

Loan Portfolio Quality Diversification Factor, Loan Syndication and Financial Performance of Commercial Banks in Kenya

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Abstract

Existing literature has demonstrated that loan syndication factors can affect banks performance. Good financial performance rewards the shareholders for their investment efforts and in turn, motivates them for additional investment and enables economic growth. On the other hand, underperformance can lead to banking failure and crisis which have negative repercussions on the economic growth. This study sought to determine the influence of loan syndication factor on the financial performance of commercial banks in Kenya. This study specific objective sought to determine the influence of loan portfolio quality diversification factor on the financial performance of commercial banks in Kenya To achieve the objective the study used descriptive survey design. A census of all 39 commercial banks that were in operation consistently was the object of the research. In each bank, a self-administered questionnaire was used to collect data from the 78 respondents who composed of credit directors and operation directors. A multiple regression analysis was run so as to determine the influence of loan syndication factors on the financial performance of commercial banks in Kenya. Theories anchoring this study included Modern intermediation theory, Modern portfolio theory, and Loanable fund theory. Data collected was analyzed using descriptive and inferential statistics. The study established that loan portfolio quality diversification had a significant statistical positive influence on the financial performance of commercial banks in Kenya. Recommendations included: banks' management to establish a special unit to take charge of loan portfolio management to deal with credit rationing in the bank. This study contributes to enhancing the existing knowledge gap on loan syndication and financial performance of commercial banks in Kenya.

1. Introduction

Commercial banks have essential roles to play in the economic resource distribution in most countries of the world. Among such roles that they play is to act as an intermediary between lenders and borrowers of funds (Oduro, Asiedu & Gadzo, 2019). These banks have essential roles to play in the economic resource distribution since they have command over a large part of the supply of money in circulation, foster liquidity and proper functioning of the financial system (Udom & Onyekachi, 2018). They play a crucial role in economic growth and industrialization via channeling funds from surplus units (the depositors), to the deficit units, (the borrowers), in the process gaining from the spread (the positive difference between the interest received and interest paid) of the different interest charged (Aldeehani, 2019). Commercial banks continuously channel funds which they have received from depositors to those investors who need money for investments (Sporta, 2018). They can do so if they can make the necessary income to cover the operational cost they incur in due course. In other words for sustainable intermediation function, banks should be profitable.

A profitable and persevering banking sector helps a country to withstand a financial crisis (Salim, 2018). Good financial performance rewards the shareholders for their investment efforts and, in turn, motivates for additional investment and enables economic. On the other hand, low financial performance can lead to banking failure and crisis which have negative repercussions on the economic growth (Muriithi & Waweru, 2017). The government of all nations should have a a maximum concern on the the financial performance of all banks which are

operating in the territory of the country. As a result of such outcome and concern, the financial health of each bank should have been evaluated from time to time and managed efficiently and effectively (Alemu & Aweke, 2017). In consideration of this, financial performance analysis of commercial banks has been of great interest not only to academic research but also to the potential investors. Financial performance is a subjective measure of how well a firm can use assets from its primary mode of business and generate revenues.

Over the last decade, Sub-Saharan African (SSA) as a whole has been experiencing high annual economic growth rates, in the range of 5-7% on average and with a rapidly expanding middle class. Robust growth was made possible by economic reforms, coupled with a favorable external environment, including high commodity prices and ample capital inflows. Studies have indicated that SSA commercial banks are making more profits than the rest of the world (Slocombe, 2017). According to CBK, (2016), the Kenya banking sector registered an improved performance in 2016 with profit before tax increasing by 10.0 percent to KShs 147.4 billion in December 2016 from KShs 134.0 billion in December 2015. The improvement in profitability is as a result of a higher increase in income compared to the increase in expenses.

Some interesting development in the East African Loan Market, most notably increased larger deal sizes which demands vigorous mobilization of huge funds (Slocombe, 2017). The lending environment has also led to the development of a genuine syndicated loan market with both international and local banks participating in loan syndication. One of the funding mechanisms used by commercial banks to mobilize funds to borrowers for good returns is loan syndication (Bruche, Malherbe & Meisenzahl, 2017). Loan syndication refers to the joint issuance of loans by multiple banks (lenders). It is a process involving a group of banks, at least two, which jointly make a loan, and thereby offer funds, to a single or to multiple borrowing firms (Bos, Contreras & Kleimeier, 2016).

By forming a syndicate, banks diversify, share risk across the syndicate, information, and skills, and can more easily meet capital constraints (Chantal, Namusonge & Shukla, 2018). In a syndicate, participants can leverage each other's skills with the purpose of reducing information asymmetries in the loan arrangement process. In a syndicate, various tasks and different kinds of expertise can be allocated among lead arrangers to avoid double work, thereby reducing each arranger's effort costs (Gao & Jang, 2018). Factors motivating banks to engage in loan syndication include regulatory environment, information asymmetric, the capital strength of a bank, liquidity constraints, loan portfolio diversification opportunity, loan maturity period (Burzynska, Quyen & Contreras, 2017).

Global syndicated lending reached to US\$4.0 trillion during the full year 2016, down 10% likened to a year since and the slowest year for global credit from 2012 (Slocombe, 2017). Similarly, in African countries, loan syndication practice has also spread in countries such as Nigeria which started from the year 1960's when a consortium of commercial banks and acceptance houses buy trade bills for marketing boards under the produced bill finance project (Okonkwo 2015). Formalized loan syndication came into being during the oil boom of the 70s when there was a need for the adequate capital of financing the industrialization programs.

In the Kenyan financial market, there is visible evidence of loan syndication practices by commercial banks in a bid to mobilize huge funds for mega projects. Both private and public corporation is using a loan syndicate model from commercial banks in Kenya to finance megaprojects. The National Treasury has even gone ahead and allowed government-owned enterprises engaging in economic activities that are commercially viable to borrow from commercial banks to fund mega infrastructure projects, a move which is expected to generate more earning to commercial banks in Kenya (Anyanzwa, 2015).

2. Research Gap

Previous studies show that one of the modern approaches commercial banks mobilise funds to improve on their performance is loan syndication (Buche et al., 2017). In the recent period, loan syndications by banks have become an increasingly important part of the financial landscape in the developing countries (Cornelissen *at al*, 2016). The corporate loan markets have evolved over years with banks offering a variety of loans on a yearly basis. One of the ways banks provide corporate loans is through loan syndication. The syndicated loan market has evolved into a key vehicle through which banks lend to large corporations. Okonkwo, (2015) states that syndicated loans currently represent the largest source of financing globally.

Loan syndication as a project financing mechanism globally has been increasing over the last decade regardless of the transactions costs involved in securing the loan agreement of all the participating parties in the syndicate (Slocombe, 2017). In the face of such an evolving corporate loan market in which banks are prone to syndicate to raise loans, the influence of loan syndication factors on the financial performance of banks is a relevant question. Global syndicated lending growth rate indicates that the syndicated loan market is becoming one of the most important sources of financing of commercial banks for large and medium-sized companies globally. Commercial banks in SSA are making high profits through loan syndication (Slocombe, 2017). This background on syndicated loans growth globally and locally has motivated this study to investigate the influence of loan syndication on financial performance among commercial banks.

2.1: General Objective of the study

The general purpose of this study research was to determine the influence of loan syndication (lending sharing) factors on the financial performance of commercial banks in Kenya

2.1.1: Specific Objective of the study

a) To establish the influence of loan portfolio quality diversification on the financial performance of commercial banks in Kenya;

2.2: Hypothesis testing

H₀₁: Loan portfolio quality diversification has no significant influence on the financial performance of commercial banks in Kenya;

3. Methodology

Research philosophical approaches were examined and since the choice of research philosophy is based on a research hypothesis to be tested, positivism was considered the most appropriate method for this study. Positivism reflects the belief that reality is stable that can be observed and described from an objective viewpoint without interfering with phenomena (Cresswell, 2008). This study used mixed research design encompassing both descriptive and correlational research techniques in carrying out the study which investigated the influence of loan syndication (lending sharing) factors on the financial performance of commercial banks in Kenya. The target respondents included credit directors (managers) and operation directors (managers) from each of the commercial banks. This resulted in a target population of 78 possible respondents. This research study made use of primary and secondary data. Data collection procedure involved designing a questionnaire. After reviewing and rearranging the questionnaires, the total number of questions in the final questionnaire was 78.

This study used both descriptive and correlational statistical analyses techniques for analysis of data. The mean standard deviation and the different percentiles of the dependent variable (Financial performance) were calculated for all of the banks over the sample period. A correlation test was run for each significant variable the relationship between loan syndication and commercial banks financial performance in Kenya for the 39 commercial banks from the independent variable.

4. Study Results

4.1: Response rate

The questionnaires that were issued out to the respondents were 78 and 74 were successfully completed and returned for analysis. This means that the response rate was 95%. This is a reliable response rate for data analysis as Kothari and Gard, (2014) posited that any response of 50% and above is adequate for analysis. Further analysis was done to those respondents who completed their questionnaires and returned for analysis. The results from the study showed that out of 74 who successfully completed and returned their questionnaires for the analysis, 37 of them held the position of operation directors while the rest held the position of Credit directors. This means that 50% (37) of the respondents who successfully completed and returned their questionnaires for analysis were operation directors while 50% (37) were Credit directors.

Table 1 Response Rate

Respondents	Frequency	Percentage (%)
Questionnaires issued	78	100
Questionnaires returned	74	95
Questionnaires not returned	04	05

4.2: Reliability Test

A pilot study was carried out to determine the reliability of the questionnaires using 14 respondents. Reliability analysis was subsequently done using Cronbach's Alpha which measures the internal consistency by establishing if certain items within a scale measure the same construct. The findings were as summarized in Table 2.

Table 2: Reliability Analysis

Statements	Cronbach's Alpha	Number of Items
Loan portfolio quality diversification	0.703	5
Financial performance	0.833	10

Cronbach's Coefficient Alpha in the table 2 reveals that financial performance had reliability of a value ($\alpha=0.703$), information asymmetric had a value of ($\alpha=0.833$). This demonstrates that all the two scales were reliable as their reliability values exceeded the prescribed threshold of 0.60, which is considered acceptable. According to Cronbach's Alpha reliability, a coefficient of 0.60 and above is considered "acceptable" in most social science research situations (Manerikar and Manerikar, 2015).

4.3: Financial Performance and Loan Syndication

4.3.1: Loan portfolio quality diversification and Financial Performance

Loan portfolio quality diversification is a factor that motivates commercial banks to engage in loan syndication and the extent to which this factor influences financial performance was tested, and findings are shown in table 3

Table 3: Loan portfolio quality diversification and Financial Performance

Statements	N	Mean	Std. Dev.	Rank
Banks diversify loan portfolio to improve performance	74	4.270	.84881	1
Lending sharing among banks reduce loan portfolio risk	74	4.040	.65038	3
Loan portfolio diversification increases banks' lending capacity	74	3.554	.86233	4

Diversifying loan portfolios influence the financial performance	74	4.175	1.3175	2
Loan portfolio diversification may not be associated with high financial performance in every circumstance	74	3.189	1.6190	5
Grand average	74	3.845	.69483	

The respondents were further asked to respond to the influence of loan portfolio quality diversification factor in loan syndication (lending sharing) on commercial banks financial performance in Kenya. The majority of respondents indicated that there is a strong influence of loan portfolio quality diversification factor in loan syndication (lending sharing) on commercial banks financial performance in Kenya with the aspect of banks intention to diversify its loan portfolio to improve on the financial performance scoring a mean score of 4.270, lending sharing (loan syndicate) among banks help to reduce loan portfolio risk scoring a mean of 4.040, loan portfolio diversification to increase the lending capacity of banks scoring a mean of 3.554, diversifying loan portfolios influence the financial performance level of banks scoring a mean of 4.175 and loan portfolio diversification may not be associated with higher financial performance in every circumstance scoring a mean of 3.189.

The aspect of banks diversification of loan portfolio to improve performance had the highest scores which were an indication that diversification of loan portfolio can improve banks financial performance. This finding concurred with Howcrofta et al., (2014) who found out that risk diversification is significant and positively related to the likelihood of extending syndicated loans to improve on performance. Banks that appear to hedge against their currency, market and interest rate risk positions seem to participate more in the syndicated loan market. This provides evidence that banks aiming to manage their risks consider syndicated lending as a tool to achieve diversification

4.3.2: Financial Performance

The financial performance involved verifying performance indicators ROA (measured by net income to total assets) and ROE (measured by net income to total capital or shareholders funds). The result regarding banks performance is shown in table 4.

Table: 4: Financial Performance

Statements	N	Mean	Std.Dev.
Net income to total assets for the year ended 2012	74	3.770	1.02766
Net income to total assets for the year ended 2013	74	3.500	1.21914
Net income to total assets for the year ended 2014	74	3.513	1.23655
Net income to total assets for the year ended 2015	74	3.297	1.30587
Net income to total assets for the year ended 2016	74	3.243	1.34194
Net income to total capital for the year ended 2012	74	3.676	1.02179
Net income to total capital for the year ended 2013	74	3.635	1.18112
Net income to total capital for the year ended 2014	74	3.595	1.28824
Net income to total capital for the year ended 2015	74	3.405	1.30253
Net income to total capital for the year ended 2016	74	3.311	1.39391

The influence of loan syndication factors on financial performance indicates that there is a strong influence of loan syndication factors on the financial performance of commercial banks in Kenya. This is shown by the financial performance (net income to total assets) in the year 2012 with a mean of 3.770, 2013 with a mean of

3.500, 2014 a mean of 3.513, 2015 a mean of 3.297 while 2016 had a mean of 3.243. The results for net income to total assets in the year 2012 indicated a mean of 3.676, 2013 indicated a mean of 3.635, 2014 a mean of 3.595, 2015 - a mean of 3.405 while 2016 had a mean of 3.311. From the findings, it can be noted that the year 2012 recorded the highest value for the ROA (net income to total assets) as shown by a mean of value of 3.770 while the year 2016 recorded the lowest value for the ROA (net income to total assets) as shown by a mean value of 3.243. From the findings, it was also noted that the year 2012 recorded the highest value for the ROE (net income to total capital) as shown by a mean of value of 3.676 while the year 2016 recorded the lowest value for the ROE (net income to total capital) as shown by a mean value of 3.311. In addition, the values for standard deviation depict variability in the ROA (net income to total assets) during the five-year period with the highest deviation of 1.34194 in the year 2016 and the lowest 1.02766 in the year 2012. Further, the values for standard deviation depict variability in the ROE (net income to total capital) during the five-year period with the highest deviation of 1.39391 in the year 2016 and the lowest 1.02179 in the year 2012.

Overall the financial performance for the five years was a mean of 3.495 showing that performance of commercial banks in Kenya are satisfactory and therefore the management should come up with appropriate financial innovations that can enable them to maintain and improve on their performance. This agrees with the finding of Thiongo (2016) whose study covered a five-year period from 2011 to 2015 on the effect of growth in loan portfolio on the financial performance of commercial banks in Kenya and found that loan factors had an influence on the financial performance of commercial banks in Kenya.

4.4: Regression Analysis and Hypothesis Testing

The test of the hypothesis was performed and the results presented on the influence of loan portfolio quality diversification on the financial performance of commercial banks in Kenya;

4.4.1: Model Summary Results

The model summary in table 5 shows the results of regression for the influence of loan portfolio quality diversification on the financial performance of commercial banks in Kenya;

Table 5: Model Summary Results

Model	R	R Square	Adjusted R Square	Std. The error of the Estimate
1	.553 ^a	.306	.296	.79967

The results in Table 5 indicates that Loan portfolio quality diversification has a significant positive relationship influence on the financial performance of commercial banks in Kenya, an indication that loan portfolio quality diversification had 55.3% significantly positive relationship with financial performance. A possible explanation for this significantly positive relation is the benefits of lending banks from being able to syndicate large corporate loans (Echekoba, 2015). Syndicating, i.e., selling a large proportion of loans that banks originate themselves or participating in loans to borrowers banks usually do not have access to, helps them diversify their loan portfolio.

4.4.2: Loan portfolio quality diversification and Financial Performance

Table 6: Coefficients^a

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
(Constant)	.547	.526		1.039	.302
Loan portfolio quality diversification	.759	.135	.553	5.633	.000

The regression results in Table 6 show that there is a positive and significant influence between Loan portfolio quality diversification and the financial performance of commercial banks in Kenya ($\beta_1=.553$, $P = .000$). This

leads to the rejection of the null hypothesis (H_{01}) and the acceptance of the alternative hypothesis (H_1). The study, therefore, concludes that Loan portfolio quality diversification has a significant positive relationship influence on the financial performance of commercial banks in Kenya

5 Conclusions and recommendations

The main purpose of this study was to establish the influence of Loan portfolio quality diversification on the financial performance of commercial banks in Kenya. The data for the study was collected from 39 commercial banks using a structured self-administered questionnaire with five-point Likert-type scale questions. The target population for the study was all the 39 banks operating in Kenya. Most importantly, the study established that majority of the respondents generally agreed that there is an influence of Loan portfolio quality diversification on the financial performance of commercial banks in Kenya.

5.1 Loan portfolio quality diversification and Financial Performance

The coefficients in the regression model indicate that Loan portfolio quality diversification will always exist at a certain minimum ($\beta_0 = 0.547, P=0.302$). The Loan portfolio quality diversification has a significant influence on the financial performance of commercial banks in Kenya ($\beta_1 = .553, P = .000$). This finding agrees with the results of (Nkuah, 2015) that carried out a study on the effect of loan portfolio quality on the performance of banks in Ghana. The return on equity and net interest margin were used to proxy financial performance while loan portfolio profitability and loan loss provision/gross loan advances were used as proxies for loan portfolio quality. The findings of the study established that loan portfolio quality has a significant effect on the financial performance of the selected Ghanaian universal banks.

5.2 Recommendations

Based on the study findings, it is important for the Kenyan government and regulatory authority to monitor the syndicated lending activity of banks. However, monitoring and regulating syndicated lending poses a significant challenge for the government and regulatory authority as loans are generally originated outside their regulatory sphere. This study research, therefore, recommends a collaborative effort displayed both by local government and regulatory authority and international authorities to regulate the syndicated loan market and control the possible excessive risk-taking behaviour.

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