Kenya listed banks

2023 Financial Results and Future Outlook

September 2024

Foreword

The 2023 financial year for Kenya's listed banks is a testament to their resilience and adaptability in a challenging global economic landscape.

This report provides a detailed insight into the capital management, growth, and profitability strategies employed by these financial institutions, offering a comprehensive overview of their performance and resilience.

Kenyan banks have demonstrated remarkable adaptability, effectively navigating an environment characterized by inflationary pressures, fluctuating interest rates, and stringent regulatory requirements. The Central Bank of Kenya's enforcement of a minimum Capital Adequacy Ratio (CAR) of 14.5% has been a pivotal factor in ensuring the stability and robustness of these institutions. Compliance with these regulations has been achieved through strategic capital-raising activities, including rights issues and bond issuances, which have bolstered the banks' capital buffers and enabled them to withstand economic shocks

One of the key highlights of 2023 has been the strategic emphasis on digital transformation.

Kenyan banks have heavily invested in digital platforms, significantly enhancing their service delivery and customer engagement. Mobile banking, internet banking, and agency banking have seamlessly integrated into their operations, driving increased transaction volumes and expanding their customer base. This digital shift not only underscores the banks' commitment to innovation but also highlights their ability to adapt to changing consumer preferences and technological advancements, instilling confidence in their future prospects.

Another critical factor in sustaining profitability is the diversification of revenue streams. Kenyan banks have mitigated risks associated with over-reliance on traditional lending by venturing into areas such as bancassurance, asset management, and investment banking.

This strategic diversification has opened new revenue channels and contributed to overall financial stability, enabling banks to navigate the challenges posed by the macroeconomic environment.

Despite the positive trends, the banking sector has faced its share of challenges. The rise in non-performing loans (NPLs) to 13.33% in 2023, from 11% in the previous year, reflects the ongoing economic pressures and the impact on asset quality. Banks have responded with enhanced credit appraisal processes and stringent loan recovery efforts, underscoring their unwavering commitment to maintaining financial health and stability, thereby securing your investments.

Through process automation and branch network optimization, banks have significantly reduced operational costs. These measures have not only improved efficiency but also contributed to better financial performance, highlighting the importance of operational excellence in achieving sustainable growth.

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The banking sector is poised for continued growth and profitability, driven by heightened credit demand and strategic interest rate management. However, the industry must remain vigilant regarding potential risks, including a volatile interest rate environment and global economic uncertainties. Enhanced credit risk management frameworks and ongoing investment in digital ecosystems will be essential in navigating these challenges and ensuring long-term resilience.

In conclusion, the 2023 financial year has underscored the resilience and adaptability of Kenyan listed banks. Through strategic capital management, technological innovation, and revenue diversification, these institutions have successfully navigated a complex economic landscape and positioned themselves for continued success. As the sector evolves, maintaining a solid capital base and exploring new growth avenues will be critical in sustaining long-term profitability and stability.

Joseph Kariuki
Partner
Head of Banking sector

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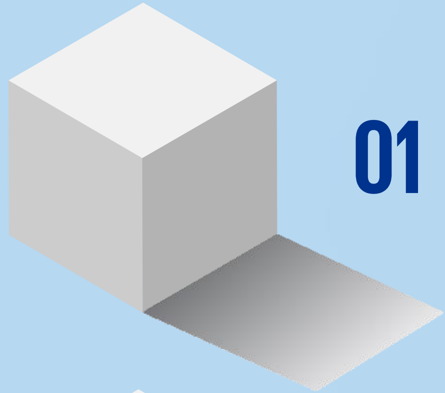

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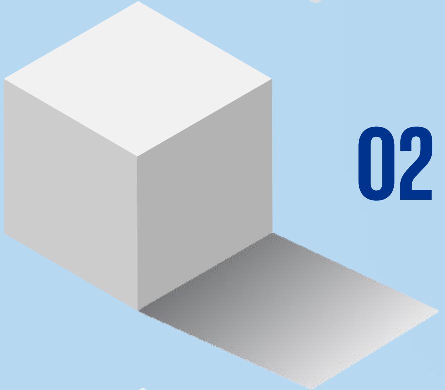

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01

Executive Summary

Perfomance trends in 2023

21.82%

Total Assets

Total assets increased from KES 6.3 trillion in 2022 to KES 7.7 trillion in 2023

0.70%

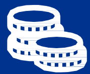
Capital adequacy ratio

decreased from 17.9% in 2022 to 17.2 % in 2023

0.71%

Cost to income ratio

increased from 48.62 % in 2022 to 49.83% in 2023



5.05%

Net profit

Net Profit increased from KES 170.7 billion in 2022 to KES 179.2 billion in 2023

0.92%

Net interest margin

increased from 7.33% in 2022 to 8.25% in 2023

0.29%

Dividend payout ratio

decreased from 33.36% in 2022 to 33.07% in 2023

0.07%

ROA

ROA decreased from 2.57% in 2022 to 2.50% in 2023

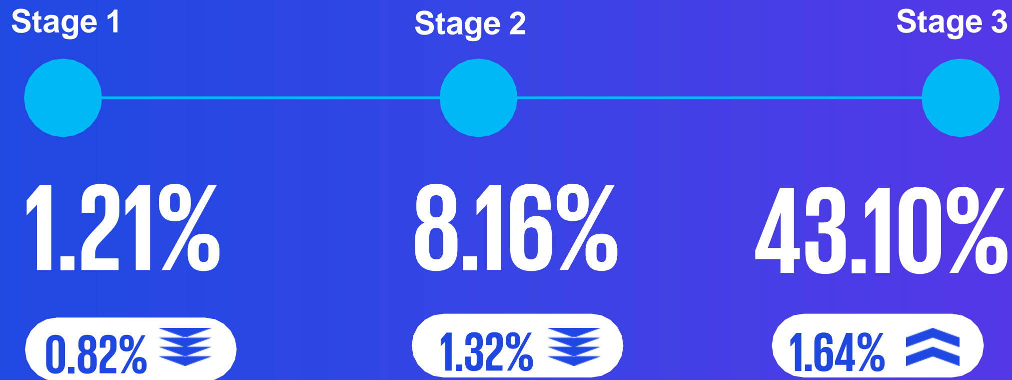
0.49%

ROE

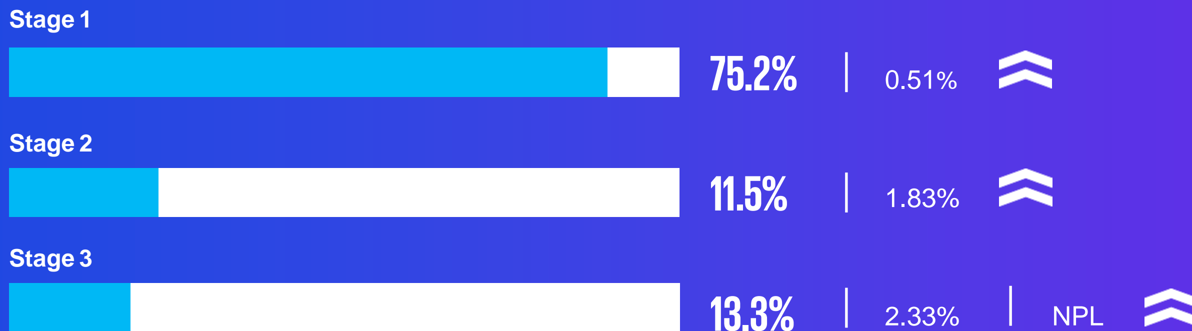
increased from 17.24% in 2022 to 17.73% in 2023

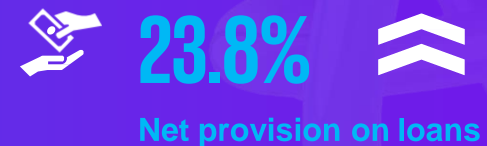
Perfomance trends in 2023

Coverage ratio on loans



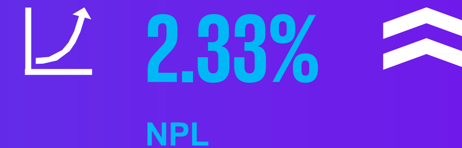
Exposure subject to ECL





Net provision on loans

increased from
KES 261.5 billion in 2022
to KES 323.6 billion in 2023.



NPL

Increased from
11.00% in 2022
to 13.33% in 2023

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Executive summary continued

	2023 Highest	2023 Average	2023 Lowest	2022 Highest	2022 Average	2022 Lowest
Capital Adequacy Ratio	22.21%	17.21%	9.01%	20.70%	17.91%	12.20%
Cost to income Ratio	83.46%	49.33%	41.01%	87.14%	48.62%	40.80%
Net Interest Margin	14.11%	8.25%	5.15%	9.87%	7.34%	4.83%
ROA	3.62%	2.50%	0.65%	3.56%	2.57%	0.48%
ROE	24.36%	17.73%	4.40%	25.05%	17.24%	3.12%
Dividend Payout Ratio	63.05%	33.07%	0.00%	55.00%	33.36%	0.00%
Lending Assets (in KES millions)	1,094,289	393,777	38,788	863,268	329,160	36,299
Operating Income (in KES millions)	181,683	66,734	3,892	145,935	56,959	3,039
Loan to Deposit ratio	91.48%	68.20%	47.59%	92.50%	72.18%	50.00%
Net Profit (in KES millions)	41,976	17,928	388	44,893	17,065	265
Total Assets (in KES millions)	2,170,874	766,792	61,550	1,554,029	629,461	56,995
NPL Ratio	25.50%	13.33%	6.84%	21.36%	11.00%	7.70%

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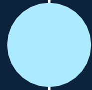
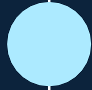
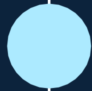
Interpretation statements



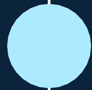
Profitability saw an increase of 5.05 percent, driven particularly by a growth in loan books, increased interest margins, and effective cost management and revenue generation strategies.



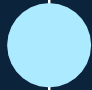
Asset growth remained robust as banks increased their asset base by 21.82 percent, which was driven by increased lending activities, strategic investments, and higher deposit inflows.



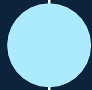
Net interest margin increased slightly by 0.92 percent, because of the rising interest rate environment alongside effective management of interest rate risk which helped drive profit growth.



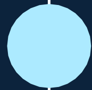
The overall NPL ratio for the banking sector increased by 2.33 percent and now stands at 13.33 percent, reflecting the tough macroeconomic environment in 2023 that impacted all business segments (i.e., corporate, business banking and retail segment) thus necessitating cautious monitoring of credit quality.



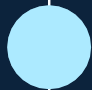
ROA (2.50 percent in 2023) decreased marginally by 0.07 percent compared with the prior year, owing to the rise in marginal increases in profitability compared to the asset growth.



Cost-to-income ratios increased slightly by 0.71 percent compared to 2022 (48.62 percent to 49.33 percent), underscoring the growing pressures on operational efficiency amid evolving market dynamics and rising costs.



ROE (17.73 percent in 2023) increased by 0.49% percent compared with the prior year as profitability marginally outpaced equity growth.



Dividend pay-out ratio marginally decreased by 0.49 percent driven by larger payouts done by the banks in 2022 and need for strategic reinvestment of earnings for growth.

02

Economic Outlook

The global economies are faced with increased global uncertainties, that impact financial sector stability, volatile financial markets, weaker global growth tensions particularly the war in Ukraine, and continued tightening of monetary policies.

Most currencies in emerging and developing economies weakened against the U.S. Dollar, due to the tightening of U.S. monetary policy. As a result, the MPC has increased the Central Bank Rate (CBR) from 10.5% in June 2023 to 12.5% in 2024 due to rising inflationary pressures and the need to stabilize the economy. This increase has continued to put pressure on the lending rates by banks

The banking sector has remained stable and resilient with strong liquidity and capital adequacy ratios despite the global and local economic challenges. Going forward, the banking sector is projected to remain resilient and stable. However, credit risk and Interest rate risk is expected to remain elevated in the short to medium term.

Kenya's poor credit ratings have had a noticeable impact on the performance of the banking sector. As credit ratings decline, the cost of borrowing for the government and private sector increases, leading to tighter liquidity conditions and higher interest rates. This environment creates challenges for banks, which face elevated costs for their borrowing and funding. Additionally, lower credit ratings undermine investor confidence, potentially leading to reduced capital inflows and tighter credit conditions. The banking sector may experience increased non-performing loans as borrowers struggle with higher costs and economic pressures, affecting profitability and overall stability. Consequently, the strain on the banking sector further exacerbates Kenya's financial challenges, creating a cycle of economic and financial instability.

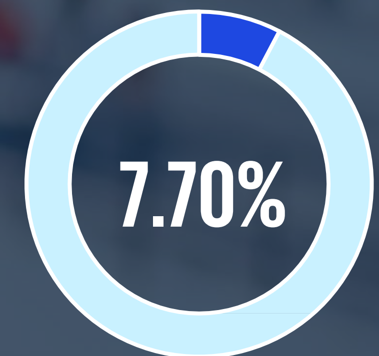
Kenya

113,420
GDP (million US$)

CREDIT RATINGS

S&P	MOODY'S	FITCH
B-	Caa1	B-

INFLATION RATE



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03

Key Insights

Capital Management and Growth & Profitability : A 2023 Financial Review

The financial landscape in Kenya, particularly in the banking sector, has shown significant evolution. Listed banks have demonstrated resilience and adaptability in capital management and in sustaining growth and profitability. The 2023 financial year provides a clear lens into these dynamics, revealing trends and strategies that have shaped the sector's status.

Capital management is crucial for the stability and growth of banks. For Kenyan listed banks, effective capital management strategies have been pivotal in navigating economic challenges and seizing growth opportunities. The Central Bank of Kenya (CBK) has enforced stringent capital adequacy requirements to ensure banks maintain a healthy buffer against potential losses, mandating a minimum capital adequacy ratio (CAR) of 14.5%.

In 2023, Kenyan banks exhibited strong compliance with these regulations, reflecting robust capital buffers. This compliance was driven by strategic capital-raising activities, including rights issues and bond issuances. Additionally, banks have increasingly turned to innovative financial instruments to manage their capital efficiently. Instruments like Additional Tier 1 (AT1) and Tier 2 capital have become more prevalent, providing banks with flexible and cost-effective means to strengthen their capital positions.

The strategic issuance of these instruments has enabled banks to optimize their capital structures, ensuring compliance with regulatory requirements while supporting growth initiatives
The Central Bank of Kenya (CBK) has enforced stringent capital adequacy requirements to ensure banks maintain a healthy buffer against potential losses, mandating a minimum Capital Adequacy Ratio (CAR) of 14.5%.

The growth trajectory of Kenyan listed banks in 2023 was marked by strategic expansion, technological innovation, and diversification of revenue streams. Despite a challenging economic environment characterized by inflationary pressures and fluctuating interest rates, banks managed to achieve commendable growth and profitability.

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One of the key drivers of growth has been the adoption of digital banking solutions. Banks have heavily invested in digital platforms, enabling them to reach a broader customer base and offer a wide range of services. Mobile banking, internet banking, and agency banking have significantly contributed to increased transaction volumes and customer engagement.

Furthermore, the diversification of revenue streams has been crucial in sustaining profitability. Banks have expanded their offerings beyond traditional lending, venturing into areas such as bancassurance, asset management, and investment banking. This diversification has mitigated risks associated with over-reliance on interest income and opened new revenue channels.

Profitability in 2023 was also bolstered by prudent cost management strategies. Banks implemented measures to enhance operational efficiency, including process automation and branch network optimization. These strategies have resulted in reduced operational costs and improved profitability.

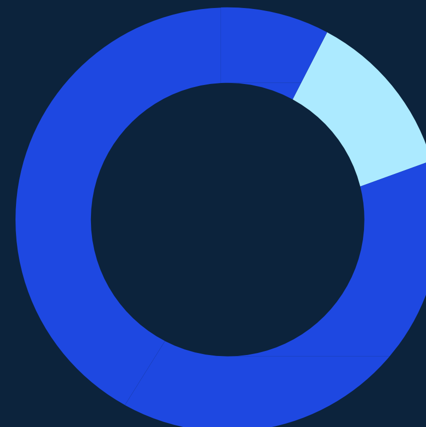
Despite positive trends, Kenyan banks faced several challenges in 2023. Non-performing loans (NPLs) remained a significant concern, impacting asset quality and profitability. Banks have responded by tightening credit appraisal processes and enhancing loan recovery efforts. Additionally, the uncertain global economic environment posed risks, necessitating prudent risk management practices.

As the global economic landscape evolves, the banking sector is recalibrating its strategies to navigate emerging challenges and opportunities. With inflation displaying signs of moderation amid recent monetary policy tightening and economic activity stabilizing, banks are focusing on managing margins, controlling costs, and innovating business models to sustain growth and profitability. The cost of doing business in Kenya has been increasing, with the economy facing various challenges including exchange rate pressures, high cost of living, and global economic uncertainties.

Going forward, the banking sector is expected to see increased growth and profitability due to heightened credit demand from businesses and rising interest rates, as indicated by the Central Bank's rate increase to 13% in February 2024. However, a rise in the non-performing loan ratio from 11% in 2022 to 13.33% in 2023 could affect asset quality and profitability. Enhanced credit risk management frameworks will be essential amid a potentially volatile interest rate environment.

The 2023 financial year underscored the resilience and adaptability of Kenyan listed banks in managing capital and sustaining growth and profitability. Through strategic capital management, technological innovation, and diversification, banks have navigated challenges and positioned themselves for continued success. As the sector evolves, maintaining a strong capital base and exploring new growth avenues will be critical in sustaining long-term profitability and stability. Strategic planning, efficient interest rate management, improved credit risk assessment, enhanced investment in digital ecosystems, prudent capital management, and revenue diversification will be crucial for navigating the evolving financial landscape and ensuring resilience, growth, and sustained profitability.

12.75% | **Central Bank's rate**



13.33% in 2023

Non-performing loan ratio

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Transparency - The Common Reporting Standard

The global banking landscape has seen the introduction of crucial measures to combat tax evasion and promote financial transparency. The Common Reporting Standard (CRS) is one such measure, introduced by the Organisation for Economic Co-operation and Development (OECD). The CRS draws significantly from the framework established by the United States Foreign Account Tax Compliance Act (FATCA), adapting its principles to a global context. Similar to FATCA, the CRS requires financial institutions in participating jurisdictions to implement due diligence procedures to document and identify reportable accounts and establish reporting processes for these accounts.

The number of jurisdictions adopting CRS continues to grow each year. There are currently over 5400 bilateral exchange relationships activated with respect to more than 120 jurisdictions committed to the CRS, with next exchanges between these jurisdictions set to take place at the end of September 2024.

In Africa, several countries have already begun exchanges under the CRS framework. South Africa, as an early adopter since 2017, Mauritius since 2018, Ghana since 2019, and Nigeria since 2020. Kenya is set to undertake its first exchange by September 2024, and Uganda and Rwanda are both committed to start exchanging information by 2025.

Given this growing and widespread adoption, banks with pan-African presence should prioritise CRS compliance as a core component of their compliance strategy.

The year 2024 marks the first year for reporting for financial institutions in Kenya in line with the Tax Procedures Act (No. 29 of 2015) and the CRS regulations, which were gazetted on 7 February 2023, with an effective date of 1 January 2023.

Following a recent public notice by the Commissioner for Domestic Taxes, the reporting deadline for financial institutions was extended from 31 May 2024 to 31 August 2024.

Banks play a pivotal role in ensuring compliance with the CRS. They are responsible for identifying and documenting the tax residency of account holders, performing due diligence to verify information, and reporting relevant financial data to local tax authorities for subsequent exchange under the Automatic Exchange of Information (AEOI) global standard. To maintain customer trust, banks must implement robust internal controls, secure data protection measures, and ensure the accuracy and relevance of reported information without violating data protection laws. Establishing internal procedures specific to CRS, instead of relying on existing anti-money laundering or FATCA procedures is critical.

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Several banks in Kenya have proactively implemented self-certification forms as part of their account opening procedures. While this signals a step in the right direction, banks must go a step further and implement robust procedures, policies, staff training programs, and effective internal controls to ensure full compliance with CRS requirements. This will enable banks to accurately identify and document the tax residency of account holders, perform thorough due diligence, maintain the integrity and confidentiality of exchanged information and ensure accurate reporting of financial data to the tax authority.

Finally, technology plays a key role in ensuring compliance with the CRS. With the CRS now operating across over 120 jurisdictions, many organisations have found reporting under the AEOI challenging without a reliable technology solution. Evaluating existing IT systems to identify whether they are capable of collecting, analysing, monitoring and reporting requisite financial and tax data to the authorities is crucial. KPMG AEOI Reporting is a simplified and cost effective solution designed to simplify the reporting process for both large and small banks, across multiple jurisdictions.

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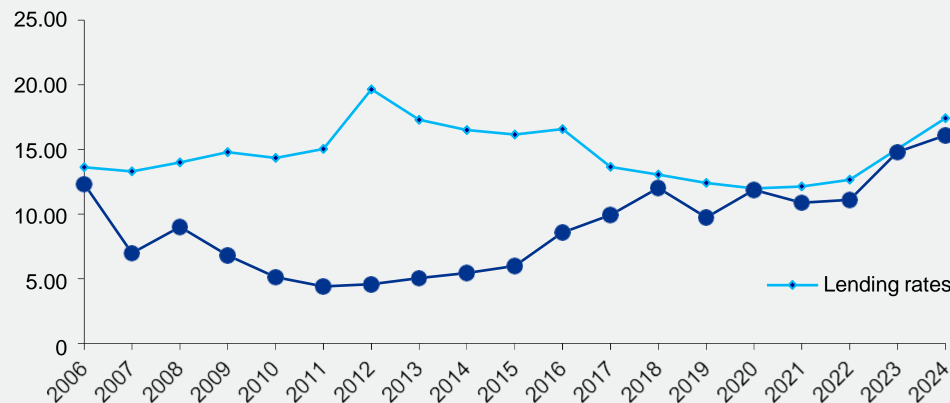
Asset quality outlook

The banking sector has seen a consistent deterioration in overall asset quality over the post – Covid period, leading up to an April 2024 industry NPL ratio of 16.1%, the highest in the past 18 years (Central Bank of Kenya Bi-Annual Report of the Monetary Policy Committee, April 2024). As depicted in the below illustrative, it may not always be the case that NPL ratios, a common indicator of asset quality in banking, retains strong, positive correlation to average lending rates.

Industry lending rates vs NPL ratios



Source data: Business Monitor International, World Bank

It is therefore imperative to decouple asset quality drivers attributable to lending rates and those that relate to other underlying credit risk drivers. In this case, credit lifecycle management (including development and review) comes to the fore as an important consideration in industry – wide asset quality improvement.

In credit origination, both the banks and regulator (Central Bank of Kenya) have a role to play in optimization of the paradox that exists in maximizing asset growth and maximizing the “true negatives” in initial customer risk assessment. For banks, this calls for investment in robust systems, data, models, and ongoing performance tests to risk scorecards, as well as establishment of comprehensive risk appetite frameworks around lending thresholds. The regulatory spotlight on the same encompasses comprehensive review of bank customer rating systems as well as future state establishment of leading practice data and process sharing platforms across banks.

For banks, this calls for investment in robust systems, data, models, and ongoing performance tests to risk scorecards, as well as establishment of comprehensive risk appetite frameworks around lending thresholds.

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The regulator also holds a central supervisory role in credit monitoring steps to improve the banking industry's asset quality. This is domiciled in enhanced validation of impairment models, including alignment to global supervisory focus towards formulation of regulatory floors on expected credit loss (ECL) parameters. For banks, this requires a greater emphasis on validation and back testing of existing models and methodologies, investments in data and systems as well as people and governance. Both the banking industry and the regulator have a role to play in formulation, implementation, and validation of robust early warning frameworks as well as innovative collections management frameworks.

Moving into the second half of 2024 and transitioning into 2025, we expect asset quality to continue forming the crux of discussions in the banking sector. This is considering the continued impact of global economic shocks, sustained record – high global interest rates among other existing and emergent stressors to the sector. In the absence of market consolidation, the need to ensure healthy loan books cannot possibly be over emphasized.

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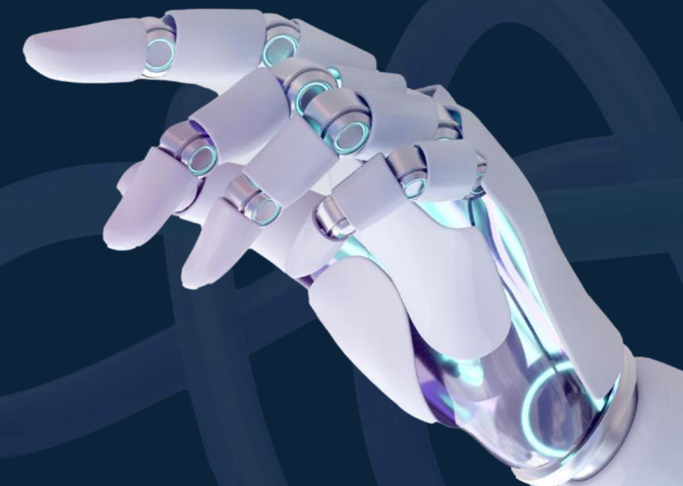
Harnessing AI: Revolutionizing Regulatory Reporting in Kenya's Banking Sector

The Kenyan banking sector operates within a dynamic landscape characterized by both opportunities and challenges coupled with intricate regulatory controls. In the ever-changing regulatory environment, it is imperative to emphasize the critical role of regulatory reporting in fostering trust, transparency, and stability within the banking sector. Regulatory reporting serves as the bedrock upon which the industry's integrity and resilience are built. However, traditional approaches to regulatory reporting are increasingly being challenged by the need for agility, accuracy, and efficiency.

In the recent years, artificial intelligence (AI) has gained traction right across the banking and capital markets and insurance industries, and in other walks of life, touching almost every aspect of day-to-day banking functions including fraud detection, compliance and regulatory reporting and more with an aim to promote frictionless banking. Global estimates indicate that AI could add between USD 200 bn and USD 340 bn in value annually across the global banking sector equivalent to 2.8% to 4.7% of total industry revenues, primarily through increased productivity. AI is a transformative force poised to revolutionize how banks navigate regulatory requirements. By harnessing the power of AI, banks can unlock precedented levels of efficiency, accuracy, and agility in regulatory reporting thereby empowering them to stay ahead of the curve in an ever-changing regulatory landscape.



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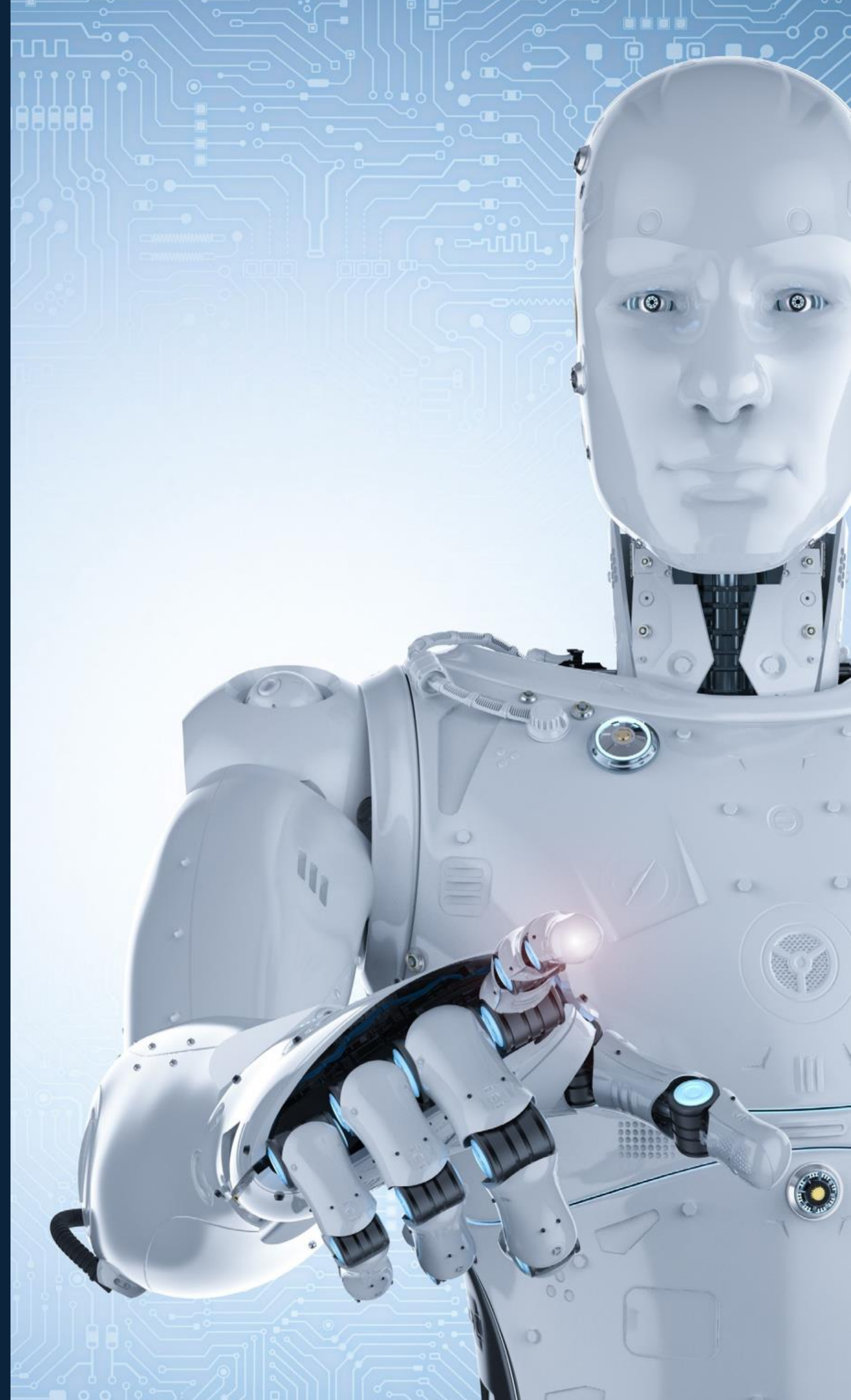
One of the primary challenges facing Kenyan banks in regulatory reporting is the sheer volume and heterogeneity of data dispersed across disparate systems and silos. AI-powered solutions offer a comprehensive approach to data aggregation, cleansing, and harmonization. Through advanced machine learning algorithms and natural language processing, AI can ingest and process vast datasets in real-time, ensuring compliance with regulatory mandates while minimizing the risk of manual errors.

Furthermore, AI augments regulatory reporting by enhancing risk detection and mitigation capabilities. By leveraging anomaly detection algorithms and predictive analytics, banks can proactively identify irregular patterns and potential compliance breaches, thereby mitigating regulatory risks before they escalate. This proactive approach not only safeguards the banks' reputation but also instils confidence among stakeholders, including regulators and customers.

In the Kenyan banking sector, the integration of AI into regulatory reporting holds immense promise. With the proliferation of digital channels and fintech innovations, banks are faced with a myriad of compliance obligations, ranging from anti-money laundering (AML), financing of terrorism (FT), proliferation financing (PF), fraud detection to consumer protection regulations. Moreover, AI-powered regulatory reporting could foster operational resilience and strategic foresight. Through dynamic scenario modelling and regulatory impact assessments such as the recently concluded AML/CFT/PF risk-based audits for the banking and capital markets sectors, banks can anticipate compliance implications and adapt their strategies, accordingly, ensuring regulatory readiness and sustainable growth.

However, it is essential to acknowledge that the adoption of AI in regulatory reporting is not without challenges. Key among them is the need for robust data governance frameworks and pilot projects, ethical considerations, and talent development to ensure algorithmic, transparency and mitigate biases effectively.



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Given the challenges stated should banks consider adopting AI-powered regulatory reporting?

AI heralds a new era of efficiency, transparency, and resilience for institutions. By embracing AI-powered solutions, Kenyan banks can navigate regulatory complexities with confidence, unlocking new opportunities for innovation and value creation. Industry thought leaders must seize this transformative opportunity to shape the future of regulatory reporting for banking in Kenya. As a result, it can be envisioned to have a sector that is propelled towards greater efficiency, transparency, and resilience, ultimately driving sustainable growth and fostering trust in the financial ecosystem.

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