

Determinant of Market Performance of Public Commercial Banks in Kenya

¹ABDULLAH MOHAMED, ²DR. SAMSON NYANG'AU

Abstract: The General objective of this research was to assess the determinant of market performance of commercial banks in Kenya. The specific objectives of this project were to establish the effect of capital structure, bank size, loan structure and bank liquidity on market performance of commercial banks in Kenya. The study adopted secondary data analysis research design. The observations used dated from January the year 2012 to December 2015 and included 48 monthly observations. The population composed of all the 42 commercial banks in Kenya. The data was obtained from Kenya National Bureau of statistics, the central bank and audited financial statements of individual banks. Correlation and multiple regressions were employed as the analytical tools. The study had been driven by the absence of laborious studies that address the dynamics of the market performance in commercial banks in Kenya. The research was also motivated by the mixed results that various previous researchers got for the same types of the variables. The study was also helpful to other researchers as a source of reference and as a stepping stone for those who wanted to make further study on the area afterwards. The study findings established that size positively affects bank market performance. Capital structure had an inverse relationship with market performance of commercial banks while bank loan growth was negatively correlated with market performance. Moreover, the study established that liquidity is significantly and positively related with the market performances of commercial banks.

Keywords: Liquidity, Capital Adequacy, Bank size and Market capitalization.

1. INTRODUCTION

Commercial banks play a vital role in the economic resource allocation of countries. They channel funds from depositors to investors continuously. They can do so, if they generate necessary income to cover their operational cost they incur in the due course. In other words for sustainable intermediation function, banks need to be profitable. Beyond the intermediation function, the financial performance of banks has critical implications for economic growth of countries. Good financial performance rewards the shareholders for their investment. This, in turn, encourages addition investment and brings about economic growth. On the other hand, poor banking performance can lead to banking failure and crisis which have negative repercussions on the economic growth.

Statement of the problem:

The Kenyan financial sector is largely bank-based as the secondary market is still not established in the country. Banks dominate the financial sector in Kenya and as such the process of financial intermediation in the country depends heavily on banks. Keeping their optimal market performance for banks in Kenya is very important to meet the expectation of their stakeholders. Hence understanding bank specific factors that influence the performance of commercial banks is critical not only to the management of these commercial banks but also to other stakeholders and interest groups such as the country's Central Bank, the government as a whole, the banker's association as well as other financial authorities in the country (Ayele, 2012).

Empirical studies have mixed findings on the determinant of market performance. Chaganti and Damanpour (2001), Grier and Zychowicz (2004), Bathala et al. (2004) and Crutchley and Jensen (2006) find a negative relationship between

determinants factors and market performance. On the other hand, Leland and Pyle (2007), Berger et al. (2007) and Chen and Steiner (2009) show that determinants factors and market performance are positively related.

Most of the studies on bank market performance determinants have covered developed economies, whereas much less studies covered developing economies such as Kenya's economy. Some of these studies include Aburime (2008) in Nigeria, Al-Tamini (2010) in UAE, Clair (2004) in Singapore, Heffernan & Fu (2010) and Wong, Fong, Wong, & Choi (2007) in China. It is however important to note that countries differ in terms of the macro-economic conditions, the financial systems as well as the operating environment of these banks (Ongore and Kusa, 2013). This shows that factors that influence performance in one country may not be the same as those in another country (Lipunga, 2014).

Studies that are close to effect of bank specific factors on bank market performance in Kenya include Njihia (2005), Mwanja (2009), Okutoyi (1988), and Ndungu (2003). These studies were however designed to focus on each factor of bank financial performance to the exclusion of the other factors while some only focused on listed commercial banks as in the case of Ndungu (2003). There is no study that has been done on a larger sample of commercial banks hence a gap that needs to be filled in by carrying out the present study. This study builds on the study by Njihia (2005) as the former study was limited by the scope as it only focused on one aspect of commercial banks market performance. Given the passage of time and limitations of case studies as far as generalization of results to the population is concerned, there is need for the present study to be conducted. The study posed the following research question: What are the determinants factors on the market performance of commercial banks in Kenya?

Objectives:

- i) To establish the effect of Bank Size on the market performance of commercial banks in Kenya.
- ii) To determine the effect of Capital Structure on the market performance of commercial banks in Kenya.
- iii) To examine the effect of Loan Structure on the market performance of commercial banks in Kenya.
- iv) To assess the effect Liquidity on the market performance of commercial banks in Kenya.

2. THEORETICAL REVIEW

Capital Structure Theory:

Capital structure puts into perspective the way in which a firm finances its operations Brigham (2004), this can either be through debt or equity capital or a combination of both David (1979). Capital structure theory as attributed to Modigliani and Miller concluded that it doesn't matter how a firm finances its' operations and that the value of a firm is independent of its 'capital structure making capital structure irrelevant. The study was based on the assumption that there were no brokerage costs, earnings before interest and tax were not affected by the use of debt and that investors could borrow at the same rate as corporations and lastly there was no information asymmetry. Although this statement didn't reject the possible preference of a firm's owner to a certain type of financing over others, it did affect the irrelevance of the value of the firm to the means of financing it given a perfect market (Fischer, Heinkel, & Zechner, 1989). A number of theories were from then onward advanced to explain capital structure notable among which are the pecking order theory and trade off theory which have been often than not a centre of debate.

Financial fragility theory:

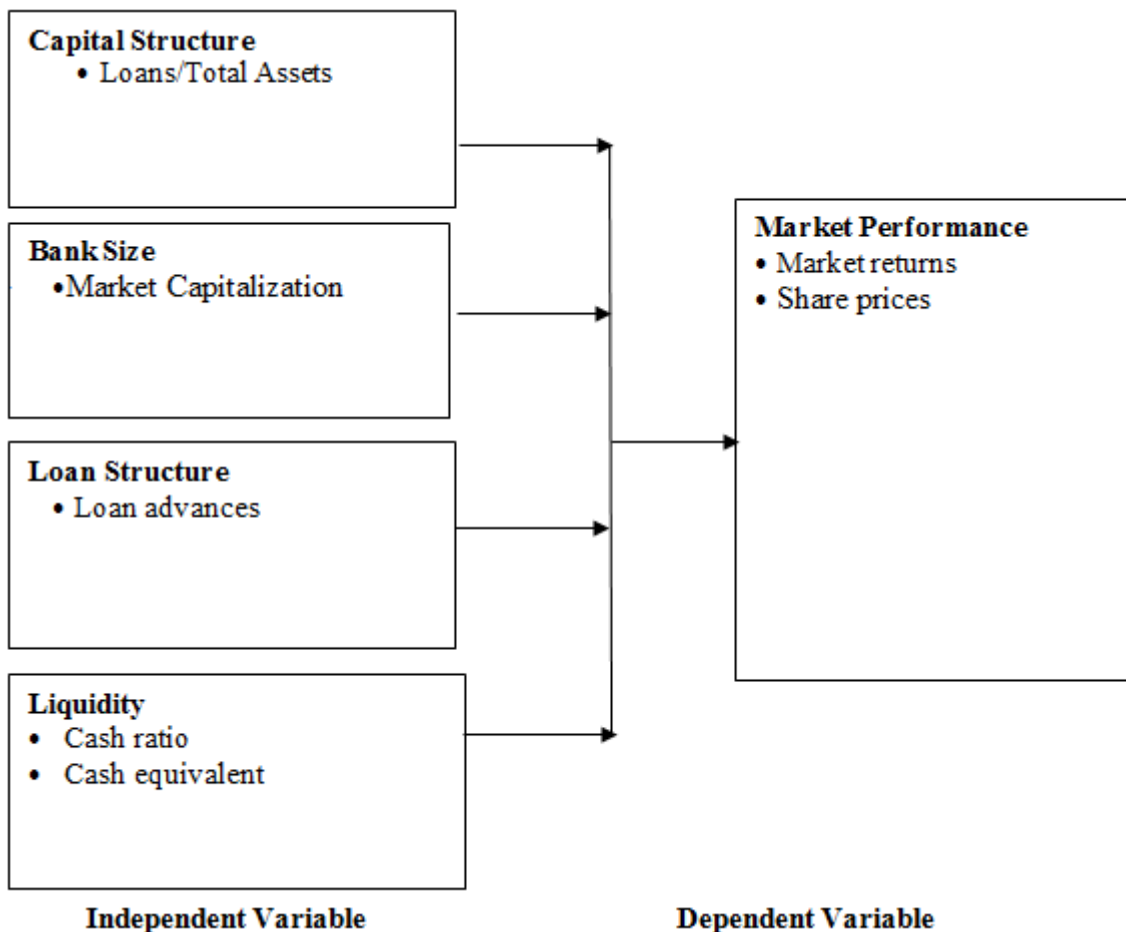
This theory was first developed by Diamond and Dybvig (1983), who assert that bank runs are a common feature of the extreme crises that have played a prominent role in the monetary history. They note further that during a bank run depositors rush to withdraw their deposits because they expect the banks to fail. This sudden withdrawal can force the bank to liquidate many of its assets at a loss and subsequently to failure. They conclude that in a panic with many banks failures, there is a disruption of the monetary system and a reduction in production in the economy.

Cash Inventory Management Theory:

This theory developed by Baumol (1952), who assert that a stock of cash is its holder's inventory of the medium of exchange, and like an inventory of a commodity, cash is held because it can be given up at the appropriate moment. Baumol note that this serves as its possessor's part of the bargain in an exchange. Fola (2015), note that in inventory management theory, firms identify their optimal level of cash holding by weighting the marginal costs and marginal benefits of holding cash. The study note further that the benefits related to cash holding are: reduced likelihood

of financial distress, allow the pursuance of investment policy when financial constrains are met, and minimizes the cost of raising external funds or liquidating existing assets. The conclusion was firms will trade-off holding cash and investing it depending on its investment needs.

Conceptual Framework:



Research gaps:

Melese (2015), noted that since market performance is very crucial to the existence of banks, factors that affect it should be identified. The author notes that further research on the area of factors that affect market performance of commercial banks by incorporating any more relevant variables would enhance the understanding of the sector. The literature available on market performance in relation to bank specific factors on Kenyan context is limited. The few papers that have been written on financial performance in Kenya have been supported mainly by reviews of papers from other countries. Some of these papers are Mugenyah (2015), Maaka,(2013)and Karani (2014)who investigated the effect of bank specific factors on banks performance.

3. RESEARCH METHODOLOGY

The research design used in this study was descriptive research design. The target population for this study was the 11public commercial banks in Kenya.This study used census sampling since the population also constituted the sample that was the 11 public commercial banks. The data that was used was dated from year 2012 January to 2015 December. Each year consisted of 12 monthly observations for each variable so in total 48 observations which was a fairly large sample above the minimum acceptable small sample size of 30 for inferential analysis. The researcher used secondary data in empirical analysis.The statistical Package for Social Sciences (SPSS) was used for data analysis purpose.

Model Specification:

$$R = \beta_0 + \beta_1 (R_m - R_f) + \beta_2(DET)$$

Where;

R=Returns

The return on the overall theoretical market portfolio which includes all assets and having the portfolio weighted for value.

β_0 = Intercept

Refers to the point at which a curve intersects

R_f = risk-free rate of return

The risk-free rate of return is the theoretical rate of return of an investment with zero risk.

β_i = beta value for financial asset i

Beta is a measure of the volatility, or systematic risk, of a security or a portfolio in comparison to the market as a whole..

R_m = average return on the capital market

It refers to a ratio used in finance, valuation and accounting, as a measure of the profitability and value-creating potential of companies after taking into account the amount of initial capital invested.

DET= Other variables

These are other variables apart from the stated variables which also affect the market performance of commercial banks

4. RESULTS AND DISCUSSION

Regression Results:

From the model, it is clear that, all the variables are positively related to the dependent as all the coefficients are positive. The model also shows that holding the predictor variables constant at zero (0), the market performance would be 4.205. Further, the results show that, market size has a positive relationship with market performance of public commercial banks where a unit increase in market size would result to 1.260 times increase in market performance of the public commercial banks. From the model, it is also clear that, a unit increase in the capital structure would result to 0.805 times reduction in the market performance, a unit increase in the loan structure would lead to 1.10 times reduction in market performance and a unit change in liquidity would result to 0.317 times positive changes in market performance. The significance of the coefficients at 5% level with a 2-tailed test was found to be significant as indicated by their p-values which are all less that 0.025 (the critical value at 5% level).

Table 4.1: Regression Coefficients

| | Unstandardized Coefficients | | Standardized Coefficients | | |
|-------------------|------------------------------------|------------------|----------------------------------|----------|------------|
| Model | B | Std Error | Beta | T | Sig |
| Constant | 4.205 | 0.233 | | 0.885 | 0.009 |
| Bank Size | 1.260 | 0.675 | 1.310 | 1.815 | 0.0215 |
| Capital Structure | -0.805 | 0.024 | 1.102 | 1.027 | -0.012 |
| Loan Structure | -0.890 | 0.458 | 0.042 | 0.085 | -0.007 |
| Liquidity | 0.317 | 0.980 | 0.355 | 0.316 | 0.005 |

The table gives the regression coefficients which are used to answer the regression model proposed; $Y = Y = \alpha + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4 + \epsilon$ Where: Y = Market Performance

X_1 = Bank Size

X_2 = Capital Structure

X_3 = Loan Structure

X_4 = Liquidity

β_0 = Constant,

€ = standard error

Based on the table results, the model therefore becomes;

$$Y=4.207+1.262X_1+0.806X_2+1.110X_3+0.089X_4$$

5. CONCLUSION

The study concluded that there is a statistically significant relationship between the bank size and their market performance. The market capitalization of the firms is directly related with the market performance. The study further concludes that capital structure has a significant negative effect on the market performance public commercial banks in Kenya. In this case therefore from the independent variables involved in the study capital structure has a negative impact on the market performance of public commercial banks. From the study, it can also be concluded that bank loan growth is negatively correlated with market performance. The explanation is that when a bank involves in excessive lending, the possibility of defaulting loans increases. This default deteriorates the commercial bank market performance. Finally, the study established that current ratio positively affect the market performance of public commercial banks, thus the study concludes that liquidity positively affect the market performance of public commercial banks.

6. RECOMMENDATION

The findings revealed that market capitalization is directly related to the market performance. More investments should therefore be done through establishing more public commercial banks networks across the country which is associated positively with their market performance. The conclusion that borrowing does not always improve a firm's market performance leads to the recommendation that public commercial banks should use shareholders' funds as much as possible before they undertake to borrow, so that they minimize the risks related to borrowing, which include interest on the debt exceeding the return on the assets they are financing. The firm must select source of funding carefully to avoid falling into the leverage risk trap. When public commercial banks has exhausted its shareholders' funding and chooses to finance its expansion of operations by borrowing, special consideration must be taken to ensure that the assets financed by the borrowed funds bring in a higher return than the interest the firm is required to pay on the debt. Loans are the main assets to a bank. However, banks should also avoid concentrating on long term loans as they are riskier and illiquid. Banks should plan their loan portfolio to an optimal level to reduce their risk and increase their liquidity.

Suggestions for Further Research:

The study suggests that further readings should explore on the specific factors that affect each of the study variables. For instance, further studies should aim to establish the determinants of bank size, Capital structure, Loan structure and liquidity. Also, further studies can be conducted to establish other factors that influence market performance of public commercial banks. Establishing other factors that influence market performance can help the regulators to safeguard the market performance so that appropriate results are obtained for the good of investors and the listed corporate bodies. Also, future studies should include comparison of a simultaneous comparison of the determinant of market performance of commercial banks in Kenya. Comparison of different markets can help reach concrete conclusions as regards the subject of the study. Lastly, future researchers are encouraged to include more banks and years to increase the sample size improving representativeness. This can be done by adding banks from private sector into their research to provide a more accurate and inclusive and suitable finding to be used by others.

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