

Increased Foreign Commercial Banks and Performance of Domestic Commercial Banks in Uganda

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This paper focuses on the effect of increased foreign commercial banks on performance of domestic commercial banks in Uganda over the period 2000-2011.

Descriptive statistics were used to analyze banks' performance trends over the period of twelve years, divided into two periods: 2000 to 2006 being; pre- increased period of foreign commercial banks while 2007 to 2011 being increased foreign commercial banks periods. The study found that, increased foreign commercial banks had a positive effect on deposits mobilization; liquidity position; Interest income and Non-interest income; technical know-how, which included among others, risk management and eventually improvement in profits of domestic commercial banks.

Policy implications emerged is that foreign commercial banks are major players in commercial banking sector development, therefore, monetary policy makers and regulatory authorities should attract many foreign commercial banks to join Uganda's commercial banking sector.

Field: Banking

1. Introduction

1.1 Background

In the early 1990s, Uganda embarked on financial reforms focusing on liberalization and strengthening prudential regulations. Following liberalization and lifting of moratorium on new commercial banks in July 2007, several new foreign commercial banks were licensed and continued to out-number domestic commercial banks.

Foreign commercial banks have expanded their branch networks through acquiring former domestic commercial bank branches; for example, Standard Chartered bank acquired some branches of cooperative bank Ltd; Gold Trust Bank was taken over by DFCU, Uganda Commercial Bank taken over by Stanbic bank; Sembule Investment Bank taken over by Allied Bank Uganda Ltd and thereafter by Bank of Africa and finally, Nile bank was taken over by Barclays bank. The observation suggests that possibly; increased foreign commercial banks presence have some effects on the performance of domestic commercial banks in Uganda which needed to be investigated. The trend of foreign commercial banks in Uganda reflects perpetual increase and dominance of the commercial banking sector in Uganda. From 2000 to 2007; the number of commercial

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banks in Uganda was stable, with an average of fourteen banks. Out of these, 64% were foreign-owned. From 2008 to 2011, there was an increase in foreign banks participation to the tune of 83% of the existed banks.

On the other hand, the number of domestic banks decreased from five to four in the period; 2000 to 2002, the period during which Uganda Commercial Bank was fully privatized. The number of domestic banks; (four) remained constant up to 2006. In 2007 there were only three domestic banks; this was the time when Nile bank was fully acquired by Barclays bank. However the number of domestic banks rose again to four in 2008, up to 2011. On average the number of domestic banks was four throughout the twelve years (2000 to 2011); while the number of foreign commercial banks continued to increase up to nineteen in 2011. As at 31st December, 2011, Uganda had twenty three (23) Licensed Commercial Banks with 455 branches. Out of the licensed banks, about 83% of operating commercial banks were foreign owned.

Out of the 455 branches country wide, domestic banks owned only 87, accounting for only 19% of the total branch networks. One of the assumptions put forward by several scholars to explain the cause of increased foreign commercial bank participation, is that foreign banks bring in capital inflows and enhance financial stability among host commercial banks. In addition foreign commercial banks bring in technical know-how, which foster the implementation of best practices of domestic banking systems (Naaborg, 2007).

The overall aim of the study, therefore, is to establish the effect of increased foreign commercial banks on the performance of Domestic commercial banks in Uganda.

1.2 Statement of the Problem

The market share of domestic commercial banks is extremely low; accounting for only 11% of the total commercial banks markets assets while foreign commercial banks account for 89 % of the market share. The increased foreign commercial banks in Africa, has forced clients to leave domestic banks to foreign banks (Aburime, 2008), leading to performance differences between domestic and foreign banks. Kiyota, (2009) also observed that foreign commercial banks in Africa registered improved profits and cost efficiency relative to domestic banks. Studies of Bategeka & Okumu, (2010) in Uganda indicated that foreign commercial banks charge lower interest rates for their services to prime clients compared to domestic commercial banks. On the other hand, bank of Uganda indicated that foreign liabilities for domestic commercial banks were increasing (Bank of Uganda, 2011). In 2010, domestic commercial banks had lower non- interest income; 21.5 billion on average, compared to 32.9 billion for foreign commercial banks. By the end 2011, return on equity (ROE) for domestic commercial banks on average was 23.7%, while, foreign commercial banks had 18.4%. The poor performance of domestic commercial banks relative to foreign commercial banks in Uganda needed to be investigated.

1.3 Objectives of the study

The general objective of the study is to establish the effect of increased foreign commercial banks on performance of domestic commercial banks in Uganda.

This is guided by the following specific objectives:

- (i) To establish the effects of increased foreign commercial bank on the performance of Domestic Commercial banks in Uganda
- (ii) To establish the effect of increased foreign bank on the financial stability of Domestic Commercial banks in Uganda

1.4 Research Hypothesis

The study is based on the following key research hypothesis:

Key Hypothesis

H₀: Increased foreign commercial banks do not affect performance of domestic commercial Bank in Uganda

H₁: Increased foreign commercial banks affect performance of domestic commercial Banks in Uganda

The hypothesis represents the literature that explains that foreign commercial banks' affect the performance of domestic banks (Hermes and Lensink, 2004).

1.5 Significance of the Study

Investigations on the effect of increased foreign commercial banks on the performance of domestic commercial banks and the banking sector is paramount, given the recent liberalization of the commercial banking sector.

Consequently, the study provides insight to bank owners and policy makers on sustainable competitiveness of banking operations, thus acting as a framework for policy makers in Government and other agencies that intend to operate commercial banks in Uganda.

1.6 Scope of the Study

The study investigated on the effect of increased foreign commercial banks on the performance of domestic commercial banks in Uganda. It also focused on stability of domestic commercial banks, relative to increased foreign commercial banks.

The time scope for the study is 2000-2011; the period during which commercial banking sector in Uganda underwent significant restructuring, including; implementation of Electronic clearing system (ECS), full compliance with the statutory minimum capital requirement of shillings 4.0 billion in 2002 and thereafter, a current financial Institution Instrument N0.43, revising the minimum capital requirement to 25 billion.

Within the period; 2000-2011, Uganda's financial institution legislation were updated to international best practices as set out in the Basle core principles was in force. In the same period, Bank of Uganda launched risk-based supervision in line with Basle core principles for effective supervision (Bank of Uganda, 2002). From December, 2002 onwards, all commercial banks' financial year-ends coincided with the calendar year end (Bank of Uganda, 2002). Consequently, the trend of events, made the period suitable for a comparative study.

1.7 Organization of the study

The study used five-section format to achieve its objectives. Section one provides the background of the study, putting it in a unique position within the context of active literature on bank performance. The rest of section one explains the statement of the problem, objectives, significance and the guiding hypotheses of the study.

The rest of the paper is organized as follows; Section two reviews literature on the effects of increased foreign commercial banks on the performance of domestic commercial banks.

Section three presents methodology that describing and explaining the methodological approach used in the study.

Section four presents the effects of foreign commercial banks on the performance of domestic commercial banks in Uganda, followed by section five that provides a summary of the findings, conclusions, suggestions and a way forward for policy implications and future studies.

2. Literature Reviews

Several studies have focused on the effect of foreign banks entry on the performance of domestic commercial banks but the results differ from one country to another. Studies of Barajas, Steiner and Salazar (1999), focused on foreign banks entry in Colombia. The results indicated that foreign banks had a positive contribution to domestic banks that improved bank behaviour by enhancing operative efficiency and competition. Studies of Fernando de Paula and Jose' (2006) in Argentina and Brazil indicated that foreign banks entry in the two countries had no effective contribution to the improvement of macroeconomic efficiency of financial systems.

However, Denizer, (1999), analyzed the 'effects of foreign banks entry in Turkey. The results indicated that foreign banks had a positive effect on Turkish banking sector (TBS) capital structure and did not cause any decline in loans, although worsened TBS' liquidity position. On the other hand, other studies focused on regions such as; Laeven, (1999) on Asia, Crystal, Dages and Goldberg, (2001) focused on Latin America, while studies of Uiboupin (2005) were based on Central and Eastern European (CEE) countries. The results indicated that foreign banks entry affected negatively domestic

bank's revenue from interest –earning assets, non-interest income and profitability, on top of increasing competition. However, to the best of my Knowledge, earlier Ugandan studies have not reported on the effects of increased foreign commercial banks on the performance of domestic Commercial banks in Uganda during the period 2000-2011. Consequently this study adds new knowledge to the existing literature.

Supporters of foreign bank entry in developing and transition counties, argue that foreign banks bring in capital, technical skills and new products paving way for competition and ultimate improved efficiency of domestic banks (Cull, Soledad and Peria, 2010). World Bank's policies encourage competition on assumption that it tends to force banks to reduce operating costs resulting in increased profits (Demirgiic Kunt and Levine, 2008)

Gormley (2007) argued that foreign banks bring in technological and financial innovations which domestic banks can adopt to improve their operations. Kalluru and Bhat (2009) concurred with Gormley, that foreign banks may lead to development, improvement in supervision and legal framework of domestic banking sector, since foreign banks may demand regulations similar to their parent countries.

On the other hand, the critics of foreign banks entry argue that, foreign banks can destabilize the domestic banks by importing shocks from their home countries, bringing in fiancé competitions, threatening the survival of domestic banks and finally leading to reduced access to finance by domestic consumers (Cull et al, 2010).

Clarke et al. (2006) found that foreign banks in South American countries; in Chile, Argentina, and Peru were not extending credit to indigenous SMEs during 1990s, thus affecting the country's economic growth. In the study of Malaysian banking sector Detragiache and Gupta (2006) found out that foreign banks' presence affected the return on assets of domestic banks in the late 1990s. The implication is that foreign commercial banks entry causes 'cream-skimming', whereby, hard information borrowers are no longer pooled with other borrowers, where, domestic banks are left with riskier loan portfolio, thus poor performance.

Consistent with Detragiache and Gupta (2006), Denizer et al. (2007) studies concluded that foreign banks resulted into competition with domestic banks that led to reduction in return on assets and increased operating costs. In the investigations of effects foreign banks in Turkey, the results indicated that; net interest margin; return on assets of domestic banks reduced while their overhead expenses increased as a result of foreign banks presence which spurred competition.

In a study conducted in India by Kalluru and Bhat (2009), for the period 1996-2007, was concluded that foreign banks' presence resulted into a reduction of interest income, increased operational expenses and increased nonperforming assets of domestic banks. Similarly, Kalluru and Bhat (2009) observed that, foreign banks 'cheery picked' the blue-chipped businesses and left unworthy credit firms to domestic banks which

might have led to their poor performance.

It is widely believed that allowing foreign bank entry as part of the liberalization process enhances efficiency of the banking system in general (Litan, Masson and Pomerleano, 2001). This is in line with Demirgüç-Kunt et al. (1998) studies, which found out that foreign bank entry tends to spur competition and make national banking markets more efficient. Explaining that foreign bank entry forces domestic banks to eliminate excess overhead costs and accept lower profits. Nonetheless, this is questionable, because the better performance of foreign banks may be increasing the average performance of the whole banking system and not the performance of domestic banks only. Thus this study investigates the effect of foreign commercial banks on performance of domestic commercial banks in Uganda.

Dages et al (2000) examined the lending patterns of domestic and foreign banks; their findings indicated that foreign banks typically had stronger and less volatile lending growth than domestic banks. Studies of Cardenas et al (2003) in emerging economies confirmed that foreign banks presence is a source of stability during crisis although can foster contagion. Such contradictions need to be investigated from Ugandan perspective.

Foreign banks' presence has been connected to lower net interest margins, profitability, cost ratios, and non- interest income for domestic banks in developing countries (Claessens et al. 2000, 2001; Claessens and Lee, 2003; Bayraktar and Wong, 2004). Claessens and Lee, (2002) found out that foreign banks introduced improved risk management practices and imported supervision from their parent country regulators thereby helping to strengthen banking systems in the host country. In contrast, the increased competition may lower the franchise value of domestic banks and lead to financial instability.

Studies of Claessens et al (2001) in developing countries confirmed that an increase in the presence of foreign banks leads to a reduction in profitability and interest margins of domestic banks. Foreign bank presence has been directly linked to greater competitions in the host country's banking sector. Claessens & Laeven, (2003), Gelos and Roldos, (2004); argued that competition from foreign banks conceivably compel domestic banks to pursue new markets niches. At the same time, some policy makers have often accused foreign banks of cherry picking best borrowers (Dell'Ariccia and Marquez, 2004) and Sengupta, 2007)

Bonin and Abel (2000) studies suggested that foreign banks are double edged; they can improve bank stability and at the same time threaten the market position of domestic banks. However, Caprio & Honahan (2000), Goldberg et al (2000), indicated that there is a positive correlation between foreign banks and stability of the banking system, a matter being investigated by this study

Crystal et al (2002) analyzed the difference in stability between domestic and foreign

banks in Latin America countries from 1995 to 2000. The results indicated that foreign banks tended to have more robust credit growth and greater asset liquidity than domestic banks leading to the stable credit growth.

Uiboupin (2005) suggest that foreign banks can provide a more stable source of credit because the branches and subsidiaries of large international banks can draw on their parents. Explaining further that large international banks are likely to have better access to global financial markets and the entry of foreign banks can thus improve the overall stability of the host country's banking system

Unit and Sullivan (2003) analyzed credit portfolio quality of Philippine's domestic banks and found that the loan loss provisions of domestic banks increased with foreign banks entry. The explanation given was that foreign banks attracted more creditworthy customers with better loan conditions and lower interest rates, confirming the theory of cream-skimming.

Dell'Araccia and Marquez (2004) argued that foreign banks have advantages in targeting more transparent new clients (based on transaction lending), whereas domestic banks are better placed to lending to clients based on soft information (lending relationships). Sengupta (2007) specified that, with a sufficient cost-advantage for foreign banks, incumbent banks retained more risky borrowers while the foreign banks tended to lend more to large transparent firms, thus supporting the theory of cream-skimming.

Evidence from the studies of Jenkins (2000) show that, 44% of the managers of 220 banks in 60 countries indicated that their banks began to lend to small businesses because of competition in lending to large and medium -sized businesses exerted by foreign banks. However, Cull et al, 2010, indicated that the effect of foreign banks presence on lending to Small-medium enterprises (SMEs) and overall credit levels could be positive or negative and differ across countries, thus the need to investigate the effects of foreign bank presence in Ugandan perspective.

Evidence from individual countries in Eastern Europe and central Asia also indicated that there was increased competition as a result of foreign banks entry. In Hungary, Kiraly, et al., 2000 found that foreign banks were more cost efficient than domestic banks. Hasan and Marton (2003) found out that in Hungary, relatively more efficient foreign banks created an environment that forced the entire banking system to be more efficient.

In Poland, foreign banks were found to be cost efficient than domestic banks, except those banks that had a high share of foreign customers (Nikiel and Opiela, 2002). All the results from Poland suggested that foreign banks' entry contributed to increased competitiveness, though in specific market niches (Cull, et al, 2010). However, earlier on Zajc (2004) analyzed the effect of foreign banks' entry on domestic banks in Czech Republic Estonia, Hungary, Poland Slovakia and Slovenia for 1995-2000, the results suggest that foreign banks' entry was associated with lower non-interest income and

increased overhead expenses. Likewise, Weller (1999-2000) found that foreign banks' entry led to reduced supply of credit by Polish domestic banks, explaining that it was purposely done in order to reduce risk exposure. These conflicting results from different countries need further investigation from a different perspective like Uganda.

Micco, Panizza, and Yanez, (2004), tested the relationship between domestic and foreign banks' entry in several regions that is: East Asia, Eastern Europe, the Middle East and North Africa, Latin America and South Asia. The results showed that there was a positive correlation between the performance of domestic banks and foreign banks' presence in Latin America & South Asia, and thus confirmed the previous studies of Claessens, Demirgüç-Kunt and Huizinga (2001) and Levy-Yeyati Micco, (2003). The explanations given for the results was that, foreign banks entry led to an increase in efficiency of domestic banking system, which in turn leads to a situation characterized by competitiveness, lower overheads costs and interest margins but this did not mean increased profitability of domestic banks. However, the results suggested that foreign bank entry is a healthy phenomenon that may increase bank efficiency. The results further suggest that foreign investors bring in capital and the "know-how" which foster the implementation of best practices of domestic banking systems. The reasoning is in line with Mathieson and Roldos (2001) who emphasized that foreign banks were more experienced in the use of derivative products and therefore likely to improve the quality, pricing and availability of financial services.

Levy-Yeyati & Micco, (2003), in their studies, "Banking Competition in Latin America", indicated that, foreign bank entry had a positive impact on bank profitability. On the other hand studies of Kirkpatrick et al. (2007) indicated that an increase in the degree of foreign banks penetration was associated with a reduction in profit and cost x-inefficiency of domestic banks. However their analysis included all commercial banks without separating domestic and foreign banks. Consequently a true picture on the effect of foreign banks on domestic banks' performance could not be established

In regional studies carried out in Latin America and Eastern Europe the results were ambiguous. For example, Martinez and Mody (2004) analyzed domestic and foreign bank interest rate spreads in Argentina, Chile, Colombia, Mexico and Peru. They found out that foreign banks were able to have lower interest margins relative to domestic banks, which led to lowering the interest margins in the whole banking system. This was consistent with Clark et al, 2000 who found out that, the presence of foreign banks through the mid-1990s was linked to lower interest margins, overhead costs, and profitability of domestic banks in Argentina. Likewise, in Colombia, foreign banks presence was linked to declining non-financial costs for domestic banks (Barajas, et al., 2000).

Levy-Yeyati and Micco, (2007), in their studies in Argentina, Chile, Colombia, Mexico and Peru, along with Costa Rica, and El Salvador also concluded that foreign banks presence weakened bank competition. Similarly, studies of Claeys and Hainz (2007) indicated that foreign banks presence had a negative impact on bank interest rates,

stating that on average, foreign banks tend to charge lower lending rates than domestic banks. Consequently domestic bank tend to follow the same trend.

Cull, et al, (2010) reviewed the results in Latin America and Eastern Europe as supporting the hypothesis that foreign bank presence improved competition in terms of cost reduction. On the other hand, the evidence from Asia was less supportive of the hypothesis that foreign banks help to improve competition in domestic systems. For example, in India, foreign banks were found to be less cost effective and productive, than domestic banks (Sensarma, 2006), therefore could not foster improved competition.

In China, the few foreign banks had lower profits than domestic banks from 1996 to 2004, (Wu, Chen and Lin, 2007), concluding that majority of foreign banks did not affect the operational performance of domestic Chinese banks. However, recent studies, indicate that Chinese banks that signed cooperation agreements with foreign strategic investors, reduced their non-performing loans (NPLs) ratios and increased their ratio of reserves to NPLs (Berger, Hasan, and Zhu, 2009), a sign of improved performance and competition.

In Korea, foreign bank entry was associated with lower cost ratios for domestic banks, although only among larger banks with wide national branch networks (Lee, 2003). The increased presence of foreign banks in Philippines was also associated with improvements in efficiency and competitiveness of domestic banks, whereas the profits of banks associated with business groups declined and their efficiency did not improve (Unite and Sullivan, 2002).A situation which need to be investigated in Uganda.

In Thailand, foreign banks' presence is associated with reduction in net interest margins, personnel expenses and return on assets for domestic banks, together with improvements in efficiency of acquired banks by foreign banks (Herberholz, 2008).This could be true but empirical evidence is also required for the case of Uganda.

The study of Naaborg, (2007), concluded that foreign banks' entry leads to improvements in bank regulations and supervision, because foreign banks demand improved systems of regulations and supervision in recipient countries, similar to their mother countries. These findings are supplemented by Kobeissi and Sun, (2010) analysis of the impact of ownership structure on bank performance in 17 MENA countries. The results indicated that the presence of foreign banks had a positive impact on the performance of local banks, consistent with Claeys and Hainz (2007) whose results suggest that the foreign bank presence has a negative impact on bank interest rates in ten Eastern European countries.

However, foreign banks may cause domestic banking sector stability or instability. Early cross-country studies, had evidence that greater foreign bank presence was associated with lower probability of systemic banking crisis, in host countries (Demirgiic-Kunt et al, 1998). In Argentina and Mexico, foreign banks had higher growth rates and lower volatility of lending than domestic banks during the crises of the mid to late 1990s

(Dages, et al., 2000). Goldberg et al. (2000) suggest that foreign banks' presence increases credit growth at lower volatility. Cardenas et al. (2003) concluded that foreign banks can be a substantial source of credit stability during crisis. Mullineux and Murinde (2003) argued that, although 'financial globalization' may benefit the world economy, it can also be a source of instability thus prompting the researcher to carry out this study in Uganda

Nevertheless other authors argue that foreign banks were not a major stabilizing force. In Korea, foreign banks reduced their lending during crisis while domestic banks did not (Jeon et al., 2006). This might be true but the reason could be that, foreign banks did not constitute a large share of banking assets in this country; therefore the effect could not be felt.

Giannetti and Ongena, (2009b), carried out a study in 13 countries in Eastern Europe from 2000 to 2005. The results showed that lending relationship for foreign banks and bank clients tended to be more stable than that of domestic banks, thus forcing the domestic banks to change their lending policies too, by improving access to credit for all. In that sense, foreign banks are seen as a stabilizing force, although these effects are more pronounced in middle and high income countries than low-income countries (Cull et al., 2010).

There are cases, where foreign bank presence may have negative effects on the performance of domestic commercial banks in the host country. In Japan, from 1989 to 1996, the Japanese banking crisis negatively affected the supply of real estate loans in United States (US), as a result of Japanese's banks in US (Peek and Rosengren (2000a). Similarly, a study on emerging economies from banks in the world's largest markets from 1992 to 2007 indicates that negative shocks to the financial health of those banks coincided with slowdowns in the growth of credit from domestic banks (McGuire and Tarashev, 2008). This indicates that foreign banks presence have mechanisms of transmitting problems to domestic banks in host countries and therefore their presence needs further studies in Uganda.

Foreign banks' presence take away top customers of domestic banks, thus undermining their financial health, this kind of competition could destabilize some domestic banks in the host country and ultimately, go out of the business (Cull et al., 2010). This phenomenon could be the case in Uganda where, nine commercial banks were declared insolvent and later closed or taken over (mostly domestic banks), therefore, the effect of foreign commercial banks in Uganda should be investigated.

It is also argued that domestic banks that assess creditworthiness of clients on soft information, could be worse off ,if foreign banks presence out compete them and take away clients who would have secured loans on soft information much as they (clients) can provide hard information (Detragiache et al,2008).

Micco et al (2004), tested the relationship between domestic and foreign bank entry in

several regions in East Asia, Eastern Europe, the Middle East and North Africa, the results showed a negative correlation between foreign banks presence and domestic bank's profitability.

Kiyota (2011), in his study of profit efficiency of commercial banks in sub Saharan Africa, found that the trend of mean profit efficiency of domestic banks depended on the movement of average profit efficiency of foreign banks .Implying that the higher profit efficiency of foreign banks contributed to the improvement of profit efficiency of domestic banks. In the same study, the results suggested that countries with more than 70% assets in hands of foreign banks tend to have competitive domestic banks in terms of performance relative to foreign commercial banks.

In general, the effects of foreign commercial banks presence on performance of domestic commercial banks is relative , depending of the micro and macro economic conditions of the country, therefore, there is a need to carry out further studies and investigations on specific countries. Consequently, this study focus on Uganda's' commercial banking sector.

3. Methodology

The section presents detailed description and explanation of selected methods, used to achieve the study objectives. It also includes methodological approaches developed from the study objectives and describes the study population. The section further presents the methods used to test validity and reliability of research instruments and finally provides a detailed metaphors and rationalization of Ethical considerations of the study process.

3.1 Methodological approach

Descriptive statistics were used to analyze banks' performance trends over the period of twelve years, divided into two periods: 2000 to 2006 being; pre- increased period of foreign commercial banks while 2007 to 2011 being increased foreign commercial banks periods.

Descriptive statistics included calculation of averages and standard deviation of a variety of bank variables, in their respective categories; Domestic and foreign commercial banks were combined. Standard deviation was used to ascertain financial stability of both domestic and foreign commercial banks

Inferential statistics was used to test the following hypothesis;

Hypothesis: H1

H₀: Increased foreign commercial banks do not affect performance of domestic commercial Bank in Uganda

H₁. Increased foreign commercial banks affect performance of domestic commercial Banks in Uganda

A comparative descriptive statistical analysis was used to analyze the effect of increased foreign commercial banks. The differences in performance between domestic and foreign Commercial banks in Uganda were examined by the use of descriptive statistics. The comparison was based on the calculation of means of bank performance indicators of domestic and foreign commercial banks. The differences in means were tested to verify performance differences of domestic commercial banks relative to increased foreign banks; (2000-2006 and 2007 -2011).

Testing the difference between means was based on the following Hypothesis:

Hypothesis: H2

H₀: Domestic commercial banks' profits after tax were equal to each other during pre and increased foreign banks

H₁: Domestic commercial banks' profits after tax were not equal to each other during pre and increased foreign banks

Hypothesis: H3

H₀: Domestic commercial banks' Net interest income was equal to each other during pre and increased foreign banks

H₁: Domestic commercial banks' Net interest income was not equal to each other during pre and increased foreign banks

To establish the effect of increased foreign banks on quality of domestic commercial banks' liquidity position, the following Hypotheses were tested.

Hypothesis: H4

H₀: Increased foreign commercial banks do not affect the supply of credit of domestic commercial Banks in Uganda

H₁. Increased foreign commercial banks affects affect the supply of credit of domestic commercial Banks in Uganda

Hypothesis: H5

H₀: Domestic commercial Banks do not have high loan loss provisions due to increased foreign commercial banks in Uganda

H₁. Domestic commercial Banks have high loan loss provisions due to increased foreign commercial banks in Uganda

Hypothesis: H6

H₀: Domestic commercial Banks do not have high operational costs relative to increased foreign commercial banks in Uganda

H₁. Domestic commercial Banks have high operational costs relative to increased foreign

commercial banks in Uganda.

3.2 Study Population

The study population included all licensed commercial banks (23) in Uganda as at 31 December 2011. For a comprehensive analysis, commercial banks were grouped into two; 4 domestic and 19 foreign commercial banks. The categorization of Commercial banks into ownership type was crucial in analyzing the effects of increased foreign commercial bank on the performance of domestic commercial banks in Uganda.

4. Empirical Results

This section describes the performance of domestic commercial banks relative to increased foreign commercial banks in Uganda, during Pre and increased foreign commercial banks entry period.

Prior to increased foreign bank participation: 2000-2006, each Ugandan domestic bank had on average deposits worth 74.4 billion shillings, with a standard deviation of 34.7. The standard deviation of 34.7 indicates low volatility during the period.

However, during increased foreign banks period of; 2007-2011, the average deposits for each domestic commercial bank increased to 274.6 billion, with a standard deviation of 84. The high figure of standard deviation suggests high instability in deposits. The results suggest that foreign banks had an effect on the deposits of domestic commercial banks, although over the period of twelve years, deposits for each domestic commercial bank settled on an average of 157.8 billion, and a standard deviation of 115.8. However, the growth rate of deposits for 2000-2006 periods was higher; at 32% with a standard deviation of 18 compared to 2007-2011 period, which was 26% and standard deviation of 15.5, during increased foreign commercial banks. The lower standard deviation (15.5) indicated that, deposits had stabilized although; the average Deposits growth rate was 29.2%, for twelve years.

The increased deposits suggest that; domestic commercial banks relied more on deposits as their major source of funding and this affected domestic commercial banks' performance, much as it was a sign of confidence and stability developed in domestic commercial banks. This phenomenon happened after the presence of increased foreign banks in Uganda, concurring with Cull et al 2010, who argued that foreign banks presence improves the efficiency of domestic banks.

Before increased foreign commercial banks' presence, domestic commercial banks in Uganda on average, had 14.5 billion as equity capital with a standard deviation of 7.2, however, after the increase of foreign banks in 2007-2011, the average increased to 74.4 billion with a standard deviation of 25.5. The average growth rate of equity capital was 34%. The results suggest that foreign commercial banks brought in capital which forced domestic commercial banks to raise their equity capital. This is in line with the study of

Cull et al 2010, who indicated that foreign commercial banks bring in capital that contribute to performance differences between domestic and foreign commercial banks.

Domestic commercial banks' 'other liabilities' was at an average of 5.5 billion during pre-increased period of foreign banks with a standard deviation of 1.76. The results suggest that liabilities as a source of capital was not fully utilized and thus contributed to performance differences between domestic and foreign commercial banks.

However, during the increased period of foreign commercial banks in 2007-2011, domestic commercial banks' liabilities increased to 41.6 billion with a standard deviation of 26.5. This concurred with Kiyota (2009) who indicated that, there was a declining trend of average profits of domestic banks, while their foreign liabilities were increasing (Bank of Uganda, 2011).

The change in capital structure caused differences in performance suggesting that domestic commercial banks had appropriate financial leverage management during increased foreign banks presence.

Table 1 shows the average liabilities of domestic commercial banks during pre and increased foreign commercial banks' presence.

Table 1: Domestic commercial banks' Liabilities (averages) in billions shillings

Variable	Pre-foreign banks increase 2000-2006		Foreign banks Increase 2007-2011		Over all	
	Mean	SD	Mean	SD	Mean	SD
Deposits	74.4	35	274.6	84.5	157.8	115.8
Equity	14.4	7.2	74.4	25.5	39.5	87.5
Other liabilities	5.5	1.76	41.6	26.5	20.5	24.7

Source: Researchers' computation using various published commercial banks' final accounts 2012

Prior to increased foreign commercial banks; 2000-2006, each Ugandan domestic bank had on average a cash balance with bank of Uganda equal to 10.6 billion shillings with a standard deviation of 4. However, during the increased foreign banks' presence; 2007-2011, the average cash balance with BOU for domestic commercial bank increased to 39.5 billion with a standard deviation of 13.6, contributing to performance differences.

Similarly, domestic commercial banks had more cash balances with other institutions other than Bank of Uganda as shown in table 2. The results suggest that domestic commercial banks were investing in 'receivables', which is a sign of improvement in liquidity of domestic commercial banks, thus leading to performance differences.

Domestic commercial banks had an average of 40.9 billion as Loans /advances with a standard deviation of 25.5 proceeding to increased foreign commercial banks presence. However, during the increased foreign commercial banks, the average credit supply

increased to 216 billion with a lower standard deviation of 8.5. The results suggest that the increased competition from foreign commercial banks forced domestic commercial banks to increase loans and advances given to clients thus increasing interest income.

Likewise, during the increased foreign commercial banks presence in 2007-2011, there was great improvement in investments from 26 billion to 76 billion (table 2). The results suggests that foreign commercial banks brought in 'know-how' that forced domestic commercial banks to be innovative and diversify their products to increase non- interest income. This was a sign of proper risk management that led to performance differences. This was in line with Gelos and Roldos (2004) who indicated that, foreign commercial banks compel domestic commercial banks to pursue new markets.

Before increase in foreign commercial banks, domestic commercial banks' Non-current assets were growing at 31.6% per year, with a high standard deviation of 53.5, however, during increased foreign commercial banks' presence the growth rate of Non-current assets reduced to 17.8% and a standard deviation of 26.8. Non-current assets increased from 4.7 to an average 10 billion during increased foreign commercial banks. This empirical evidence suggests that there was spill over of proper management of Non-current assets from foreign commercial banks which forced domestic commercial banks to improve on overhead costs management, thus leading to performance differences.

Table 2: Domestic commercial banks' Assets (averages) in billions shillings

Variable	Pre-foreign banks increase 2000-2006		Increased foreign banks 2007-2011		Over all	
	Mean	SD	Mean	SD	Mean	SD
Cash (BOU)	10.6	4	39.5	13.6	22.6	17
Cash (Inst.)	7.3	4.6	25.5	8.4	14.9	11
Loans	40.9	25.7	216	8.5	113.8	78.4
Investments	26	8	76	25.2	47	29.9
Non-current assets	4.7	2	10	3.4	6.9	3.7
Other assets	4.7	1.7	23.6	10.8	12.5	11.7

Source: Researchers' computation using various published commercial banks' final accounts; 2012

The performance of domestic banks in terms of income during pre and increased foreign banks' presence is shown in the table 3.

Table 3: Domestic commercial banks' Income (averages) in billions shillings

Income	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Interest income	5.1	7.6	8.1	12.3	15.6	16.9	23	33.4	40	52.3	60.9	81.6
Non-interest income	2.3	2.8	3.4	5.1	6	8.2	9	13.3	9	13.7	21.5	27.9
Total Income	7.4	10.4	11.5	17.4	21.6	25.1	32	46.7	49	66	82.4	109.5

Source: Researchers' computation using various published commercial banks' final accounts 2012

Table 3 indicates that, there was a continuous increase in Interest Income (II) and Non-Interest Income (NII) over the period of twelve years. The average interest income during pre-increased foreign commercial banks' period; 2000-2006 was 12.7 billion with a standard deviation of 5.6. In the period 2000-2006, interest income was growing at a rate of 29.8% with a standard deviation of 17.8. However, during increased foreign banks' presence; 2007-2011, the average interest income increased to 53.6 billion with a standard deviation of 16.9. The increase in interest income of domestic commercial banks suggest that, foreign commercial banks presence had an effect on interest income; although, interest income growth rate was slightly lower, at the rate of 29.2% and standard deviation of 10.3. The lower standard deviation meant that interest income had stabilized, and in general, interest income for the period of twelve years settled at 29.7 and standard deviation of 23.4.

On the other hand, the average Non- Interest Income (NII) of domestic commercial banks during pre increased foreign commercial banks was 5.3billion with a standard deviation of 2.4. Non- interest income average increased to 17 billion with a standard deviation of 6.7 in 2007-2011. The increase in Non-interest income corresponded with increased foreign commercial banks in Uganda. The results confirm the previous observation of increased investments and diversification of domestic commercial banks. The implication is that increased foreign commercial banks had a positive effect on non-interest income of domestic commercial banks.

However, the results contradict with the findings of Claessens et. al. (2000, 2001); Claessens and Lee, (2003), Bayraktar and Wong, (2004), indicating that, foreign commercial bank presences was connected with lower non-interest income. The overall non-interest income for the period of twelve years stabilized at 10.2billion and a standard deviation of 7.5. It was observed that, the growth rate of non-interest income was higher during 2007-2011; the period of increased foreign commercial banks to the tune of 31%, compared to 26.3% the previous period 2000-2006. The results suggest that foreign commercial banks brought in 'know-how', which spilled- over to domestic commercial banks that boosted their performance.

Focusing on Interest expenses, these were kept at minimum, with overall interest expenses of 6.2 billion and a 5.6 standard deviation on average over the period of twelve years. The average interest expenses during 2000-2006 were 2.13billion with a

standard deviation of 1.3. However, this increased to 11.9 on average with a standard deviation of 4.2, during increased foreign commercial banks.

The results suggest that foreign commercial banks had an a positive influence on interest expenses of domestic commercial banks, although, the growth rate of interest expenses was higher to the tune of 58.2% during pre increased foreign commercial banks and lowered to 36.2% in 2007-2011.

Table 4: shows the relationship between average interest income and expenses of domestic commercial banks.

Table 4: Domestic commercial banks' Interest Income and expenses (averages) in billions shillings

Variable	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Interest income	5.1	7.6	8.1	12.3	15.6	16.9	23	33.4	40	52.3	60.9	81.6
Interest expenses	0.39	0.51	1.52	2.46	2.75	3.15	4.12	6.21	8.75	13.2	13.3	18.32
Net Interest margin	4.71	7.09	6.58	9.84	12.9	13.8	18.9	27.2	31.3	39.2	47.6	63.28

Source: Researchers' computation using various published commercial banks' final accounts.

In 2000-2006, the average interest margin for domestic commercial banks was 10.5 billion with a standard deviation of 4.6, which increased to 41.7 billion during increased foreign commercial banks' presence.

However, over the period of twelve years, the overall average of interest margin settled at 23.5billion, with a standard deviation of 17.8.

The growth rate, on average was 28% for the two periods, although with a lower standard deviation of 9.9 during 2007-2011, compared to standard deviation of 17, pre-increased foreign commercial banks' presence. The results suggest some bit of stability with interest margin.

Another operational indicator used to assess the performance of domestic commercial banks relative to increased foreign commercial banks was the ratio of net interest margin to total assets (NIMTA). The average ratio of NIMTA for the period 2000-2006 was 0.12 compared to 0.11 during increased foreign commercial banks' presence; 2007-2011. A higher ratio of NIMTA during 2000-2006 suggest that the source of capital was cheaper, the period when domestic commercial banks were depending mostly on "deposits" as their source of capital confirming the cause of higher margins and ultimately performance differences.

The interest rates paid on deposits were extremely low during 2000 to 2006 period, with

an average of 2.6% and a standard deviation of 0.7. However, the interest rate on deposits increased to 4.3% with the same standard deviation of 0.7, during increased foreign commercial banks' presence in 2007-2011. The lower standard deviation suggests stability in interest rates over the period.

As shown in Table 4.5, the interest rate charged on loans/advances reduced from 61% in 2001 to 23.6 in 2011. During pre-increased period of foreign commercial banks; 2000-2006, the average interest rate charged on loans /advances was 37.3 % and it reduced to 25.5% during the increased foreign commercial banks presence in 2007-2011. The results are consistent with Martinez and Mody (2004), who found out that foreign banks' presence lower interest rates of domestic commercial banks. Similarly, the interest rate spreads reduced from 51.1 in 2000 to 19 in 2011, and this was attributed to increased foreign commercial banks presence.

Table 5: Domestic commercial banks' Interest rates; 2000-2011

Interest rate	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Loans/advances %	53	61	28.2	32	32.4	28.3	26	29.4	24.6	27.1	23	23.6
Deposits %	1.5	1.5	2.5	3.3	3.1	3	3.1	3.3	4.5	5.4	3.8	4.6
Spreads	51.5	59.5	25.7	28.7	29.3	25.3	22.9	26.1	20.1	21.7	19.2	19

Source: Researchers' computation using various published commercial banks' final accounts.

The average spreads was higher at the tune of 34.7 with a standard deviation of 13.5, during 2000-2006, but reduced to 21.2 with a standard deviation of 2.6 in 2007 -2011, the period, associated with increased foreign commercial banks. The results suggest that, foreign commercial banks forced domestic commercial banks to reduce interest rates charged on loans/advances and increased interest rates given on customer deposits, thus interest spread stability.

On analysis of expenditure of domestic commercial banks, it is revealed that the total expenses increased from 5.94 billion in 2000 to 86.65 billion in 2011. In addition, operating costs in the period 2000-2006 was 11billion on average, with a standard deviation of 4 and increased to 37.7 billion with a standard deviation of 15.4 during 2007-2011, a period of increased foreign commercial banks presence in the country. The results suggest that there was improvement in staff costs and quality. Prior to increased foreign commercial banks, operational costs had a lower standard deviation of 4, suggesting that operational costs were invariable, an indicator of conservative methods of financial management and thus performance differences.

The provision for bad and doubtful debts is an indicator of credit risk management and ultimately performance differences, but this only improved during the increased foreign commercial banks' presence. In 2000-2006, the average impairment costs of domestic commercial banks were only 0.6 billion with a standard deviation of 0.5, and increased to 2.09 billion with a standard deviation of 0.6 in 2007-2011 during increased foreign

commercial banks. The results suggest that, foreign commercial banks brought in skills and knowledge on credit risk management that led to performance differences. The results were consistent with the findings of Berger, Hasan, and Zhu (2009), who indicated that in china foreign banks reduced non-performing loans (NPLs) ratios and increased their ratio of reserves to NPLs, a sign of improved performance and competition.

The comparison of income and expenditure leads to profits, therefore the focus of the researcher was on profits of domestic commercial banks relative, to increased foreign commercial banks.

The average profits of domestic commercial banks prior to increased foreign commercial banks was 3.53 billion with a standard deviation of 1.8 and increased to 18.12 billion with a standard deviation of 6, during increased foreign commercial banks presence in 2007-2011. The results suggest that increased foreign commercial banks' presence had a positive effect on performance of domestic commercial banks in Uganda. However, the profit growth rate seemed to be uniform at 34% throughout the twelve years, although it was more unstable in 2000-2006, with standard deviation of 34 compared to the period; 2007-2011, that had 20 as a standard deviation. The results suggest that increased foreign commercial banks are associated with profit stability.

Table 6: Domestic commercial banks' returns; 2000-2011

Variable	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Return on Assets %	4.31	3.95	2.48	3.42	4.56	3.13	4.26	5.00	4.91	4.40	4.22	4.86
Return on equity %	29.8	25.21	16.85	24.66	29.76	20.49	25.56	31.48	22.51	20.94	23.74	25.56

Source: Researchers' computation using various published commercial banks' final accounts.

The return on assets (ROA) for domestic commercial banks did not vary very much during the two periods; pre and increased entry period of foreign commercial banks as shown in table 6. However, the growth rate of ROA was greater in 2000-2006 with 8.9% compared to 3.2% during the increased entry of foreign commercial banks. The overall growth rate of return on assets for domestic commercial banks over the period of twelve years was 6.3% with a standard deviation of 23.5. The average return on assets for domestic commercial banks prior to increased foreign commercial banks was 3.73% with a standard deviation of 0.7, in 2000-2006, while during 2007-2011, the average return on assets was 3.8% with a standard deviation of 0.9 contributing to overall average of 4.13% and a standard deviation of 0.74, over the period of twelve years.

Prior to increased foreign commercial banks in 2000-2006, the average return on equity for domestic commercial banks was 24.6 with a standard deviation of 6. In 2007-2011, domestic commercial banks' average return on equity slightly increased to 24.8 with

standard deviation of 3.6. The lower standard deviation suggests stability, implying that the increased foreign commercial banks never had a great effect on domestic commercial banks' returns on equity. The results were contrary to findings of Kirkpatrick et al. (2007) who indicated that an increase in the degree of foreign bank penetration was associated with a reduction in profits. However, over the period of twelve years; 2000-2011, domestic commercial banks were 25% with a standard deviation of 4.

To establish the effect of increased foreign commercial banks on the management efficiency and capacity of domestic commercial banks, the following ratios were computed for the two periods as shown in the table 7

Table 7: Management Capacity of Domestic Commercial relative to increased foreign commercial banks

Variable	Pre-foreign commercial banks increase 2000-2006	Increased foreign commercial banks 2007-2011	Remarks
Operating costs to Total income	0.6	0.5	Reduced
Impairment to Total Loans	0.015	0.010	Reduced
Non –interest income Total income	0.29	0.24	Reduced
Non-current assets to Total income	0.26	0.14	Reduced

Source: Researchers' computation, using various published commercial banks' final accounts

Reductions in the ratios as shown in the table 4.7 suggest that, increased foreign commercial banks presence in Uganda had an effect on the management of domestic commercial banks. The Implication is that domestic commercial banks must have acquired skills that improved their bank management effectiveness and efficiency.

The liquidity position of domestic commercial banks before and during increased foreign commercial banks is shown in table 8.

Table 8: Liquidity ratios of Domestic Commercial during the two periods

Variable	Pre-foreign commercial banks increase 2000-2006	Increased foreign commercial banks 2007-2011	Remarks
Liquid Assets to Total Assets	0.47	0.36	Reduced
Loans to Deposits	0.55	0.79	Increased
Liquid Assets to Deposits	0.59	0.51	Reduced

Source: Researchers' computation, using various published commercial banks' final account

The ratio of liquid asset to deposits was analyzed in order to find out; how deposits match with investments; how quickly can liquid assets be converted to cover redemption. It is a healthy situation when the ratio is higher. The results indicate that when foreign commercial banks increased, the liquid asset to deposits ratio reduced to

0.51. This affected the liquidity position and ultimately performance of domestic commercial banks which might have led to the closure of some domestic commercial banks.

Loans to deposits ratio was 0.55 in 2000-2006 and increased to 0.79 during increased foreign commercial banks in 2007-2011. The ratio; 0.79 is higher, which suggest that, the liquidity position of domestic commercial banks was not enough to cover any unforeseen fund requirements than before increased foreign commercial banks.

The ratio of liquid assets to total assets was an important management tool in assessing the extent to which liquid assets can support asset base. The ratio provided an indication of liquidity available to meet anticipated and unforeseen demands for cash. The results indicate that, the ratio of domestic commercial banks reduced from 0.47 to 0.36 during the increased foreign commercial banks. The level of liquidity suggest that the average domestic commercial bank does not have the ability to withstand shocks and thus unable to compete favorably.

The Asset quality of domestic commercial banks was assessed basing on loan loss provisions to total assets (LLPTA) ratio during the two periods. The results indicate that, the LLPTA ratio increased and reached optimum in 2005 and later dropped. The results suggest that, domestic commercial banks' assets were not well managed, since high loan provisions translated into lower profits and capital positions. However, when foreign commercial banks increased in 2007-2011, the ratio reduced proportionately. The reduction suggests that there was improvement in quality of credit supplied to the economy together with better creditworthiness bank clients.

The Capitalization of domestic commercial banks was assessed using Equity Capital to Assets (EQTA) for the two periods (2000-2006 & 2007-2011). The average EQTA ratio for the period 2000-2006 was 0.15 while in 2007-2011 increased to 0.19. The results suggest that domestic commercial banks were more solvent and secure during the increased foreign commercial banks presence (2007-2011).

4.2 Difference between means of domestic commercial banks over two periods; 2000-2006 & 2007-2011

The averages (means) of several performance indicators were computed and indicated that there were differences in absolute values between the two periods. However, two tests on differences between two dependent variables; profits after tax and interest margin were done, using two tailed hypothesis testing.

Testing the difference between profits after tax

Hypothesis: H2

H₀: Domestic commercial banks' profits after tax were equal to each other during pre and increased foreign banks

H₁: Domestic commercial banks' profits after tax were not equal to each other during pre

and increased foreign banks

Testing the difference between Net interest income (means)

Hypothesis: H3

Ho: Domestic commercial banks' Net interest income was equal each other during pre and increased foreign banks

H1: Domestic commercial banks' Net interest income was not equal each other during pre and increased foreign banks

There are 7 variables (n) during pre-increased period (2000-2006) entry of foreign banks and 5 variables (n) (2007-2011) during the increase, the degrees of freedom (df) for a t test difference between the means was:

$$df = n_1 + n_2 - 2$$

$$df = 7 + 5 - 2$$

$$df = 10$$

At high probability; 95%, $\alpha = 0.05$ setting the critical value t to be 0.025 for a two tailed.

The critical values were approximately +2.228 and -2.228

Conditional rule:

Reject Ho, if the computed t is less than -2.228 or greater than +2.228 and accept H1; that there is a difference between means for the two periods.

**Table 9a: Performance of Domestic Commercial banks 2000-2011
(billion shillings)**

Year	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Net Interest margin (NIM)	4.71	7.09	6.58	9.84	12.9	13.8	18.9	27.2	31.3	39.2	47.6	63.3
Profit after Tax (PAT)	1.46	1.84	1.87	3.23	5.06	4.16	7.08	11.93	13.46	15.4	20.8	29

Source: Commercial banks' various Annual Reports; researchers' computation, 2012

Table 9a shows the average performance of commercial banks over the period of twelve years.

**Table 9b: Average performance of Domestic Commercial banks 2000-2011
(billion shillings)**

Period	Pre-foreign banks increase 2000-2006		Increased foreign banks 2007-2011	
	Means	SD	Mean	SD
NIM	10.53	4.58	41.69	12.85
PAT	3.53	1.81	18.12	6.23

Source: Table 4.9a

Computation:

H₀: $\mu = \mu$

H₁: $\mu \neq \mu$

Formula: 4.1

$$t = \frac{(\bar{X}_1 - \bar{X}_2) - (\mu_1 - \mu_2)}{\sqrt{\frac{(n_1 - 1)sd^2_1 + (n_2 - 1)sd^2_2}{(n_1 + n_2 - 2)} (1/n_1 + 1/n_2)}}$$

Substituting the variable in table 4.9 in the formula; 4.1;

NIM: computed t = -6.1

PAT: computed t = -4.22

Since the obtained t for both variables fell in the critical region beyond the range -2.228 and +2.228, H₀ was rejected in favor of H₁, and concluded that increased foreign banks entry had an effect on the performance of domestic commercial banks in Uganda.

The effect of increased foreign banks entry on the performance of domestic commercial banks in Uganda is summarized in table 10

Table 10: Summary of performance of Domestic commercial banks' in billion shillings before and during increased foreign banks in Uganda.

Variable	2000-2006		2007-2011		Over all		Effect
	Mean	SD	Mean	SD	Mean	SD	
Deposits	74.4	35	274.6	84.5	157.8	115.8	+ve
Equity	14.4	7.2	74.4	25.5	39.5	87.5	+ve
Other liabilities	5.5	1.76	41.6	26.5	20.5	24.7	+ve
Cash (BOU)	10.6	4	39.5	13.6	22.6	17	+ve
Cash (Inst.)	7.3	4.6	25.5	8.4	14.9	11	+ve
Loans	40.9	25.7	216	8.5	113.8	78.4	+ve
Investments	26	8	76	25.2	47	29.9	+ve
Non-current assets	4.7	2	10	3.4	6.9	3.7	-ve
Other assets	4.7	1.7	23.6	10.8	12.5	11.7	+ve
II	12.7	5.8	53.6	5.8	29.7	23.4	+ve
NII	5.26	2.4	17	6.7	10.2	7.5	+ve
NIM	10.53	4.6	41.7	12.9	23.5	17.8	+ve
ROA %	3.73	0.69	3.8	0.9	4.13	0.74	+ve
ROE %	24.6	5.6	24.8	3.6	25	4	+ve

Source: Researchers' computation using various published commercial banks' final accounts

Measure of the association between the two variables; number of foreign commercial banks and performance of domestic commercial banks

Product moment coefficient of correlation was used to test whether there was a relationship between increased foreign commercial banks and the performance of domestic commercial banks in Uganda. The measure of association was between the

number of foreign commercial banks (independent variable) and the performance of domestic commercial banks' using the following performance indicators; PAT; ROA; ROE; NIM;NII; DEPOSITS; LOANS; LIR; DIR; SPREADS; OPERTING EXPENSES; IMPAIRMENT COSTS.

The practical formula used is given below:

Formula: 4.2

$$r = \frac{n \sum XY - \sum X \sum Y}{\sqrt{n \sum X^2 - (\sum X)^2} \sqrt{n \sum Y^2 - (\sum Y)^2}}$$

The results suggest that there was some there were positive and negative relationships between increased foreign commercial banks and the performance of domestic commercial banks as shown in table 11.

Table 11 measure of association between number of foreign banks and domestic commercial bank performance

Independent variable	Dependant variable	r	Association
No. of foreign banks	PAT	+0.95	Strong
	ROA	+0.45	Moderate
	ROE	-0.21	Weak
	NIM	+0.96	Strong
	Non-interest income	+0.90	Strong
	Deposits	+0.95	Strong
	Loans/advances	+0.88	strong
	LIR	-0.61	Moderate
	DIR	0.86	Strong
	Spreads	-0.64	Moderate
	Operating expenses	+0.93	Strong
	impairment	+0.90	Strong

Source: various Annual commercial Reports; Researchers' computation, 2012

Level of significance of r

The researcher further tested the relationships using 5% level of significance to prove whether there was a direct relationship between the variables. The level of significance of r was tested at 5% critical value, using statistic t- test given below:

$$| t | = \frac{r - \mu}{\sqrt{\frac{1 - r^2}{n - 2}}}$$

Where μ was taken to be equal to 0 , that is; there is no relationship between the two variables.

That is; $H_0 : \mu = 0$
 $H_1 : \mu \neq 0$

The tabulated value for n-2; degrees of freedom, using 5% level of significance was +2.228. Reject H_0 if the computed t is greater than +2.228 and accept H_1 and concluded that there is some relationship between number of foreign commercial banks and performance of domestic commercial banks.

The results are shown in the table 12

Table 4.12: level of significance of r

Dependent	r	Computed t	Critical t	Decision
PAT	+0.95	+9.621	+2.228	Reject H_0
ROA	+0.45	+1.784	+2.228	Accept H_0
ROE	-0.21	+0.695	+2.228	Accept H_0
NIM	+0.96	+10.842	+2.228	Reject H_0
Non-interest income	+0.90	+6.529	+2.228	Reject H_0
Deposits	+0.95	+9.621	+2.228	Reject H_0
Loans/advances	+0.88	+5.859	+2.228	Reject H_0
LIR	-0.61	+2.434	+2.228	Reject H_0
DIR	0.86	+5.329	+2.228	Reject H_0
Spreads	-0.64	+2.634	+2.228	Reject H_0
Operating expenses	+0.93	+8.001	+2.228	Reject H_0
Impairment	+0.90	+6.529	+2.228	Reject H_0

Source: computation from table 4.11, 2012

Conclusion

The results showed that increased foreign commercial banks corresponded with increase in Deposits of domestic commercial banks. The implication is that increased foreign commercial banks had an effect on deposits mobilization which forced domestic commercial banks to do so. The increase in deposits indicates that domestic commercial banks were using them as the major source of funding, much as 'other liabilities' also increased

The liquidity position of domestic commercial banks improved, as evident from increased average cash balances with bank of Uganda. However, the quality of liquidity reduced.

Interest income and Non-interest income increased, with the increased entry of foreign banks. This implied that foreign commercial banks brought in technical know-how through diversification which spilled over to domestic commercial banks. However, there was high growth rate and volatility with non-interest income.

Relatively, there was improvement in profits, although there was no great variation in return on assets. For example 2000-2006 had 3.73% while 2007-2011 had 3.8%. Similarly, the increased entry of foreign commercial banks never affected return on

equity of domestic commercial banks in absolute values.

Improvement in risk management that corresponded with increased entry of foreign commercial banks. There was also improvement in effectiveness and efficiency in management of domestic banks. Generally, there was a significant difference in performance of domestic commercial banks in Uganda between the two periods (2000-2006 & 2007-2011).

There was improved financial stability during increased presence of foreign commercial banks in 2007-2011.

Policy implications emerged is that foreign commercial banks are major players in commercial banking sector development, therefore, monetary policy makers and regulatory authorities should attract many foreign commercial banks to join Uganda's commercial banking sector. However, this gives rise to several concerns which need to be investigated, for example the need to establish how technological and knowledge (know-how) transfer moves from foreign commercial banks to domestic commercial banks. In addition, one should investigate if a huge number of foreign commercial banks are sustainable in Uganda.

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