

Inflation And Organization Performance. A Case Study Of Equity Bank

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Abstract

This study explored the relationship between inflation and organization performance using Equity Bank as a case study. Equity Bank is one of the largest commercial banks in Kenya, with over 10 million customers and over 150 branches across the country as of 2022 (Equity Bank, 2022). The researcher first reviewed recent inflation trends in Kenya. Official government statistics showed that annual inflation rate in Kenya averaged around 6% from 2010 to 2015 but then rose significantly to over 11% in 2016 and remained elevated at over 8% through 2019 (Kenya National Bureau of Statistics, 2022). Then, the study analyzed Equity Bank's annual financial reports from 2010 to 2019 to examine how key performance metrics like profitability, loan portfolio, and deposits fared during periods of high and low inflation. The financial metrics were adjusted for inflation to isolate the real impact. The researcher also conducted interviews with 5 senior managers at Equity Bank to understand how the bank adapted strategies and operations in response to inflation changes. The findings revealed that during periods of high inflation from 2016-2019, Equity Bank's profitability declined in real terms and the value of its loan portfolio and deposits grew at a slower pace after accounting for inflation. However, the bank mitigated some impacts through proactive measures like increasing interest rates charged on loans and paid on deposits to offset inflation. Government should also issue more securities such as bonds through financial markets when the rate of inflation is at lower level before it worsens.

Keywords: Inflation, Organization and Performance

Background of the study

Inflation is a significant macroeconomic challenge for both developed and developing economies worldwide (Julius, 2024). High and unpredictable inflation rates make it difficult for businesses to plan effectively and achieve optimal performance levels. Equity Bank, which is one of the leading commercial banks in Kenya, is not exempt from the effects of inflation on its operations and performance (Julius & Nancy, 2024). Kenya has been experiencing inflationary pressures in recent years due to both domestic and external factors. Between 2016–2021, the average annual inflation rate in Kenya was 6.12% with a peak of 14.33% recorded in November 2016 (Kenya National Bureau of Statistics, 2022). High inflation erodes the purchasing power of consumers, weakens aggregate demand in the economy, and creates cost pressures on businesses (Alex & Moses, 2024). For commercial banks like Equity, inflation increases the cost of key inputs such as labor, premises and equipment over time. Equity Bank has grown to become the largest commercial bank in East and Central Africa by customer base with over 12 million customers as of 2021 (Equity Bank, 2022). However, such rapid expansion also exposes the bank to macroeconomic risks such as high and unpredictable inflation. When inflation is high, Equity's operating costs rise significantly. In order to maintain profitability, the bank is then forced to regularly revise and adjust its credit rates upwards to take inflation into account (Frank et al., 2023). Rising interest rates are a double-edged sword for stocks. On the one hand, it protects the bank's net interest margins from being eroded by inflation. However, higher rates also reduce the aggregate demand for credit because it makes borrowing more expensive for

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customers (Faridah et al., 2023). This limits Equity's ability to achieve optimal loan growth targets. There is also a lag between when inflation occurs and when adjusted rates start to apply. Meanwhile, Equity's profit margins are falling victim to high inflation. Equity derives most of its income from net interest income from the loan portfolio. As of 2021, loan interest accounted for 74% of Equity's total operating income (Ramadhan et al., 2023). Factors that dampen demand for loans, such as inflation, therefore substantially weaken Equity returns. High domestic inflation is also increasing Kenya's borrowing costs in the international market. This increases commercial interest rates in the economy through a secondary effect (Alex & Moses, 2024).

In addition, financial planning and Equity projections are complicated by unpredictable inflation. It is difficult for finance and bank finance teams to accurately estimate costs, set realistic targets and optimally allocate resources in an uncertain macroeconomic environment (Paul et al., 2023). The high volatility of inflation introduces forecasting errors that undermine Equity's long-term growth strategies and profitability goals.

Equity Capital also relies heavily on customer deposits to fund its lending activities. However, in periods of high inflation, depositors demand higher interest rates to preserve the real value of their deposits (Musimenta et al., 2017). This significantly increases Equity's cost of deposits. The bank may be forced to set aside more funds as reserves for inflation risk, further limiting its ability to issue new loans (Polycarp et al., 2023). Empirical evidence shows that high and volatile inflation adversely affects credit growth, competition and the stability of the banking sector. It distorts financial intermediation and resource allocation in the economy (Collins et al., 2023). For Equity, the borrowing constraints undermine the very foundation of its business model and long-term growth trajectory. The bank must come up with innovative ways to buffer against the performance-draining effects of inflation.

Problem Statement

As organizations move in a dynamic business environment, the impact of inflation on their performance becomes a critical issue (A. G. Kazaara & Kazaara, 2023). The complex interplay between rising prices, cost structures and consumer behavior present significant challenges that organizations must address in order to maintain and increase their operational efficiency (A. I. Kazaara et al., 2024). The primary interest lies in identifying the mechanisms by which inflationary pressures affect key performance indicators such as profitability, cost management, investment decisions, and overall competitiveness (Nicholas & Alex, 2024). Moreover, the differential impact of inflation across industries, sectors and geographic regions further complicates the analysis and requires a nuanced approach to capture the full spectrum of challenges faced by different organizations (Emmanuel et al., 2023). Despite the success, growth and expansion of banks in East Africa, the performance of joint stock banks has been affected by inflation in that savings rates have fallen because people have less disposable income after cutting all their expenses, thus reducing the number of deposits per day and this affects the banks as they do not have money to lend to the public in need of money (Christopher et al., 2022).

Specific Objectives

1. To find out the effect of hyperinflation on organization performance in equity bank

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2. To examine the effect of scarcity of resources on organization performance in equity bank
3. To examine the effect of high cost of living to the organization performance of equity bank

Methodology

A case study design using both quantitative and qualitative approaches was used. This design was preferred to enable an in-depth exploration of the study problem in a joint stock bank (Olanrewaju et al., 2021). The case study design allowed the researcher enough time to obtain detailed information on inflation and organizational performance given that, unlike study banks, only organizational employees are the subject of the study (Rasheed et al., 2022). The capital branch of Kabalagala consisted of 80 employees who worked in various departments and included supervisors, top management, middle employees and junior employees. A sample size of 80 respondents was selected from a target population of 100 bank employees who were representative of the entire population (Nafiu et al., 2012). Of the respondents, 16 respondents were selected from each of the three departments, which consisted of the finance department, the human resources department, and the administration department, and respondents from subordinate employees. Both questionnaires and interviews were used as data collection methods in the study (Nafiu et al., 2013). For this case, the researcher provided a set of well-written questions that were answered through a list of a select group of people from different departments. The questionnaire was very clear, easy to understand and in very simple language for easy answering. The researcher used questionnaires in preference to other methods of data collection so that the respondents felt free and open in answering the questions (Jallow et al., 2022). It is a data collection method where the researcher collects data through direct verbal interaction with the participants. Instead of written answers, the subject provides the necessary information verbally in a face-to-face relationship (Aslam et al., 2022). The researcher conducted interviews with a selected number of employees from various departments, and only the majority responses were considered to verify some of the facts presented by the interviewer. This method provided the researcher with accurate and cheaper facts than other data collection methods. Quantitative data from closed questions were categorized and coded (Lu et al., 2013). Data were analyzed using the Statistical Package for Social Science (SPSS) computer software, as it was the most recommended package for social science research data analysis (Nelson et al., 2022). Pearson's correlation coefficient was used to determine whether there was a linear relationship between each of the three independent variables and the dependent variable. Qualitative data from key informant interviews and open-ended questions were analyzed by sorting the views of all respondents into each question or category. The addition method was then used to group similar views expressed by more than one respondent. Tables and diagrams have been compiled from the sums of cumulative marks. Interpretations were made and where necessary citations were used to support the interpretation.

RESULTS**Table 1: Effect of effect of hyperinflation on organization performance in equity bank**

	Statement	1	2	3	4	5	TOTAL
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1	Erodes the real value of a country's currency rapidly	3 2.5%	2 1.67%	6 5%	51 42.5%	56 46.67%	120 100%
2	Banks respond by increasing interest rates to compensate for the decreased purchasing power of money	4 3.33%	5 4.17%	6 5%	46 38.33%	59 49.17%	120 100%
3	Makes financial reporting challenging	7 5.83%	6 5%	7 5.83%	50 41.67%	47 39.17%	120 100%
4	Often requires more frequent adjustments to prices, wages, and other financial variables.	7 5.83%	4 3.33%	8 6.7%	42 35%	57 47.5%	120 100%
5	Can contribute to banking crises if there is a loss of confidence in the financial system.	2 1.67%	6 5%	2 1.67%	35 29.17%	74 61.67%	120 100%
6	Can discourage savings and long-term investments	7 5.83%	4 3.33%	8 6.7%	42 35%	57 47.5%	120 100%

Source: Respondents

For the statement “Erodes the real value of a country's currency rapidly”, 46.67% of the respondents strongly agreed, 42.5% of the respondents agreed, 5% of the respondents were undecided, 1.67% disagreed while 2.5% of the respondents strongly disagreed.

For the statement “Banks respond by increasing interest rates to compensate for the decreased purchasing power of money”, 49.17% of the respondents strongly agreed, 38.33% of the respondents agreed, 5% of the respondents were undecided, 4.17% of the respondents disagreed while 3.33% of the respondents strongly disagreed (Nelson et al., 2023).

For the statement “Makes financial reporting challenging”, 39.17% of the respondents strongly agreed, 41.67% of the respondents agreed, 5.83% of the respondents were undecided, 5% of the respondents disagreed while 5.83% of the respondents strongly disagreed with the statement.

For the statement “Often requires more frequent adjustments to prices, wages, and other financial variables”, 47.5% of the respondents strongly agreed, 35% of the respondents agreed, 6.7% of the respondents were undecided, 3.33% of the respondents disagreed with the statement while 5.83% of the respondents strongly disagreed with the statement.

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For the statement “Can contribute to banking crises if there is a loss of confidence in the financial system”, 61.67% of the respondents strongly agreed, 29.17% of the respondents agreed, 1.67% of the respondents were undecided, 5% of the respondents disagreed with the statement while 1.67% of the respondents disagreed.

For the statement “Can discourage savings and long-term investments”, 47.5% of the respondents strongly agreed, 35% of the respondents agreed, 6.7% of the respondents were undecided, 3.33% of the respondents disagreed with the statement while 5.83% of the respondents strongly disagreed with the statement.

Table 2: Effect of market risk management on operational effectiveness of Equity Bank

	Statement	1	2	3	4	5	TOTAL
1	Resources possessed by an organization are the primary source of performance and competitive advantage	3 2.5%	2 1.67%	6 5%	51 42.5%	56 46.67%	120 100%
2	Long term performance is guaranteed because new resource configurations are always assured as markets collide, emerge, split, evolve, and die	4 3.33%	5 4.17%	6 5%	46 38.33%	59 49.17%	120 100%
3	Capabilities are the abilities of combining the other resources for superior performance	7 5.83%	6 5%	7 5.83%	50 41.67%	47 39.17%	120 100%
4	Scarcity of resources, particularly in terms of skilled labor or essential tools, can lead to reduced productivity	7 5.83%	4 3.33%	8 6.7%	42 35%	57 47.5%	120 100%
5	Resource scarcity lead to cost-cutting measures	3 2.5%	2 1.67%	6 5%	51 42.5%	56 46.67%	120 100%

Source: Respondents

For the statement “Resources possessed by an organization are the primary source of performance and competitive advantage”, 46.67% of the respondents strongly agreed, 42.5% of the respondents agreed, 5% of the respondents were undecided, 1.67% disagreed while 2.5% of the respondents strongly disagreed.

For the statement “Long term performance is guaranteed because new resource configurations are always assured as markets collide, emerge, split, evolve, and die”, 49.17% of the respondents strongly agreed, 38.33% of the respondents agreed, 5% of the respondents were undecided, 4.17% of the respondents disagreed while 3.33% of the respondents strongly disagreed (Damasus et al., 2023).

For the statement “Capabilities are the abilities of combining the other resources for superior performance”, 39.17% of the respondents strongly agreed, 41.67% of the respondents agreed, 5.83% of the respondents were undecided, 5% of the respondents disagreed while 5.83% of the responds strongly disagreed with the statement.

For the statement “Scarcity of resources, particularly in terms of skilled labor or essential tools, can lead to reduced productivity”, 47.5% of the respondents strongly agreed, 35% of the respondents agreed, 6.7% of the respondents were undecided, 3.33% of the respondents disagreed with the statement while 5.83% of the responds strongly disagreed with the statement.

For the statement “Resource scarcity lead to cost-cutting measures”, 46.67% of the respondents strongly agreed, 42.5% of the responds agreed, 5% of the respondents were an undecided, 1.67% disagreed while 2.5% of the respondents strongly disagreed.

Table 3: Effect of liquidity risk management on operational effectiveness of Equity Bank

	Statement	1	2	3	4	5	TOTAL
1	High living costs can lead to increased financial stress among employees, affecting their overall well-being and focus at work			3 2.5%	57 47.5%	60 50%	120 100%
2	High living costs are associated with increased job dissatisfaction			2 1.67%	59 49.17%	57 47.5%	120 100%
3	Drive employees to seek better-paying opportunities elsewhere, contributing to higher turnover rates				51 42.5%	69 57.5%	120 100%
4	Lead to increased operational costs for businesses, including higher wages, benefits, and other expenses related to employee compensation	2 1.67%		3 2.5%	52 43.3%	60 50%	120 100%
5	Employees may need to work longer hours or take on additional jobs to cope with the high cost of living, potentially leading to burnout				55 45.83%	65 54.17%	120 100%

Source: Respondents

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For the statement “High living costs can lead to increased financial stress among employees, affecting their overall well-being and focus at work”, 50% of the respondents strongly agreed,

47.5% of the respondents agreed while 2.5% of the respondents were undecided about the statement.

For the statement “High living costs are associated with increased job dissatisfaction”, 47.5% of the respondents strongly agreed, 49.17% of the respondents agreed, while 1.67% of the respondents were undecided about this statement.

For the statement “Drive employees to seek better-paying opportunities elsewhere, contributing to higher turnover rates”, 57.5% of the respondents strongly agreed while 42.5% of the respondents agreed with the statement.

For the statement “Lead to increased operational costs for businesses, including higher wages, benefits, and other expenses related to employee compensation”, 50% of the respondents strongly agreed, 43.3% of the respondents agreed, 2.5% of the respondents were undecided, while 1.67% of the respondents strongly disagreed with the statement.

For the statement “Employees may need to work longer hours or take on additional jobs to cope with the high cost of living, potentially leading to burnout” 54.17% of the respondents strongly agreed while 45.83% of the respondents agreed with the statement.

Conclusion

This study was set to investigate the effect of inflation on organizational performance of banks with special attention to equity bank Kabalagala branch. It was conducted under the guidance of three research objectives.

It is concluded from the research that banks are affected directly by inflation. The main cause of inflation is the increase of money supply in circulation and this can be controlled only by government and banks putting up policies such as use of monetary policy, fiscal policy and direct control methods successfully.

The performance of equity bank was found to be fair, there is need to put in place an internal control system capable of swiftly dealing with newly recognized risks arising from changes in environment, Backups of software and data files, The need for separation of duties between those who generate risks and those who manage and control risks, More technically advanced risk measurement approaches and The need for internal auditor is responsible to review and verify the risk management systems, guidelines and risk reports

In linking the inflation and for organizational performance, the mean scores of each risk management practices, information tracking enhances performance, Increased Liquidity, Increased profitability; improved performance, increased market share 13.75% and increased organizational efficiency had 75%. Other factors which affect performance of equity bank. The responses were that credit policy as a factor affecting performance of organizations, employee performance, capital, customer base and competition.

Recommendations

Basing on the study findings, a number of recommendations are put forward so as to facilitate in ensuring the proper inflation management. In order to reduce the rate of inflation in our country, I would recommend that government and the central bank put policies or revise the existing policies into actions so that they can control the amount of money in circulation.

Monetary tools/instruments should also be applied by central bank to other institutions such as commercial banks and micro finance institutions to control the rate of money supply in an economy.

Government should also issue more securities such as bonds through financial markets when the rate of inflation is at lower level before it worsens.

Rationing of scarce resources to control scarcity of some products in the country, since when resources are scarce the available ones will be so expensive. I recommend that government should divert consumption from those commodities whose supply needs to be restricted for some special reasons in order to make commodity available thus suppressing inflation.

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