship between internal controls and financial distress. The coefficient determinant (R^2 = 0.860). The findings imply that 86.0% of the variation in financial distress is accounted for by three variables in the study. 14.0% is accounted for by other factors outside the study. R^2 adjusted value of 0.841 is slightly lower than R^2 0.860 is an indicator of the relationship between the independent variables and dependent variable. Std error value when the model is used to predict financial distress was 0.04863.

Assessing the Fit of Multiple Regression Model

The study sought to determine whether the multiple regression model was fit for the data.Analysis of variance (ANOVA) was used to establish if financial distress of unlisted banks can be predicted without including internal control system being examined in the study. Table 4.9 illustrates the results.

Table 4.9: ANOVA Test Results

Model	Sum of Squares	Df	Mean Square	F	Sig
Regression	0.320	3	0.107	45.125	0.000[b]
Residual	0.052	22	0.002		
Total	0.372	25			

Predictors: information and communication

Dependent Variable: Financial Distress on unlisted banks.

The results in Table 4.9indicate that the significant value is 0.000 which is less than 0.05 thus the model is statistically significant in predicting risk assessment, information and communication; monitoring and evaluation. The values (F=45.125; P value 0.000<0.05). The findings imply that the multiple regression model was fit for the data and therefore

risk assessment, information and communication; monitoring and evaluation affects financial distress of unlisted banks significantly.

Regression Coefficients

The study conducted a t-test of statistical significance of each regression coefficient. The Beta values indicate how strongly the independent variables affect the dependent variable. Table 4.10 shows the results.

Table 4.10: Regression Coefficient Analysis

		Unstandardized Coefficients	Standardized Coefficients	t	Sig
Model	**B**	**Std Error**	**Beta**		
Constant	0.070	0.047		1.479	0.053
Information&Comm.	0.318	0.143	0.340	2.231	0.036

Dependent variable: Financial Distress of unlisted Banks.

The results in table 4.10show that information and communication had a positive significant effect on financial distress of unlisted banks (β= 0.318;p< 0.05).

The multiple regression equation for internal control systems is shown below:

$Y=0.070 + 0.318X_2 +$ ……...……Equation 4.1

Theconstant term implies that at zero, information and communication and financial distress is 0.070 units. The data findings analyzed show that all the independent variable at zero, a unit increase in information and communication causes a change of 0.318 units infinancial distress.

Hypothesis Testing

The results obtained in table 4.10show that the Hypothesis was tested at a predictable significant level of 0.05. The aim of testing was to either accept or reject the null hypotheses.

There isno Significant Effect of Information and Communication on Financial Distress of Unlisted Banks in Kenya

The null hypothesis stated that there is no significant effect of information and communication on financial distress of unlisted banks in Kenya. The results showed that information and communication have a positive and significant effect on the financial distress of the unlisted banks in Kenya (β= 0.318, p< 0.05). The (H_{02}) null hypothesis was rejected indicating that information and communication has a positive and significant effect on financial distress of unlisted banks in Kenya. The beta factor of 0.318 shows that information and communication affect financial distress of unlisted banks by 31.8%. The p value of 0.036 < 0.05(predictable value) shows that information and communication had a positive and significant effect on the financial distress of unlisted banks in Kenya. This implies thatinternal information out with the competitors may result in the competitors using the same information to outsmart the bank.

This study concurs with the study by *Damien (2014)*analyzed banks' communication policies in crisis times and the role of imperfect information in enhancing bank financial distress in Romania. The study emphasized on the impact of a manager's communication policy on the financial distress of the bank and showed that uncertainty can contribute to improving social welfare of banks. The findings are contrary to the findings of Mwangi (2012) in his study on effect of information technology on financial distress of commercial banks in Kenya. The findings of the study were that information and communication enormously improved the banking industry causing the banks to remain quite competitive.

Information and communication technology resulted in high operational efficiencies and increased bank liquidity levelsand reduced on financial distress.

Summary, Conclusions and Recommendations

Summary of the Study Findings

This section contains the summary of the study as per the specific objectives of the study. It is based on the results of the descriptive and inferential statistics analysis. The target population of the study wascomposed of Bank Managers, Credit Officers and Risk Managers.

The objective of the study was to establish the effect of information and communication on financial distress of unlisted banks in Kenya. The study findings are that information and communication has a positive and significant effect on financial distress of the unlisted banks. It also revealed that transparency and disclosure of timely information and subsequent communication with the customers is detrimental to the bank as it causes increased financial distress.

Conclusions

The following conclusions were made in line with study objectives. The study concluded that information and communication cause financial distress of unlisted banks in Kenya to increase. Enhanced information and communication increase financial distress of the unlisted banks in Kenya.

Recommendations

The study provides vital recommendationsfor policy and practice in line with the findings of the study.

Recommendations for Policy and Practice

The study provides understandings on the effect of information and communication on financial distress of unlisted banks. The study will be useful to the government and policy makers in enabling them make policies governing banking industry that will effectively deter financial distress in unlisted banks. The study will provide literature that will serve as source of reference material for future scholars in conducting further studies on financial distress of banks.

Recommendations for Theories

The recommendations in regard to practical application of the theories on which the study was anchored, agency theory stipulates that a firm consists of contracts between the owners of economic resources (the principals) and managers (the agents) who are charged with using and controlling the resources.The theory describes firms as necessary structures to maintain contracts and exercise control which minimizes conflict between principal and agent. The study did not uphold the prescriptions of agency that in order to harmonize the interests of the agent and the principal, an all-inclusive contract is written to address their interests and curb imprudent behavior. Monitoring and evaluation is key in the study and the stewardship theory suggests that individuals put motives of the firms ahead of their own interests. The study will alsoboost the existing literature on internal control system and financial distress of unlisted banks.

Suggestions for Further Studies

The study sought to assess the effect of information and communication on financial distress of unlisted banks in Kenya. The study recommends that future research be undertaken to establish the effect of separation of duties, physical audits, periodic reconciliations and approval authority on financial distress of unlisted banks in Kenya.Further research needs to be carried out to establish the other external factors that contribute immensely to financial distress as the study only narrowed to risk assessment, information and communication; monitoring and evaluation as internal controls.

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