EFFECT OF FIRMS' SPECIFIC CHARACTERISTICS ON FINANCIAL PERFORMANCE OF ISLAMIC BANKS IN KENYA

[1]MOHAMED HASSAN SALAT, [2]PROFESSOR WILLY MUTURI

[1,2] JOMO KENYATTA UNIVERSITY OF AGRICULTURE AND TECHNOLOGY

Abstract: **Commercial banks and particularly Islamic Banks play vital role in the Kenyan economy as well play as indicators of strength of country economy. Over the last few years, Islamic banks have changed the way of doing business specially the banking sector. Specific characteristics that are unique to specific firms have underlying effect on their financial performance of Islamic banks in Kenya and were subject for empirical discussion for so long. The government of Kenya in collaboration with Muslim Faithfull has recognized the important of Islamic Banks in economic growth and deepening of financial services to its citizens in the Constitution. However, given the potential benefits of Islamic Banks have to the general economy and the well-being of its citizen, specific characteristics of these banks and its effects on financial performance have been of great concern and importance. The study investigated how specific or unique entity characteristics affect the performance of Islamic banks in Kenya. We focused on the three (3) main Islamic banks licensed and operating in Kenya for the period of (2010 - 2016.) Several researchers have studied firm specific/ unique characteristic and its effect on financial performance of other conventional banks as well as their growth of the firm entity but gave little information on Islamic banks hence necessitated for this research project. This study found out that Islamic banks in Kenya were affected by its own individual firm characteristic namely firm size, firm age, size, and liquidity and board size of firm as measured by overall financial performance. Previous studies gave mix and inconclusive findings on how size, firm age, liquidity and board size affect financial performance. In attempt to interpret the effect of specific firm characteristic and its financial performance on Islamic banks, this study employed descriptive research design. Secondary data from audited financial statement of respective banks and data from the central bank of Kenya was also analyzed. This study heavily relied on primary data collected by the use of questionnaires directly administered. A pilot study was validated as a research instruments. Data collected from field was analyzed by use of Statistical Package for Social Sciences (SPSS) Computer Package version 22, to evaluate how individual firm entity specific characteristics affect its financial performance of Islamic banks in Kenya, the study figured out three fully fledged Islamic banks in Kenya as study population though there a number of other conventional banks that offer sheriah window product. The finding of the research helped the board of directors, local investors, the government and regulatory bodies to monitor and evaluate performance of the Islamic banks for well-being of the economic. Islamic banks should carry out more research and developments as this still grey area that needs more research in order to understand fully Islamic banks.**

Keywords: **specific firms, Islamic Banks, Kenyan economy, banking sector.**

1. INTRODUCTION

Background of the study

The information on the background to the study are statement of the problem, the study objectives, and the research questions, significance of the study and scope of the study. The focus of the study was to find out effects of firms' specific characteristic on the financial performance of Islamic banks in Kenya.The specific objectives were size of the bank, firms' age, effect of liquidity and size of the board. Like any other financial institution, Islamic banks play an important role in the financial life of business, and for that reason they are considered as life-blood of modern economy. In the words of Stephenson & Britain “Banks are the custodians and distribution of liquid capital, which is the life-blood of our commercial and industrial activities upon the prudence of their administration depend the economic well-being of the nation”. It’s for this reasons that banking sector being closely monitor and evaluate banks performances to ensure that the financial sector is strong and efficient. In Kenya although most banks are making huge profits as per their financial statements reports banks do have affair share of challenges that hinders their financial performances including the high cost of borrowing, theft case and stiff completion from mobile money transfer services providers. Islamic banking is one of the fastest growing financial segments in the financial market industries globally in their report Ernst and young 2012 Islamic bank asset grew1.3 trillion in 2011 annual growth of 19% but local in Kenya statistical data shows worrying trend. According to CBK Report, (2017) the average adequacy ratio of Islamic banks decreased marginally from 20.0 per cent in 2016 to 18.9 per cent in 2017 with profit before tax decreasing by 5.03 per cent from Ksh. 141.1 billion in December 2016 to Ksh. 134.0 billion in December 2017. On the other hand Islamic banking expenses rose by 16.3 per cent from Ksh. 277.6 billion in December 2016 to Ksh. 322.8 billion in December 2017.The Islamic banks activities are no different from the conventional one than only that controls are derived from the Islamic law means of obtaining funds and invest. Since the inception the Islamic banks face lots of challenges including legal support requirement, balance sheet problems not showing asset finance through Ijaraa, Mubarah and PLS on deposit fear of loss is the biggest barrier to deposit mobilization in Islamic banks.

Statement of the problem:

The subject financial performance has received overwhelms attention from scholars’ academician and researchers in various area of strategic management, as well as media industries, in fact the primary role concern of any business is to increase its profit and shareholders’ wealth maximization. In order for business organization to prosper it must perform well in terms of profitability and growth. But in the day today running of business it faces a number of setbacks that undermine the sole objective of the firm. In Kenya although most banks are making huge profits as per their financial statements reports banks do have affair share of challenges that hinders their financial performances including the high cost of borrowing, theft case and stiff completion from mobile money transfer services providers. Islamic banking is one of the fastest growing financial segments in the financial market industries globally, in their report Ernst and young 2012 indicated Islamic bank asset grew1.3 trillion in 2011 annual growth of 19% but in Kenya the statistical data is different. According to CBK Report (2017), the average adequacy ratio of Islamic banks decreased marginally from 20.0 per cent in 2016 to 18.9 per cent in 2017 with profit before tax decreasing by 5.03 per cent from Ksh. 141.1 billion in December 2016 to Ksh. 134.0 billion in December 2017.On other hand expenses rose by 16.3 per cent from Ksh. 277.6 billion in December 2016 to Ksh. 322.8 billion in December 2017.The A study on guru bank of Malaysia to determine on why some banks are more successful than others and to what extent do internal management factors affect profitability performance rather than external environment concluded that management is the most determinant of bank profitability. When a firm is competitive it will greater opportunity to prosper. On contrary opinion argues that bigger firms are rigid and bureaucratic hence decision making takes time because of the firm size hence great opportunity are lost resulting less profitability of the firm (Leibestein,1976). Vafeas (1999) cited that the organization board size is relatively correlated with the organization performance however some scholars have contrary opinion Sisenberg, Sungren and Wells (1998) found out that board size and organizational performance while others suggest that their weak evidence exist between board size and organizational performance yermack (1999). Based from the above study it’s evident that there are mix and inconclusive findings, this study explored how size, firm age, liquidity and board that governed the fully fledged Islamic banks in Kenya.

2. METHODOLOGY

Here the research part deals with which and how the methods are used in the study, it provides a comprehensive discussion by outlining how the data was obtained, validated and verified, the population of the study, sampling frame and sampling techniques, research design strategies. According to Sekaran and Roger (2011), research design is a master plan that specifies the methods and procedures for collecting and analyzing the needed information. The descriptive design was preferred because the questions raised in the study required collecting data through administration of questionnaires to the respondents and also were effective since the study involved quite a large population. A descriptive study was effective since it contributed towards minimizing bias and optimizing on the reliability of data. The study adopted a descriptive research design in establishing the effects of firms’ specific characteristic on the financial performance of Islamic banks in Kenya.

Population is the complete set of cases or group members, and or the total collection of elements about which we wish to make some inferences (Saunders, Lewis & Thornhill, 2003; Cooper & Schindler, 2000). The population for the study was all the three fully Islamic banks operating in Kenya namely first community bank, Gulf African bank and Dubai Islamic bank for the period 2010 to 2016. Therefore for every bank 40 employees were picked bringing the total population to 120 employees who are involved in implementation processes of the activities in the banks.

3. DATA PROCESSING AND ANALYSIS

Questionnaires were used to gather data because the information was collected from a large sample and a diverse area, in addition confidentiality was upheld. Questionnaires were administered to all the respondents. The people who were sampled filled in the questionnaires provided while being assisted by research assistants where they were unable to interpret the questions during any scheduled meetings, otherwise, the research assistants dropped and picked the questionnaires as agreed. Secondary data was collected through published scholarly articles, journals, newspapers, books and other relevant literature. Issues covered were sequenced and worded to make the data collected systematic.

Data analysis was carried out by use of Statistical package for the social Scientists (SPSS) to obtain descriptive statistics, a summary regression and a multiple linear regression model. SPSS software version 22.0 was used to produce frequencies, descriptive and inferential statistics were used to derive conclusions and generalizations regarding the population. The particular descriptive statistics produced frequencies, mean scores and standard deviation. A multiple linear regression model was used to test the significance relationship of independent variables against the dependent variable.

4. CONCLUSIONS

Liquidity, firm size and board size effect on the financial performance of Islamic banks.

A positive correlation exists between size of the bank and financial performance of Islamic banks in Kenya. The study found out that there was a positive correlation between firms' age effect of liquidity and financial performance of Islamic banks in Kenya. It can be concluded that there was a positive relationship between firms' age and financial performance of Islamic banks in Kenya. Board size and composition of board members too affect financial performance of all banks and in particularly Islamic banks .board members should meet on regular basis as it will ensure efficiency and effectiveness in the financial performance as well as early corrections will be made.

5. RECOMMENDATIONS OF THE STUDY

The study recommends that size of the bank should be looked into to facilitate better financial performance of Islamic banks in Kenya. Financial management plays an important role in development of a country; hence size of the bank should be checked to ensure better financial performance.

Firms' age should be looked into and well integrated to enhance financial performance. The study recommends that predesigned objectives are essential to ensure financial outcomes are met by the implementation team.

Lastly, this study recommends that the size of the board should be facilitated and integrated; the finance managers and team should meet very frequently in order to effectively monitor and evaluate financial activities. The Financial activities should be well monitored and evaluated as they are critical to the financial performance of Islamic banks.

Suggestion for further research:

Effective financial performance involves a wide range of activities together. The overall financial performance of Islamic banks has uncountable research papers. Scholars have therefore not exhausted areas of financial performance of Islamic banks. Further studies can be done in other counties for the purpose of making a comparison of the findings with those of the current study. Other variables with an exception of size of the bank, firms' age, and effect of liquidity and size of the board can also be studied.

The research attempted to unveil the effects of the firms' specific characteristics to the financial performance of Islamic banks in Kenya and contributed to 63.7% which provided the researcher with more information that was important to be used for academic reference. Scholars in this field should go ahead to ascertain other different variables, their uniqueness and connection to better financial performance.

REFERENCES

[1] Abdus, S. (2004). Performance of Interest-free Islamic Banks Vis-à-vis Interest-based Conventional banks.*Journal of Economics and Management* 12, no.2.The International Islamic University, Malaysia

[2] Aggarwal R. & Yousef T. (2000).Islamic Banks and Investment Financing. Journal of Money, Credit and Banking, 32 (1), 93-120.

[3] Ahmad, A. (1987). *Development and Problems of Islamic Banks*. Jeddah: Islamic Research and Training Institute, Islamic Development Bank.

[4] Ahmad, A., Rehman, K., &Safwan, N. (2011).Comparative study of Islamic and conventional banking in Pakistan based on customer satisfaction. *African Journal of Business Management,**5**(5).* 1768-1773.

[5] Akhtar, M.H., Ali K. &Sadaqat, S. (2011). Liquidity Risk Management: A comparative study between Conventional and Islamic Banks of Pakistan, *Interdisciplinary Journal of Research in Business,* **1**(1). 35-44.

[6] Al-Tamimi, H., Hassan, A. (2010*). Factors Influencing Performance of the UAE Islamic and Conventional National Banks*. Department of Accounting, Finance and Economics, College of Business Administration, University of Sharjah.

[7] Ansari, S. &Rehman, K. (2011).*Comparative Financial Performance of existing Islamic Banks and Contemporary Conventional Banks in Pakistan*.Proceedings2nd International Conference on Economics, Business and Management, IPEDR **22.**

[8] Antoniou, A., Guney, Y., &Paudyal, K. (2002).*Determinants of Corporate Capital Structure: Evidence from European Countri.*, University of Durham, Workingpaper, pp: 1-8.

[9] Ariff, M. (1988).*"Islamic Banking*."Asian-Pacific Economic Literature, 2(2).46-62.

[10] Athanasoglou, P.P., Sophocles, N.B., Matthaios, D.D. (2005). *Bank-specific, industry-specific and macroeconomic determinants of bank profitability.* Working paper, Bank of Greece. 1(1).3-4.

[11] Baxter, N. D. (1976); Leverage, Risk of Ruin and the Cost of Capital, Journal of Financial Economics, 1976,3: 305-360

[12] Bierman , H.,(1999) Corporate Financial Strategy and Decision Making to Increase Shareholder Value, Frank J. Fabozzi Associates, Pennsylvania, USA.