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**AN ANALYSIS OF THE EFFECT OF BUSINESS DIVERSIFICATION ON
THE FINANCIAL PERFORMANCE OF COMMERCIAL BANKS IN
KENYA**

KITISYA DANIEL TAMALE

056415

**SUBMITTED IN PARTIAL FULFILMENT OF THE REQUIREMENTS
FOR THE DEGREE OF MASTER OF COMMERCE AT STRATHMORE
UNIVERSITY**

SCHOOL OF MANAGEMENT AND COMMERCE

STRATHMORE UNIVERSITY,

NAIROBI, KENYA

JUNE, 2017

DECLARATION

I declare that this work has not been previously submitted and approved for the award of a degree by this or any other University. To the best of my knowledge and belief, the thesis contains no material previously published or written by another person except where due reference is made in the thesis itself.

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Kitisya Daniel Tamale – 056415

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Approval

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DEDICATION

I dedicate this work to my father Samuel Kaleke Kitisya, my wife Teresia and our two beautiful girls Elizabeth and Olivia.

TABLE OF CONTENTS

DECLARATION.....	ii
ACKNOWLEDGEMENTS	iii
DEDICATION.....	iv
LIST OF TABLES	viii
LIST OF FIGURES	ix
LIST OF ABBREVIATIONS	x
ABSTRACT.....	xi
CHAPTER ONE: INTRODUCTION.....	1
1.1 Introduction.....	1
1.2 Background to the Study.....	1
1.3 Statement of the Problem.....	5
1.4 Research Objectives.....	7
1.4.1 General Objectives.....	7
1.4.2 Specific Objectives	7
1.5 Research Questions.....	8
1.6 Scope of the Study	8
1.7 Significance of the Study	9
CHAPTER TWO: LITERATURE REVIEW.....	10
2.1 Introduction.....	10
2.2 Theoretical Review	10
2.2.1 Portfolio Theory.....	10
2.2.2 Agency Theory.....	11
2.2.3 The Stakeholder Theory.....	12
2.3 Empirical Literature	13
2.3.1 Business Diversification and Financial Performance	13
2.3.2 Bank Size and Financial Performance	16
2.3.3 CAMELS Measure of Financial Performance.....	17
2.4 Conceptual Framework.....	19
CHAPTER THREE: RESEARCH DESIGN AND METHODOLOGY	21
3.1 Introduction.....	21
3.2 Research Design.....	21

3.3 Target Population and Sampling.....	21
3.4 Data Collection Methods	22
3.5 Data Analysis and Presentation	23
3.6 Research Reliability	27
3.7 Ethical Issues in Research.....	29
CHAPTER FOUR: PRESENTATION OF RESEARCH FINDINGS	30
4.1 Introduction.....	30
4.2 Response Rate.....	30
4.3 Demographic Characteristics	31
4.4 Effect of Forms Diversification on Financial Performance	32
4.4.1 Channel Diversification and Financial Performance	32
4.4.2 Product Diversification and Financial Performance	33
4.4.3 Location and Investment Diversification and Financial Performance.....	35
4.4.4 Effect of Bank Size on Performance.....	35
4.5 Diagnostic Tests.....	36
4.5.1 Test for Multicollinearity.....	36
4.5.2 Test for Heteroscedasticity	37
4.5.4 Test for Normality.....	38
4.5.5 Reliability Test.....	39
4.6 Business Diversification and Financial Performance of Commercial Banks	40
4.6.1 Chi-Square Test Statistics	40
4.6.2 Regression Analysis.....	43
4.6.2.2 Regression Analysis for Small Sized Commercial Banks in Kenya.....	45
4.7 Discussion of the Findings.....	50
4.7.1 Channel Diversification and Financial Performance	51
4.7.2 Product Diversification and Financial Performance	51
4.7.3 Location Diversification and Financial Performance	52
4.7.4 Investment Diversification and Financial Performance.....	53
4.7.5 Business Diversification and Financial Performance	53
CHAPTER FIVE: SUMMARY, CONCLUSION AND RECOMMENDATIONS	55
5.1 Introduction.....	55
5.2 Summary of the Findings.....	55

5.2.1 Channel Diversification and Financial Performance	55
5.2.2 Product Diversification and Financial Performance	55
5.2.3 Location Diversification and Financial Performance	56
5.2.4 Investment Diversification and Financial Performance.....	56
5.2.5 Business Diversification and Financial Performance	56
5.3 Conclusion	57
5.3.1 Channel Diversification and Financial Performance	58
5.3.2 Product Diversification and Financial Performance	58
5.3.3 Location Diversification and Financial Performance	58
5.3.4 Investment Diversification and Financial Performance.....	59
5.3.5 Business Diversification and Financial Performance	59
5.4 Recommendations.....	60
5.4.1 Managerial Recommendations.....	60
5.4.2 Policy Recommendations.....	60
5.5 Areas for Further Research	61
5.6 Limitations of the Study.....	62
REFERENCES.....	63
APPENDICES:.....	72
Appendix I: Letter of Introduction.....	72
Appendix II: Questionnaire.....	73
Appendix III: List of Commercial Banks	77

LIST OF TABLES

Table 3.1: Study Population.....	22
Table 3.2: Operationalization of Study Variables.....	26
Table 4. 1: Response Rate.....	30
Table 4. 2: Demographic Characteristics.....	31
Table 4.3: Channel Diversification.....	32
Table 4.4: Product Diversification.....	34
Table 4.5: Location and Investment Diversification.....	35
Table 4.6: Bank Size effect on Performance.....	36
Table 4.7: Test for Multi-collinearity.....	37
Table 4.8: Test for Heteroscedasticity.....	37
Table 4.9: Test for Normality.....	38
Table 4.11: Reliability Test.....	39
Table 4.11: Small Banks Test Statistics.....	40
Table 4.12: Medium Sized Banks Test Statistics.....	41
Table 4.13: Large Banks Test Statistics.....	42
Table 4.15: Model Summary Results for all Commercial Banks.....	43
Table 4.15: ANOVA Results for all Commercial Banks.....	44
Table 4.16: Model Coefficients Results for all Commercial Banks.....	45
Table 4.16: Model Summary Results for Small Sized Commercial Banks.....	46
Table 4.17: ANOVA Results for Small Sized Commercial Banks.....	46
Table 4.19: Model Coefficients Results for Small Sized Commercial Banks.....	47
Table 4.20: Model Summary Results for Medium Sized Commercial Banks.....	47
Table 4.21: Model ANOVA Results for Medium Sized Commercial Banks.....	48
Table 4.22: Model Coefficients Results for Medium Sized Commercial Banks.....	48
Table 4.23: Model Summary Results for Large Sized Commercial Banks.....	49
Table 4.24: Model ANOVA Results for Large Sized Commercial Banks.....	49
Table 4.25: Model Coefficients Results for Large Sized Commercial Banks.....	50

LIST OF FIGURES

Figure 2.1: Conceptual Framework	20
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LIST OF ABBREVIATIONS

CBK: Central Bank of Kenya

CAMELS: Capital Adequacy, Asset Quality, Management, Equity, Liquidity and Sensitivity

ROA: Return on Assets

ROE: Return on Equity

NIM: Net Interest Margin

SPSS: Statistical Package for Social Sciences

ABSTRACT

This study sought to investigate the effect of business diversification on the financial performance of commercial banks in Kenya. The study was based on the fact that the banking sector in Kenya is highly regulated with significant business restrictions and attendant disclosures which have created incentives for the banks to diversify. However, the effect of business diversification on financial performance remains inconclusive with diverse studies finding minimal or no relationship while others finding positive significant effect. The study used a mixed research design where descriptive and quantitative research designs were used. The population for this study was all the forty two commercial banks in Kenya. Sources of data were both secondary and primary where quantitative techniques were used to undertake data analysis. To determine the relationship that existed between the variables, both multiple regression analysis and chi-square tests were adopted. The study found that business diversification significantly positively affected how the commercial banks in Kenya performed. The exact effect was however established to be largely dependent on bank-size. Business diversification significantly improved financial performance for small banks. Under medium sized banks category, only location diversification affected financial performance in a significant manner. For large banks all the four forms of business diversification did not have a significant effect on their financial performance. Respondents perceived business diversification to positively affect financial performance of commercial banks in Kenya to a moderate extent. The study was limited by examining financial performance by use of the CAMELS model in a developing country and being conducted in a single industry. Further, CAMELS was measured using a constructed index by data being obtained from the commercial banks' annual audited reports. The study highlighted the need to develop business diversification strategies specifically tailored for each of the tiers of commercial banks with a focus on all forms of diversification for small banks, location diversification for the medium-sized banks and enhancement of existing forms of diversification among large commercial banks.

CHAPTER ONE: INTRODUCTION

1.1 Introduction

The study sought to determine the effect of business diversification on the financial performance of commercial banks in Kenya. This chapter contains the background to the study, problem definition, and research objectives, and research questions, scope of the study and significance of the study.

1.2 Background to the Study

In Kenya, the banking sector frequently experiences intense rivalry from microfinance institutions and non-bank financial institutions coupled with changing regulations (Tsuma, and Gichinga, 2016). Commercial banks are also required to make many disclosures in the financial statements which imply lack of confidentiality on business strategies. In August 2016, the Banking Amendment Act was assented to bringing about interest rate controls in Kenya. Collectively, these specific characteristics of the banking industry make it difficult for the local banks to achieve optimum financial returns (Central Bank of Kenya, 2016).

Bank financial performance is of unique interest due to the fact that poor financial performance will lead to liquidity problems to commercial banks leading to depositors' panic and which may in turn lead to bank failure. The consequence of a single bank failure is dire and may affect many industries and hence negative consequence on the economic growth (Makokha, Namusonge and Sakwa, 2016). Due to the banks being major financial intermediaries, sources of finance and are the main depositors of savings in the developing countries such as Kenya, their importance is more pronounced (Athanasoglou, Brissimis and Delis, 2006). This has seen the banking industry be a key target in most strategic plans like the Kenya Vision 2030 by enabling increased savings, investments, ensuring monetary stability thus progressing the economy (Republic of Kenya,

2008). So as to thrive in the commercial banks are necessitated to constantly evaluate their business dynamics (Baum and Wally, 2003).

The competitiveness of the banks in Kenya has its origin in the diversification strategies they adopt and apply. The various diversification strategies in place include location diversification, investment diversification, product diversification and channel diversification. Whereby location diversification is venturing to a new market segment, investment diversification entails increasing the assets owned by the business, product diversification entails introducing new and unique products in the market and channel diversification is introducing new service delivery methods (Adamu *et al*, 2011).

Diversification may be in the form of related diversification which involves developing the corporate entity while putting the organization's capability under consideration. This can either be through vertical or horizontal integration (concentric strategy). Diversification can also be achieved through unrelated diversification which involves development of products and services beyond the current capabilities and value network - conglomerate strategy (Johnson and Whittington, 2008).

Most commercial banks adopt a diversification strategy for three main reasons. First, the strategy may be aimed to attain efficiency by maximizing the company's resources using new products to new customers and geographical locations. In addition, a commercial bank may adopt this strategy to be able to stretch its corporate parenting capabilities into new markets and products or services. Lastly a commercial bank may employ this strategy to increase its market power by having diverse range of products and services (Luo, 2009).

Financial Performance is essential in allowing managers to evaluate the specific action to be taken towards their rivals, internal actions as well as the firm's evolution over time. Financial performance is measured by profits, return on assets (ROA), returns obtained from investments and equity and using the CAMEL models (Tsuma, and Gichinga, 2016). The financial performance of commercial banks is two-fold and hence attracts much interest. Abnormally high financial performance hinder financial intermediation due to the banks exercising strong market power and collude in charging high interest on loans and paying minimal returns on deposits. Low profitability on the other hand discourage the depositors and shareholders from banking with the poorly performing banks due to fear that it may not be able to meet depositors liquidity demand and generate adequate returns. This results in banks not being able to have adequate financing to undertake operations, liquidity problems, bank panic and collapse (Olweny, and Shipho, 2011).

In the last decade, the banking sector in Kenya has improved drastically in terms of the overall profitability accrued. However not all banks are profitable with some banks having good financial performance and others performing poorly. Small and medium sized banks which constitute to large part of financial sector have been posting considerably low returns compared to large banks (Olweny, and Shipho, 2011).

The empirical relationship between business diversification and financial performance largely remains inconclusive. Adamu *et al* (2011) argue that the results differ due to the disciplinary perspective taken by the person carrying out the study and the relationship being complex one where the research variables exist under varying organization structures. They also may be influenced by the external factors that may cause differences in the outcomes obtained.

However, theoretical underpinnings support the diversifications impacting positively on the corporate financial performance. Synergy theories for example indicate that firms that are diversified by acquiring other firms or combining with other firms (corporate diversifications) perform much better than firms which are not diversified due to synergy (Markides, 2016). Thus, relationship between diversification and financial performance would u-shaped where synergy leads to positive financial performance but for up to certain level after which diversification leads to high operational costs and inefficiencies (Adamu, *et al*, 2011). Supporting the argument by synergy theories, Palich *et al.* (2000) established that diversification influences the market performance but only to a limited extent.

Studies have also established that diversification and business performance have no relationship between them. Adamu *et al* (2011) conducted a study on the product diversification on financial performance of selected Nigerian construction firms. They found that undiversified construction firms performed much better using various performance measures like Return on Total Assets and Profit Margin. This was attributed to mainly inadequate efficiency in the asset utilization by the organizations having well diversified in generating profits (Adamu *et al*, 2011).

In the banking industry, Baele, Jonghe, Vennet (2006) found that revenue diversification could lead to reduced risks; exceeding high diversification could lead to negative consequences on financial performance. Positive relationship has also been found between components of business diversification and financial performance. Makokha, Namusonge, and Sakwa (2016) explored the impact that portfolio diversification has on commercial banks' financial performance in Kenya. The findings were that portfolio diversification was positively related to improvements in the performance while the diversification in investments enabled banks to increase profits and performance in the past years.

The banking sector performance and the economy of a country are closely related (Katrodia, 2012). Notably, the soundness of the commercial banks is largely dependent on their financial performance which is normally used to indicate the strengths and the weaknesses of such a commercial bank (Makkar and Singh, 2013). The financial performance of any business organization is normally evaluated by determining their profitability. This is due to the banks need to generate the necessary income in order to be able to cover their costs of operations which are incurred as they go about their work.

The banking sector in Kenya is governed by various Acts such as The Companies Act, the Banking Act, the Central Bank of Kenya Act and other guidelines provided by the Central Bank of Kenya (CBK) over the years. Liberalization in the banking industry was done in 1995 and this led to the controls in exchange being removed. The CBK ensures that there is proper functioning of the financial system in the country by maintaining normal monetary levels. To attain this, the CBK formulates and implements various monetary policies that are incorporated into the Kenyan government (Stoma, and Gichinga, 2016).

1.3 Statement of the Problem

The banking sector all over the world acts as the life blood of economic development and is a major source of finance to the economy. Commercial banks provide essential financial services and advice to both individuals and corporates (Tsuma, and Gichinga, 2016). However, interest rate capping has been seen as a threat to the profitability of the banks in Kenya and hence the need for commercial banks to diversify their income sources (World Bank, 2017). Additionally, banks face several (often conflicting) regulations that include capital and leverage level requirements, riskiness of assets, branching and asset investment restrictions among others raising the need to make their portfolio current and unique (Ongore, and Kusa, 2013) such as the

imposition of capital requirements. Commercial banks also are required to maintain certain level of cash flow position to ensure they meet the cash demand of the depositors (Turkmen, and Yigit, 2012).

To increase profitability and to overcome increasing competition in the banking industry, commercial banks have been forced to diversify their businesses. Business diversification has received much attention from scholars due to the debate on how exactly the business diversification impact on how the banks perform. The studies conducted in the sector have been inconclusive with contradicting results being obtained. The banks were established to have well diversified portfolios as evidenced by the studies conducted by Kamp *et al.* (2004) and Turkmen and Yigit (2012). On the relationship that exists, Acharya *et al.* (2002) established that diversification in the industry and sector caused diminished returns with more risky loans. Similarly Hayden *et al.* (2007) established that diversification led to reduced returns in the German banks.

While Makokha, Namusonge, and Sakwa (2016) investigated how the commercial banks in Kenya are impacted by the portfolio diversification established that they helped to improve how the banks performed. This contradicts Kipleting (2016) who studied the effect of investment diversification on the financial performance of commercial banks in Kenya and found no significant effect of diversification on their financial performance. In a similar manner, Kiweu (2012) on his study on the effect of income diversification initiatives by Kenyan commercial banks established only minimal positive relationship with their financial performance.

This shows that business diversification is not entirely a new concept as evidenced by the numerous studies have been conducted. However, the available literature is not sufficient enough to provide a framework for determining the influence this business diversification has on the

financial performance. This is despite the importance of banking industry in the Kenyan economy and the regular changing regulation in the banking industry such as interest rate capping. Thus, understanding the effects of business diversification will help great in improving their performance. As such, this study sought to address this research gap by investigating the effect of business diversification on the financial performance of commercial banks in Kenya.

1.4 Research Objectives

1.4.1 General Objectives

The general objective of the study was to determine the effect of business diversification on financial performance of commercial banks in Kenya.

1.4.2 Specific Objectives

- i. To determine the effect of channel diversification on financial performance of commercial banks in Kenya.
- ii. To determine the effect of product diversification on financial performance of commercial banks in Kenya.
- iii. To determine the effect of location diversification on financial performance of commercial banks in Kenya.
- iv. To determine the effect of investment diversification on financial performance of commercial banks in Kenya.
- v. To assess the perception of stakeholders in the banking sector regarding the relationship between business diversification on the financial performance of commercial banks in Kenya.

1.5 Research Questions

- i. How does channel diversification affect the financial performance of commercial banks in Kenya?
- ii. What is the effect of product diversification on the financial performance of commercial banks in Kenya?
- iii. How does location diversification affect the financial performance of commercial banks in Kenya?
- iv. What is the effect of investment diversification on the financial performance of commercial banks in Kenya?
- v. How do stakeholders in the banking sector perceive the relationship between business diversification and the financial performance of commercial banks in Kenya?

1.6 Scope of the Study

The study sought to analyse the effect of business diversification on financial performance of commercial banks in Kenya. The target population was the 40 operational commercial banks with the respondents being the respective banks' managers or directors dealing with general management, marketing, strategy, investment and finance. While there would be many forms of business diversification, the study scope was channel diversification, product diversification, location diversification and investment diversification. Further, the study scope on control variable was commercial bank size. Financial performance was measured using CAMELS model. Data used by the study was collected for three-year period (2014-2016 on annual basis).

1.7 Significance of the Study

The study will also be of significance to the scholars where the study will add to the existing body of knowledge. The relationship between business and diversification in the banking sector have had often conflicting findings making it hard for making conclusions on the relationship that exist. The study will also identify research gaps and make recommendations on areas of further research and hence form basis for future research.

The findings of this study will significant to commercial banks' management where they will be able to understand the importance of diversification as risk mitigation strategy. Commercial banks have been struggling to deal with reducing income from interest due to interest rate control and increasing competition. From the study, the managers will understand how the four forms of diversification affect financial performance of commercial banks.

The study will also be significant to the investors who will be able to earn higher dividends from their investments in commercial banks. This will be as a result of increased profitability of the banks as a result of adoption of the recommendations of the study in respect to business diversifications.

The government will also benefit from the study since the study will make recommendations relating to commercial banks business diversification. The findings will form basis of policy formulation by the bank through Central Bank of Kenya.

CHAPTER TWO: LITERATURE REVIEW

2.1 Introduction

The chapter reviews the theoretical foundations on business diversification and financial performance. Specifically, the chapter contains theoretical review, empirical review, conceptual framework and summary of literature review.

2.2 Theoretical Review

The study was guided by the following theories; Portfolio Theory, Agency Theory and Stakeholders' Theory. These theories provided the theoretical underpinnings of this study.

2.2.1 Portfolio Theory

The Modern Portfolio theory was developed by Markowitz (1952). The theory holds that both maximum expected returns and the variations in the minimum values should exist so as to attain an efficient portfolio. The portfolio which is efficient encompasses assets which are either risky but of high value or those that are less risky but having lower value. Therefore profits may be attained by avoiding those assets that are likely to result in diminished returns or those that do not perform as well as expected. This thus leads to a scenario whereby there are options in the assets and resources to be used in accomplishing a particular task or else known as diversification (Brealey and Myers, 2003).

Commercial Banks have over the years noticed that there is a need to diversify their portfolio of offerings to remain relevant, increase their earnings and maintain their sustainability in this cut-throat competitive financial services industry. With the liberalization of the market coupled with deregulation and globalization, banks have found it increasingly difficult and costly to maintain their profitability. Jongeneel (2011) noted factors such as and evolved e-commerce channel and

changes in consumer attitudes leading to the steady decline in interest margins on loans of Commercial Banks from the 1980s.

The theory's proposition to this study is that the banks may reduce the risk facing the investments by distributing the investment amounts among all those securities which give a maximum expected return. This theory indicates that where the investment diversification is well implemented as a performance improvement strategy, it may enable banks attain competitive advantage. It may also be utilised in coming up with other strategies, based on the benefits accrued.

2.2.2 Agency Theory

The Agency Theory came about through the works of Jensen and Meckling in (1976). The theory holds that in every business situation, managers may have conflicting interests from those of the shareholders (Jensen and Meckling, 1976). This arises from the fact that the managers make most managerial decisions in such a way that they benefit the most at the expense of the business. Agency problems are thus likely to occur and should be anticipated by putting in place mechanisms to monitor and regulate these managerial actions (Jensen and Meckling, 1976).

According to the theory, important managerial decisions should not be undertaken solely by the manager in charge, but by through a designated board. This will ensure that the strategies put in place have no personal motives behind them. The theory's assumption is that aligning both the interests of managers and stakeholders may lead to improved performance. The Agency Theory has however faced criticism as this may not be easy in application as each party always yearns to gain the most for themselves first (Gleason, 2011).

Agency Theory's proposition to this study is that the formulation of the diversification strategies in the banks is the sole responsibility of the managers involved. In this regard, the strategies will obtain a positive impact on the organization if the managers' interests are well aligned with those of the stakeholders. They should aim to maximize the use of the available resources to gain competitive advantage and increased returns. This is by ensuring proper implementation and evaluation of the diversification strategies.

2.2.3 The Stakeholder Theory

Stakeholder theory was proposed by Freeman (1984) to explain the association between broad categories of persons with interests in an organization. The general hypothesis of the stakeholder's theory is that in decision making, the management of the organizations ought to consider the interest of shareholders, customers, suppliers, agents, government and more broadly, the society. Thus, the decisions that the management of an organization takes to a big extent are affected by the diverse interests of the stakeholders who could be the shareholders, employees of the organizations, customers, government and their agents among other parties.

This theory exists in the context of the ideology that both the internal and external groups highly determine how organizations operate (Freeman, 2010). This is based on the assumption that firms are rooted in a network of relationships with stakeholders and that these firms allocate varying amounts of resources and attention to these stakeholders (Reuter, Goebel and Foerstl, 2012). Hence ensuring proper coordination among the stakeholders will in turn translated to improved outcomes in the organization.

The stakeholders, in the case of Kenyan commercial banks, would be the owners, the regulator, employees or customers. The decisions that commercial banks take have to be in line with the expectation and the interest of these stakeholders. The banks' shareholders, for example seek to

obtain optimum returns on their investments whilst customers require efficient services from the banks. The diversification forms to be adopted will as such be affected by the stakeholders' interests and the interests of other parties in the micro and macro environment that commercial banks operate in.

2.3 Empirical Literature

Empirical review has been done in respect to study objectives and covers business diversification, size of the bank and corporate governance and financial performance. Empirical review has also examined literature on financial performance.

2.3.1 Business Diversification and Financial Performance

Turkmen and Yigit (2012) explored diversification in banking and its effect on banks' performance using evidence from Turkey. The study analysed 40 commercial banks' data. Financial performance was measured using Return on Assets commonly abbreviated as ROA and Return on Equity commonly abbreviated as ROE with location diversification being assessed using the *Herfindahl Index* (HI). Geographical diversification was measured using Herfindahl Index which involved squaring market share and summing market share of each bank in each market. The study found that diversifying credit portfolios influenced the risk level of banks with losses in one sector or one location being compensated from the gains obtained from the other sectors or locations.

Mutua (2015) studied the effect of mitigating credit risk on the financial performance of commercial banks in Kenya. The study was descriptive in nature and used both primary and secondary data. The study found out that the banks that had policies and strategies of mitigating credit risk had a direct impact on their performance with the Credit Section being recognized as

the most important sector in the banking section. Therefore, better risk management is expected to result in better commercial banks' financial performance.

Makokha *et al* (2016a) conducted a descriptive study on the effect of portfolio diversification on commercial banks financial performance in Kenya. Portfolio diversification was measured using a *Likert Scale* with the questions covering only product diversification including loans and savings. The study established that most of the banks that had diversified their investments had enabled them to increase their profits and overall performance over prior years. The study recommended that financial institutions should invest in a combination of assets which are negatively correlated because this maximizes revenue (returns) and minimizes losses (risks).

Thiong'o (2016) studied the effect of loan portfolio growth on the financial performance of commercial banks in Kenya. The study used a correlational research design. The population of interest consisted of the then 44 commercial banks in Kenya. Data was analysed using descriptive statistics and summarized in frequency tables. Multiple linear regression was also used in the analysis. The study found that growth in loan portfolio had a positive effect on financial performance of commercial banks in Kenya, but that the effect was not significant. The effect of loan growth on financial performance of commercial banks in subsequent years was found to be adverse. The quality of the bank's assets had a positive effect on the financial performance of commercial banks in Kenya. The effect of asset quality was found to be statistically significant. It was found that liquidity management had a negative effect on the financial performance of commercial banks in that banks that hold a high level of liquid assets perform poor financially. However, the effect of liquidity management was not significant. The study found that capital adequacy had a positive effect on financial performance of commercial banks. The effect of capital adequacy was significant. The study concluded that growth in a

bank's loan portfolio had a positive but insignificant effect on the financial performance of commercial banks in the current year but that the effect was adverse in the subsequent years. The study concluded that the quality of a banks' loan portfolio had a positive and significant effect on the financial performance of commercial banks in Kenya. Finally, the study concluded that the amount of bank capital had a positive and significant effect on the financial performance of commercial banks in Kenya. The study therefore recommended that commercial banks should strategically execute their loan portfolio growth strategies so as to minimize the problem of loan losses in subsequent years. It also recommended that to enhance financial performance banks should ensure they maintain a high quality loan portfolio.

Kipleting (2016) examined the effect of investment diversification on the financial performance of commercial banks in Kenya. The main purpose of the study was to investigate the effect of portfolio diversification on the financial performance of commercial banks in Kenya. The study used an exploratory research design. The population of interest in this study consisted of 40 commercial banks. Secondary data was collected using data collection sheets as the main data collection tool and interview schedule as the primary data. Data collection sheets were used to collect data guided by the objectives of the study. The data collected was analysed using explanatory and inferential statistics and multiple regression. The study concluded that a majority of the banks over the years had in practice employed the use of insurance investment on the financial performance of commercial banks in Kenya.

In relation to diversification of channels, Mwando (2013), in his descriptive survey study on the contribution of Agency banking on financial performance of commercial banks in Kenya established that agency banking strategy has had a positive impact on the performance of

commercial banks in Kenya specifically by increasing their market share with a lower than greater scale of operational costs that translated to increased profitability.

Human resource diversity is also critical and affects financial performance. Jackson, May, and Whitney (2010) found that business organizations need to embrace diversity management policies. This will enable them to highly improve their structure and commitment in the employees, thus leading to the organizations' returns improving significantly. Additionally, uncoordinated human resource diversity may lead to lagging in the operations.

2.3.2 Bank Size and Financial Performance

Several studies have been undertaken to establish how exactly the bank size impacts on the organization's performance outcome. Amato and Burson (2007) tested size-profit relationship for firms operating in the financial services sector. The authors revealed negative influence of firm size on its profitability. On the other hand, the authors found evidence of a cubic relationship between ROA and firm size. Using financial and economic data, Ammar (2003) examined the nature of the size-profitability relationship on a sample of electrical contractors and Amato and Wilder (1985) tested size-profitability relationship in US organizations. However, the results of their analysis showed that there is no relationship between firm size and profit rate.

Pervan and Josipa (2012) examined the influence of firm size on its business success. Additionally, results showed that assets turnover and debt ratio also statistically significantly influence firms' performance. This relates to Moraa (2014) who conducted an analysis of profitability of Kenya's top six commercial banks: internal factor analysis used return on assets as a measure of profitability. The findings revealed that bank size, capital strength, ownership, operations expenses, diversification do significantly influence profitability of the top six commercial banks.

2.3.3 CAMELS Measure of Financial Performance

The CAMELS rating is a supervisory rating system originally developed in the USA to classify a bank's overall condition. CAMEL is an abbreviation of five assessment areas namely Capital Adequacy, Asset Quality, Management Efficiency, Earnings Performance and Liquidity. The Central Bank of Kenya employs the CAMEL framework as the regulatory tool for monitoring bank performance (CBK, 2016). In line with its acronym, the model applies financial ratios to assess various elements within its framework and pre-determined industry benchmarks to determine the financial soundness of Commercial Banks (Gasbarro *et al.*, 2002).

The CAMELS model is mostly used since it is the most effective, efficient and accurate to be used as a performance evaluate in banking industries and to anticipate the future and relative risk (Vijayakumar, 2012). It is due to this reason that regulators globally have been applying the CAMELS model to measure the performance and soundness of commercial banks (CBK, 2016).

The first function of capital in banks is the incentives function and then the risk-sharing function. Due to the debt-like nature of liabilities in banks, they have an incentive to engage in risk-shifting or asset substitution. This means that they will indulge in high risk activities to shift the downside risk to creditors. To avoid this, regulators require them to hold a minimum ratio of capital to assets to reduce their sensitivity to risk. In this case, capital adequacy can be measured using ratios such as capital to liabilities, debt ratio and the capital to assets ratio. Capital consists of permanent shareholders' equity including the issued and fully paid-up ordinary shares, retained earnings and intangible assets such as goodwill (Kongiri, 2012).

Asset quality comes from the concept of proper management of a bank's assets. Banks will offer loans and expect that the principal amount will be paid within a certain period. Asset Quality is that measure of the probability that the loan will either be paid or not. It is measured using credit

risk which is the risk of loss due to non-payment of debtors' loans. The failure of a debtor to pay their loan enhances the credit risk of that commercial bank and thus erodes its asset quality.

Management efficiency in commercial banks may not be easily measured using financial ratios as the effects and processes are mostly qualitative. The role of management in banking institutions ensures the smooth operations of activities, day-to-day handling of risks and the role of stewardship. The agency problem manifests itself in the management of financial institutions where managers put their personal goals first rather than maximizing shareholder value. Tools such as total expenses to the total income and operating expenses to total expenses ratios could be used to assess management quality (Kongiri, 2012).

The earnings and profitability of a financial institution shows its ability to persistently generate income to increase its own funds and reserves and to also settle its debt obligations. Furthermore, the stream of income can be used to capture a larger market share and thus seize other opportunities (Kumar, 2007). The historical source of generating earnings by banks was through interest-earning activities, that is, lending. However, over the years, banks have innovatively realized income and fees from other activities (Kumar, 2007). The tools for assessing bank earnings and profit levels include ROA, ROE and the NIM. These ratios are analysed periodically to ascertain whether performance is increasing or deteriorating (Nyathira, 2012).

Liquidity refers to the ability of financial institutions to fund increases in asset holdings and meet obligations as and when they fall due. One key aspect in banking is the management of liquidity risk. Bank managers usually face the tough balancing act of ensuring that funds are available to cater for withdrawals from the deposits held, to meet short-term obligations when they fall due and provide funds for short-term lending. With this in view, bank regulators attempt to manage liquidity risk by imposing liquidity ratios and imposing monetary policy (Vijayakumar, 2012).

The liquid assets to total assets ratio and the loans to deposits ratio are ordinarily used to assess liquidity. Waithaka (2013), notes that the liquid assets to liquid liabilities ratio may be used to measure banks' liquidity position.

Sensitivity covers how particular risk exposures can affect bank institutions. It assesses institution's sensitivity to market risk by monitoring the management of credit concentrations. In this way, bank supervisors are able to see how lending to specific industries affect banks' performance. Exposure to foreign exchange, commodities, equities and derivatives are also included in rating the sensitivity of a bank to market risk (Nyathira, 2012). For this study, sensitivity of bank returns was achieved using the standard deviation of banks' return on assets.

2.4 Conceptual Framework

A conceptual framework is a research tool aimed to helping a researcher to develop an understanding on how the research variables are interrelated (Kombo and Tromp, 2009). As shown by Figure 2.1, the independent variables were channel diversification, product diversification, location diversification, investment line diversification with bank size as the control variable. The dependent variable was financial performance. Channel Diversification was measured by the ratio of number of customers using various channels to total number customers, product diversification was measured by the ratio of customers per product to total number of customers, location diversification was measured by total value of assets at the branches to total bank assets and investment line diversification was measured by the value of assets at subsidiaries to total bank assets. Financial Performance on the other hand was measured by CAMELS Composite index using capital adequacy, asset quality, management, earnings, liquidity and sensitivity. Particularly, channel diversification, product diversification, location diversification, investment line diversification has a direct effect on the financial performance.

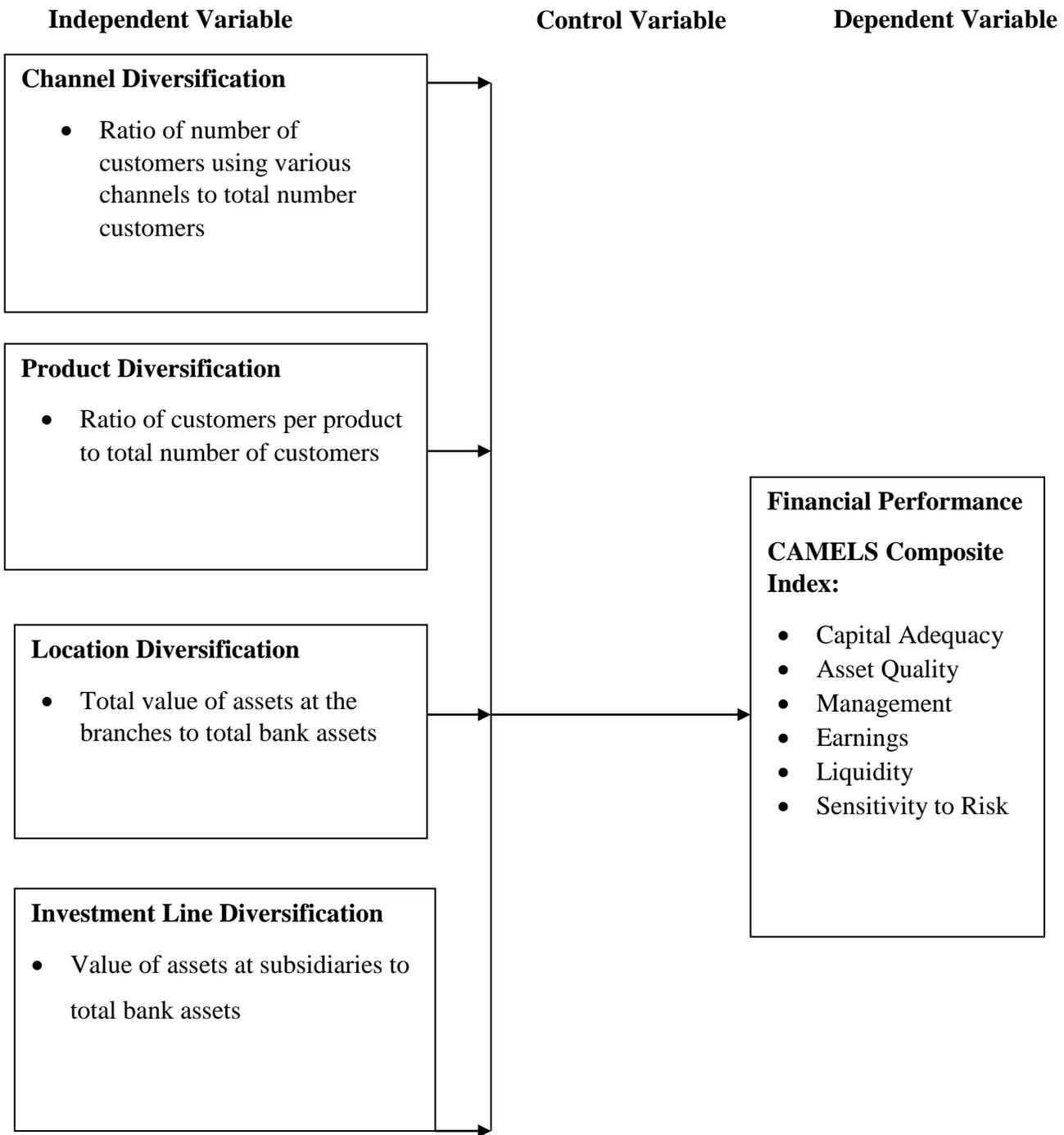


Figure 2.1: Conceptual Framework

CHAPTER THREE: RESEARCH DESIGN AND METHODOLOGY

3.1 Introduction

The chapter presents the method approach that was used in conducting the study. The chapter presents the research design, target population and sampling, data collection methods, data analysis and presentation and research quality measures.

3.2 Research Design

This study used a mixed research design where both quantitative research design and descriptive design were used. Descriptive design was used since it seeks to characterize the elements under study (Kothari, 2004). The study used descriptive research since its main objective is to accurately portray the characteristics of persons, situations, or groups, and/or the frequency with which the study phenomena occur.

Quantitative research design on the other hand was used to enable quantitative analysis of data in achievement of the study objectives which will need use of regression analysis. The achievement of the study objectives could not be possible without using a mixed research design.

3.3 Target Population and Sampling

The population for this study comprised all the 42 commercial banks in Kenya (CBK, 2017). The target population for primary data was however, the 40 operational commercial banks since Charterhouse Bank Limited and Imperial banks were not operational having been placed under receivership. The population comprised of 6 large banks (Tier-I), 15 medium-sized banks (Tier-II) and 19 small banks (Tier-III) as presented in Table 3.1.

Table 3.1: Study Population

Category	Number	Percent
Large	6	15%
Medium	15	38%
Small	19	47%
Total	40	100%

Sampling was not applied by this study and instead, a census approach was used since the population was manageable. The 40 respondents were selected by the snow balling technique so as to minimise biasness and ensure equal representation. One questionnaire was administered per bank and hence the total questionnaires administered were 40 which the researcher considered as manageable. This was in line with Kombo and Tromp (2009) recommendation that where the population is manageable, a census approach should be used and sampling should not be done.

The respondents were the banks managers or directors dealing with general management, marketing, strategy, investment and finance. One questionnaire per bank was administered. The researcher introduced himself to the banks' management and requested for the names of the names of managers based in the respective banks' head office in the four departments. The researcher then randomly picked the name of one person who would respond to the questionnaire. This ensured that data collection was not biased.

3.4 Data Collection Methods

The study used both primary and secondary data. Primary data was used to obtain non-quantitative aspects of the study that may not be established from data collected and hence validate the results of quantitative analysis. Secondary data were used to enable quantitative

assessment of the study objectives and hence provide more reliable and accurate results on the study objectives.

Primary data was collected using questionnaires where one questionnaire was administered per bank through drop and pick method. After the questionnaires were dropped, the respondents were given three days after which follow-ups were done through phone calls and text messages. Questionnaires were used since they are fast to administer and respondents can fill them at their convenience time. Questionnaires are also cost effective and give the respondents an opportunity to confirm the information being sought before responding to the question.

Secondary data was collected using secondary data collection sheets. Data was obtained from commercial banks financial statements for a period of three years (2014-2016). Data collected related to agency banking, mobile banking, online banking, loan products, saving products, other products offered, number of branches in Kenya and outside, investment in other companies, CAMEL measures (capital adequacy, asset quality, management, earnings, liquidity, sensitivity of earnings) and bank size information.

3.5 Data Analysis and Presentation

Quantitative techniques were used to undertake data analysis. This entailed the generation of descriptive statistics including the mean and standard deviation. To assess how various forms of business diversification impact on the financial performance of commercial banks in Kenya, Chi-Square tests of independence between the dependent variable and the four independent variables were done. Chi-square was used since it enabled the evaluation of relationship between the different categories of banks which were different in number. The chi square formula used was:

$$\chi^2_c = \sum \frac{(O_i - E_i)^2}{E_i}$$

Where O = Observed and E = Expected

To achieve the objectives of determining the relationship between the four forms of diversification and the financial performance of commercial banks, multiple regression analysis was undertaken. Diagnostic tests were done prior to conducting the regression analysis which included normality, auto-correlation, multi-collinearity and heteroscedasticity. Analysis was done using Statistical Package for Social Sciences (SPSS).

Multiple regression analysis took the following format:

$$Y = \beta_0 + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4 + \varepsilon$$

Where;

Y: Financial Performance measured using the CAMELS Composite Index

X₁: Channel Diversification

X₂: Product Diversification

X₃: Location Diversification

X₄: Investment Diversification

β₀: The Constant for value of financial performance when independent variables = 0.

ε: The error term

The dependent variable of financial performance of commercial banks was measured using the CAMELS composite index. The independent variables were channel diversification, product diversification, location diversification and investment-line diversification.

The objective of assessment of the perception of stakeholders in the banking sector regarding the business diversification on the financial performance of commercial banks in Kenya was tested using a questionnaire. Questionnaire was administered randomly to selected respondents. Five-likert scale was used to rate the perceived effect of the four forms of diversification on financial performance of commercial banks. Mean and standard deviation were used to rate the extent to which the various forms of diversification affects commercial banks financial performance.

The study had both primary and secondary data objectives wherein the study was seeking the opinions of bank officials about the relationship between financial performance of banks and each type of diversification (primary data). Concurrently, the study analysed these relationships using the secondary data measures like number of customers using channels and products, value of subsidiary assets and number of employees in branches. Finally, the study compared both the primary and secondary data analysis results for their consistency.

Variables operationalization was as follows:

Table 3.2: Operationalization of Study Variables

Variable	Variable	Measurement	Past Relevant Studies
Dependent	Financial Performance	<p>CAMELS:</p> <p>CAMEL index was obtained by adding the following:</p> <p>Capital Adequacy - measured by Core Capital to Risk-weighted assets ratio</p> <p>Asset Quality- measured by non-performing loans to total bank loans</p> <p>Management - measured by total costs to total income</p> <p>Earnings - measured by Return on Assets</p> <p>Liquidity- Measured by liquidity ratio.</p> <p>Sensitivity- Measured by Standard deviation of the bank's Return on Assets</p>	<p>The model used by Makokha <i>et al</i> (2016a) in assessing portfolio diversification on commercial banks financial performance in Kenya and Makokha <i>et al</i> (2016b) in evaluating the effect of risk management practices on financial performance in Kenya commercial banks.</p> <p>Mohiuddin (2014) found that CAMEL model was the most detailed model assessing commercial financial performance.</p>
Independent	Channel Diversification	Ratio of number of customers using main channels (identified in the questionnaire attached) to total number customers	Tchouassi (2012); mobile phones really work to extend banking services to the unbanked and Kigen (2010) impact of mobile banking on transaction costs of microfinance institutions.
	Product Diversification	Ratio of customers using the main products (identified in the	Chang (2014) on regional and product diversification and the

Variable	Variable	Measurement	Past Relevant Studies
		questionnaire attached) to total number of customers	performance of Retail Multinationals; and Otieno and Moronge, (2014).
	Location Diversification	Total value of assets at the branches to total bank assets	Chang (2014) on regional and product diversification and the performance of Multinationals.
	Investment Diversification	Value of assets at subsidiaries to total bank assets	Turkmen and Yigit (2012) diversification in banking and its effect on banks' performance using evidence from Turkey and Kipleting (2016) the effect of investment diversification on the financial performance of commercial banks in Kenya.

3.6 Research Reliability

The reliability of the questionnaire was tested using the Cronbach Alpha. A Cronbach Alpha of 0.7 implies that the research instrument was reliable while Cronbach Alpha less than 0.7 implies that the research instrument is not reliable and some questions need to be dropped or amended.

The validity of the study was achieved by the research questions being reviewed by the supervisor and the panel to ensure they actually achieved what the researcher sought to measure.

Diagnostic tests done on the data included normality tests, multicollinearity and heteroscedasticity. Normality was tested using the degree of skewness and kurtosis where values not in the range of +/-2 indicated lack of normality on data. For independent variables which were not normally distributed, normalization was done using the log of 10. For dependent

variable, no normalization was to be done unless on the cases of extreme of lack of normality. Decoster (2011) cautioned the normalization of relative measures specifically on a variable that could take positive or negative values. Measurement that could take negative values include profitability measures where a firm makes losses. The study further indicated that normalization on negative values can only be done by adding a hypothetical value on the negative values which further distorts data. This method is only used in extreme cases of abnormality on the variable (Kothari, 2004). Normalization therefore could not be done on the dependent variable unless in cases of high abnormality in data.

Heteroscedasticity is a situation in which the variance of the dependent variable varies across the data, as opposed to a situation where the Ordinary Least Squares make the assumption that variance of the error term is constant. To test heteroscedasticity, the Breusch-Pagan/Cook-Weisberg test of detecting heteroscedasticity in linear models was used.

Multicollinearity tests were conducted on the regression model so that incorrect conclusions about the relationship between the dependent variable and predictor variables were avoided. Variance Inflation Factor (VIF) and degree of tolerance were used to indicate presence of multicollinearity. Multicollinearity occurs where the independent variables are strongly correlated and hence results of regression analysis are as a result of the correlation between the independent variables. Multicollinearity was corrected by removing the highly correlated variables. Normality was tested using degree of skewness and kurtosis. The quality of data obtained was ensured by obtaining accurate data from bank financial statements.

Chi-square test was used since the data was not normally distributed and the banks per category were not equal as recommended by McHugh (2013). Chi-square statistic is a tool that analyses group variations when the dependent variable is being measured at nominal. It is convenient that

it is robust and does not require equality in the variance under study. This enables more detailed data to be obtained and thus be able to make valid conclusions (McHugh, 2013).

3.7 Ethical Issues in Research

Ethical standards in the study were maintained by ensuring that all information obtained from various sources was fully acknowledged. Permission to collect data was also sought from the university and from commercial banks. All information obtained was used only for academic purposes and was treated with confidentiality. The researcher ensured that no one or any organization or any party is harmed by this study.

CHAPTER FOUR: PRESENTATION OF RESEARCH FINDINGS

4.1 Introduction

The study sought to establish the effect of business diversification on the financial performance of commercial banks in Kenya. This chapter presents the research findings by focusing on the demographic characteristics of the respondents, data analysis and views of the respondents based on the specific objectives of the study. The data on business diversification and financial performance was analysed using descriptive and inferential statistics.

4.2 Response Rate

The study's target population was total of 40 respondents who were banks' managers or directors engaged in general management, marketing, strategy, investment and finance. As such, a total of 40 questionnaires were issued out of 36 which were duly filled and returned. This translates to a response rate of 90% as shown by Table 4.1. The response rate is justified as it conforms to Mugenda and Mugenda's (2008) assertion that of 70% and above is very appropriate so as to enable generalization.

Table 4.1: Response Rate

Status	Frequency	Percentage
Responded	36	90%
Not Responded	4	10%
Total	40	100%

4.3 Demographic Characteristics

The study determined the demographic characteristics of both the respondents and the banks. This was important so as to establishing the accuracy of the results obtained. The demographic characteristics are as presented by Table 4.2.

Table 4.2: Demographic Characteristics

	Demographic Characteristic	Frequency	Percent
Respondents' Gender	Male	30	83%
	Female	6	17%
	Total	36	100%
Respondents' Departments:	Marketing	3	8%
	Strategy	17	47%
	Investment	13	36%
	Finance	3	8%
	Total	36	100%
Respondents' Work Cadre	Lower Level Manager	9	25%
	Middle Level Manager	22	61%
	Senior Level Manager	5	14%
	Total	36	100%
Bank-size Category	Small	17	47%
	Medium	14	39%
	Large	5	14%
	Total	36	100%

On the respondents' gender, the results obtained show that 83% were male and the remaining 17% were female. This is an indication that there was male dominance in the banks. On the respondents' department in the banks, the findings show that 47% under the strategy department, 36% under the strategy department and 8% in both finance and marketing departments respectively. The respondents were thus directly involved on how banks' strategies were both formulated and implemented. They were therefore in a position to provide well-informed responses.

On the respondents' position in the banks, the results obtained indicated that 61% were middle-level managers, 25% were lower-level managers and 14% were senior-level managers. This implies that all the respondents held managerial positions hence conversant with how the organizations operate and hence most appropriate. On the size of the banks, the results show that 47% of the banks were under the small category, 39% were under the medium category and 14% were under the large category. This shows that the banking industry in Kenya is comprised of majority of small banks with large banks being the smallest in number.

4.4 Effect of Forms Diversification on Financial Performance

The study studied the four forms of diversification that could be adopted by the commercial banks and how they affected financial performance. The strategies included channel diversification, product diversification, location diversification and investment diversification.

4.4.1 Channel Diversification and Financial Performance

The study sought to determine channel diversification strategies put in place by the banks. The findings obtained are presented by Table 4. 3.

Table 4.3: Channel Diversification

Channel Diversification	No extent (%)	Small Extent (%)	Moderate Extent (%)	Large Extent (%)	Very	Mean	Std. Deviation
					Large Extent (%)		
Agency banking	8	22	3	19	47	3.75	1.461
Mobile Banking	6	19	14	53	8	3.39	1.076
ATM Banking	8	42	19	31	0	2.72	1.003
Internet Banking	28	42	0	22	8	2.42	1.339

On the channel diversification strategy, agency banking had a mean of 3.75 and standard deviation of 1.461. Mobile Banking had a mean of 3.39 and deviation of 1.076. Internet Banking had a mean of 2.42 and deviation of 1.339. ATM Banking had a mean of 2.72 and deviation of 1.003. This implies that agency banking and mobile banking influences the financial performance to a large extent whereas internet banking and ATMs influences the financial performance to a small extent. This increased impact could be due to the increase in popularity in the agency and mobile banking due to their convenience and availability. This has seen the traditional channels been neglected such as ATM hence reducing its impact on the performance. Similarly, internet banking is considered technical and expensive thus most people shun away from it. The findings therefore indicated that channel diversification that includes agency banking, mobile banking and ATMs are perceived as influencing financial performance.

4.4.2 Product Diversification and Financial Performance

On the Product Diversification strategy, collateral financing had a mean of 3.58 and standard of 1.05. Emergencies loans products had a mean of 3.42 and deviation of 1.052. Investment products eg share trading products had a mean of 3.22 and deviation of 1.551. Clustered current account (eg Gold, silver, pay as you go etc) had a mean of 3.11 and deviation of 1.369. Asset financing products had a mean of 3.11 and deviation of 1.036. Insurance products had a mean of 3.06 and deviation of 1.068. Unsecured loans products had a mean of 3.06 and deviation of 1.218. Bank Assurance had a mean of 3.03 and deviation of 1.232. Long term saving Products fixed deposits had a mean of 3 and deviation of 1.121. Children saving products had a mean of 2.97 and deviation of 1.404. Short term saving products had a mean of 2.44 and deviation of 1.107. This implies that Collateral financing, Emergencies loans products, Investment products, clustered current account, asset financing products, insurance products, unsecured loans products, bank

assurance and long term saving products fixed deposits impacted on the financial performance moderately. Children saving product and short term saving products impacted to a small extent. The product diversification strategy was therefore yet to meet its expected outcome as none of the measures had large extents of influences. Moreover, the saving products for children were yet to gain popularity among the customers, this explains its low impact levels on the banks.

The findings obtained are presented by Table 4.4.

Table 4.4: Product Diversification

Product Diversification	No extent (%)	Small Extent (%)	Moderate Extent (%)	Large Extent (%)	Very Large Extent (%)	Mean	Std. Dev.:
Collateral financing	6	14	8	61	11	3.58	1.052
Emergencies loans products	0	31	8	50	11	3.42	1.052
Investment products	28	3	11	36	22	3.22	1.551
Asset financing products	8	22	19	50	0	3.11	1.036
Clustered current account (Gold, silver, pay as you go)	17	25	0	47	11	3.11	1.369
Insurance products	14	11	31	44	0	3.06	1.068
Unsecured loans products	11	25	22	31	11	3.06	1.218
Bank Assurance							
Long term saving Products	8	36	11	33	11	3.03	1.23
fixed deposits	3	44	11	33	8	3	1.121
Children saving products	22	17	17	31	14	2.97	1.404
Short term saving products	17	44	25	6	8	2.44	1.107

4.4.3 Location and Investment Diversification and Financial Performance

The study sought to determine location diversification strategies put in place by the banks.

The results obtained show that the number of branches had a mean of 4.17 and standard deviation of 0.845 while the investment in other companies had a mean of 4.25 and a standard deviation of 0.906. This thus implies that the location diversification does influence the business financial performance to a large extent. This is attributed to the fact that it enables the bank to be at the nearest proximity to the customers for easier access.

The findings obtained are presented by Table 4.5.

Table 4.5: Location and Investment Diversification

Location Diversification	No extent (%)	Small Extent (%)	Moderate Extent (%)	Large Extent (%)	Very Large Extent (%)	Mean	Std. Dev
	Investment in other Companies	3		14	36	47	4.25
Number of branches	3	0	11	50	36	4.17	0.845

4.4.4 Effect of Bank Size on Performance

The study sought to determine impact that the bank size has on the performance based on the respondents' opinion. On the effect of bank size on the financial performance, 50% of the respondents stated a large extent of influence, 22% for a very large extent, 11% for a small extent, while 8% for both no extent and moderate extent respectively. This shows that over 70% of the respondents feel that the bank size affects its financial performance to a large extent.

The findings obtained are presented by Table 4.6.

Table 4.6: Bank Size effect on Performance

Bank Size effect on performance	Frequency	Percent
No extent	3	8%
Small Extent	4	11%
Moderate Extent	3	8%
Large Extent	18	50%
Very Large Extent	8	22%
Total	36	100%

4.5 Diagnostic Tests

The study quality was ensured by using both primary and secondary data and objective interpretation of the study results. Diagnostic tests on the assumptions of regression analysis were done to ensure that the quality of quantitative assessment is valid.

4.5.1 Test for Multicollinearity

Multicollinearity tests were conducted on the regression model so that incorrect conclusions about the relationship between dependent variable and predictor variables to be avoided. Variance Inflation Factor (VIF) and degree of tolerance were used to indicate if there was presence of multicollinearity in the data. The findings obtained are presented by Table 4.7.

Table 4.7: Test for Multicollinearity

Variable	Tolerance	VIF
Channel Diversification	0.932	1.073
Product Diversification	0.916	1.092
Location Diversification	0.973	1.027
Investment Line Diversification	0.996	1.004

The findings obtained show Channel Diversification had a tolerance value of 0.934 and VIF value of 1.073. Product Diversification had a tolerance value of 0.916 and VIF value of 1.092. Location Diversification had a tolerance value of 0.973 and VIF value of 1.027. Investment Line Diversification had a tolerance value of 0.996 and VIF value of 1.004. All variables had tolerance of greater than 0.1 and VIF less than 10 and there was no multicollinearity problem.

4.5.2 Test for Heteroscedasticity

Heteroscedasticity occurs when the variance of the errors varies across the observations. This study used Breusch-Pagan/ Cook-Weisberg to test for Heteroscedasticity. The findings obtained are presented by Table 4.8.

Table 4.8: Test for Heteroscedasticity

H ₀	Variables	Chi2 (4)	Prop>Chi2
Constant Variance	Channel Diversification,	0.0127	0.7328
	Product Diversification,		
	Location Diversification,		
	Business-Line Diversification,		
	CAMELS		

The study obtained a chi square of 0.0127 and p-value of 0.7328>0.05 implying that at 95% confidence, the null hypothesis of homoscedasticity could not be rejected. Hence, heteroscedasticity was not a problem.

4.5.4 Test for Normality

Normality of the data was tested by Kolmogorov-Smirnov test and kurtosis and skewness.

Table 4.9: Test for Normality

		FP	Channel div	Prod Div.	Loc. Div.	Invest Div.
Normal						
Parameters						
a,b,	Mean	2.150	0.630	0.214	0.155	0.159
	Std. Deviation	0.710	0.151	0.198	0.122	0.049
Most	Absolute	0.148	0.231	0.198	0.147	0.090
Extreme	Positive	0.148	0.101	0.198	0.147	0.090
Differences	Negative	-0.066	-0.231	-0.152	-0.117	-0.062
Skewness		1.066	-1.317	1.744	1.033	6.762
Kurtosis		1.093	1.008	1.135	1.159	7.475
Kolmogorov-Smirnov Z		1.664	2.595	2.218	1.648	1.011
Asymp. Sig. (2-tailed)		0.008	0.000	0.000	0.009	0.259
N		126	126	126	126	126

Financial performance had a p-value of 0.008<0.05, kurtosis and skewness within +/-2 and therefore the variable was normally distributed. Channel diversification, product diversification and location diversification also had a p-value of 0.000<0.05, kurtosis and skewness within +/-2 and hence the variables were normally distributed. Therefore, the variables were appropriate for parametric tests like multiple regression analysis. Investment diversification had a p-value of

0.259 > 0.05, kurtosis and skewness outside the range of +/-2 and hence indicating that the data was not normally distributed and not appropriate for parametric tests but non parametric tests.

Notably, for dependent variable, no normalization was to be done unless on the cases of extreme of lack of normality. Decoster (2011) cautioned the normalization of relative measures specifically on a variable that could take positive or negative values. Measurement that could take negative values includes profitability measures where a firm makes losses. The study further indicated that normalization on negative values can only be done by adding a hypothetical value on the negative values which further distorts data. This method is only used in extreme cases of abnormality on the variable (Kothari, 2004). Normalization therefore could not be done on the dependent variable unless in cases of high abnormality in data.

No normalization was done for chi square test since the chi square test does not require data to be normally distributed (McHugh, 2013). However, for multiple regression analysis, normalization of investment diversification was done by obtaining log of 10.

4.5.5 Reliability Test

Reliability of the research instrument was assessed using Cronbach Alpha. The study variables had a Cronbach Alpha of 0.865 on the 18 measured used to quantify the various levels of business diversification. Since the Cronbach alpha was greater than 0.7, the scale measurement instrument was reliable. The findings are presented in Table 4.10

Table 4.10: Reliability Test

Variable	Cronbach's Alpha	Number of Measures	Decision
Forms of Diversification	0.865	18	Reliable

4.6 Business Diversification and Financial Performance of Commercial Banks

The study sought to establish the effect of the four forms of diversification on financial performance of banks. To achieve this, banks were classified into three categories and chi-square for each category of bank determined to indicate the relationship between diversification and financial performance for three categories of banks. To establish the relationship that exists, both the chi square test statistics and multiple regression analysis were used.

4.6.1 Chi-Square Test Statistics

The small bank chi square test statistics where financial performance (FP) is the dependent variable and independent variables being channel diversification (channel_div), product diversification (product_div), location diversification (location_div) and investment diversification (investment_div) are presented in Table 4.11.

Table 4.11: Small Banks Test Statistics

	FP_Small	Channel_div	Product_div	Location_div	Investment_div
Chi-Square	8.188 ^a	45.469 ^b	61.937 ^c	57.469 ^d	34.438 ^e
Df	54	30	25	22	20
Asymp. Sig.	1.000	.035	.000	.000	.023

a. 55 cells (100.0%) have expected frequencies less than 5. The minimum expected cell frequency is 1.2.

b. 31 cells (100.0%) have expected frequencies less than 5. The minimum expected cell frequency is 2.1.

c. 26 cells (100.0%) have expected frequencies less than 5. The minimum expected cell frequency is 2.5.

d. 23 cells (100.0%) have expected frequencies less than 5. The minimum expected cell frequency is 2.8.

e. 21 cells (100.0%) have expected frequencies less than 5. The minimum expected cell frequency is 3.0.

The medium bank chi square test statistics where financial performance (FP) is the dependent variable and independent variables being channel diversification (channel_div), product

diversification (product_div), location diversification (location_div) and investment diversification (investment_div) are presented in Table 4.12.

Table 4.12: Medium Sized Banks Test Statistics

	FP_medium	Channel_div	Product_div	Location_div	Investment_div
Chi-Square	8.000 ^a	25.857 ^b	11.333 ^c	30.000 ^d	17.429 ^e
Df	34	24	27	17	15
Asymp. Sig.	1.000	.360	.996	.026	.294

a. 35 cells (100.0%) have expected frequencies less than 5. The minimum expected cell frequency is 1.2.

b. 25 cells (100.0%) have expected frequencies less than 5. The minimum expected cell frequency is 1.7.

c. 28 cells (100.0%) have expected frequencies less than 5. The minimum expected cell frequency is 1.5.

d. 18 cells (100.0%) have expected frequencies less than 5. The minimum expected cell frequency is 2.3.

e. 16 cells (100.0%) have expected frequencies less than 5. The minimum expected cell frequency is 2.6.

Channel diversification had a p-value of $0.36 > 0.05$, product diversification had a p-value of $0.996 > 0.05$, location diversification had a p-value of $0.026 < 0.05$ and investment diversification had a p-value of $0.294 > 0.05$. Therefore, for medium banks, channel diversification, product diversification and investment diversification do not have significant effect on financial performance. Location diversification has significant positive effect on financial performance of medium sized banks.

The chi square tests for large banks are presented in Table 4.13.

Table 4.13: Large Banks Test Statistics

	FR_large	Channel_div	Product_div	Location_div	Investment_div
Chi-Square	2.100 ^a	2.800 ^b	4.000 ^c	6.000 ^d	9.000 ^e
Df	16	11	14	12	9
Asymp. Sig.	1.000	.993	.995	.916	.437

a. 17 cells (100.0%) have expected frequencies less than 5. The minimum expected cell frequency is 1.2.

b. 12 cells (100.0%) have expected frequencies less than 5. The minimum expected cell frequency is 1.7.

c. 15 cells (100.0%) have expected frequencies less than 5. The minimum expected cell frequency is 1.3.

d. 13 cells (100.0%) have expected frequencies less than 5. The minimum expected cell frequency is 1.5.

e. 10 cells (100.0%) have expected frequencies less than 5. The minimum expected cell frequency is 2.0.

Channel diversification had a p-value of $0.993 > 0.05$, product diversification had a p-value of $0.995 > 0.05$, location diversification had a p-value of $0.916 < 0.05$ and investment diversification had a p-value of $0.437 > 0.05$. Therefore, for large banks, all forms of business diversification have no significant effect on financial performance of commercial banks. Therefore, large banks diversification will not affect financial performance.

Therefore, business diversification improves significantly financial performance of small banks. However, as the bank become bigger, business diversification continues to affect the performance of the banks to a less extent. This is supported by the findings that under medium sized banks, only location diversification has significant effect on financial performance and for large banks, all forms of business diversification do not affect commercial banks financial performance.

4.6.2 Regression Analysis

Regression analysis was used to confirm the chi square results. Regression for all the commercial banks was run followed by regression for small banks, medium banks and large banks.

4.6.2.1 Regression Analysis for All Commercial Banks in Kenya

A multiple regression model was used to establish combined relationship between forms of business diversification (predictor variables) and CAMEL measures (dependent variable). The Regression model summary is presented in Table 4.14.

Table 4.14: Model Summary Results for all Commercial Banks

R	R Square	Adjusted R Square	Std. Error of the Estimate
.473a	0.223	0.198	0.63574

a. Predictors: (Constant), Investment Line Diversification, Channel Diversification, Location Diversification, Product Diversification

b. Dependent Variable: Financial Performance

From Table 4.15, the coefficient of correlation was 0.473 indicating that business diversification has a positive effect on financial performance. Thus, bank diversifying the business would improve financial performance. The coefficient of determination (R^2 Square) was 0.223 implying that that the regression could explain only 22.3% of the variation performance. The remaining 77.7% of the variation could be due to other predictors not in the model.

The model result of model fitness indicates an F-statistic of 8.702 and a p-value of $0.000 < 0.05$. This indicates that the model is fit for prediction at 95% confidence level. Thus, business diversification generally has significant effect on commercial banks financial performance. The model test of fitness results are presented in Table 4.16 indicating the reliability of the model in predicting financial performance.

Table 4.15: ANOVA Results for all Commercial Banks

	Sum of Squares	Df	Mean Square	F	Sig.
Regression	14.068	4	3.517	8.702	.000a
Residual	48.903	121	0.404		
Total	62.971	125			

a. Predictors: (Constant), Investment Line Diversification, Channel Diversification, Location Diversification, Product Diversification

b. Dependent Variable: Financial Performance

The findings obtained show that channel diversification had a coefficient of 0.938. The positive coefficient implies that channel diversification strategy has a positive impact on the financial performance. The variable had a p-value of 0.018 implying it was significant at the 95% confidence level as it is less than 0.05.

Product diversification had a coefficient of 1.268. The positive coefficient implies that product diversification has a positive impact on the financial performance. The variable had a p-value of 0.000 implying it was significant at the 95% confidence level as it is less than 0.05. Location diversification had a coefficient of 1.186. The positive coefficient implies that location diversification has a positive impact on the financial performance. The variable had a p-value of 0.013 implying it was not significant at the 95% confidence level as it is more than 0.05.

Investment diversification had a coefficient of 0.856. The positive coefficient implies that investment diversification has a positive impact on the financial performance. The variable had a p-value of 0.018 implying it was significant at the 95% confidence level as it is less than 0.05.

The constant indicates that when business diversification is zero, financial performance of commercial banks will be 1.007. The diversification strategies thus have an overall positive relationship to the financial performance. The predictive model thus obtained is:

$Y = 1.007 + 0.938X_1 + 1.084X_2 + 1.186X_3 + 0.856X_4$ where;

Y is Financial Performance of commercial banks measured using financial performance composite index, X_1 is Channel Diversification, X_2 is Product Diversification, X_3 Location Diversification and X_4 is Business Line Diversification.

Table 4.16: Model Coefficients Results for all Commercial Banks

	Unstandardized		Standardized Coefficients		
	B	Std. Error	Beta	T	Sig.
(Constant)	1.007	0.314		3.209	0.002
Channel Diversification	0.938	0.39	0.2	2.404	0.018
Product Diversification	1.084	0.299	0.303	3.62	0.000
Location Diversification	1.186	0.472	0.204	2.515	0.013
Investment Diversification	0.856	1.169	0.059	0.732	0.465

a. Dependent Variable: Financial Performance

4.6.2.2 Regression Analysis for Small Sized Commercial Banks in Kenya

Multiple regression analysis was for done for small sized commercial banks in Kenya. As shown in table 4.16, business diversification has strong effect on financial performance of commercial banks ($r=0.867$). The coefficient of correlation is positive indicating that business diversification has positive effect on financial performance of commercial banks. Business diversification explained 75.2% of financial performance of commercial banks ($R^2=0.752$).

The findings of the model summary are presented in Table 4.17.

Table 4.17: Model Summary Results for Small Sized Commercial Banks

R	R Square	Adjusted R Square	Std. Error of the Estimate
0.867	0.752	0.685	0.66294

a. *Predictors: (Constant), Investment Line Diversification, Location Diversification, Channel Diversification, Product Diversification*

The ANOVA results in table 4.18 indicates that business diversification has a significant effect on financial performance of small sized commercial banks ($F=7.409$, $p<0.05$). Therefore, business diversification will lead to improved financial performance.

Table 4.18: ANOVA Results for Small Sized Commercial Banks

	Sum of Squares	Df	Mean Square	F	Sig.
Regression	2.447	4	3.256	7.409	.000
Residual	17.328	58	0.439		
Total	19.775	62			

Predictors: (Constant), Investment Line Diversification, Location Diversification, Channel Diversification, Product Diversification, b. Dependent Variable: financial performance

Findings as presented in table 4.19 indicate that channel diversification had a coefficient of 0.29 ($p<0.05$), product diversification 1.268 ($p<0.05$), location diversification 2.699 ($p<0.05$) and investment line diversification 2.11 ($p<0.05$). The positive coefficients indicate that the respective forms of diversification had positive effect on commercial banks financial performance. The positive effect was significant ($p<0.05$).

Table 4.19: Model Coefficients Results for Small Sized Commercial Banks

	Unstandardized Coefficients		Standardized Coefficients		
	B	Std. Error	Beta	t	Sig.
(Constant)	1.618	0.522		3.10	0.004
Channel Diversification	0.29	0.042	0.023	6.90	0.000
Product Diversification	1.268	0.466	0.965	2.72	0.005
Location Diversification	2.699	0.864	1.91	3.12	0.003
Investment Line Diversification	2.11	0.759	0.906	2.78	0.004

Dependent variable: financial performance

4.6.2.3 Regression Analysis for Medium Sized Commercial Banks in Kenya

Multiple regression analysis was for done for medium sized commercial banks in Kenya. The findings of the model summary are presented in Table 4.20.

Table 4.20: Model Summary Results for Medium Sized Commercial Banks

R	R Square	Adjusted R Square	Std. Error of the Estimate
.411	0.169	0.131	0.52899

Predictors: (Constant), Investment Line Diversification, Location Diversification, Channel Diversification, Product Diversification

As shown in table 4.20, business diversification has a moderate effect on financial performance of commercial banks ($r=0.411$). The coefficient of correlation is positive indicating that business diversification has positive effect on financial performance of commercial banks. Business diversification explained 16.9% of financial performance of commercial banks ($R^2=0.169$).

The ANOVA results in table 4.21 indicates that business diversification has an insignificant effect on financial performance of small sized commercial banks ($F=1.975$, $p>0.05$). Therefore, business diversification does not significantly lead to improved financial performance.

Table 4.21: Model ANOVA Results for Medium Sized Commercial Banks

	Sum of Squares	Df	Mean Square	F	Sig.
Regression	13.026	4	3.256	1.975	.150a
Residual	16.261	37	0.439		
Total	29.287	41			

a. Predictors: (Constant), Investment Line Diversification, Location Diversification, Channel Diversification, Product Diversification

The model coefficients are presented in Table 4.22.

Table 4.22: Model Coefficients Results for Medium Sized Commercial Banks

	Unstandardized Coefficients		Standardized Coefficients		
	B	Std. Error	Beta	t	Sig.
(Constant)	0.868	0.664		1.306	0.211
Channel Diversification	-0.288	1.567	-0.042	-0.184	0.857
Product Diversification	-0.697	0.617	-0.251	-1.129	0.277
Location Diversification	0.356	0.141	0.6	2.527	0.023
Investment Line Diversification	-0.004	2.442	0	-0.002	0.999

a. Dependent Variable: *financial performance*

4.6.2.4 Regression Analysis for Large Sized Commercial Banks in Kenya

Multiple regression analysis was for done for large sized commercial banks in Kenya. The findings of the model summary are presented in Table 4.23.

Table 4.23: Model Summary Results for Large Sized Commercial Banks

R	R Square	Adjusted R Square	Std. Error of the Estimate
.152a	0.023	0.021	0.54659

a. Predictors: (Constant), Investment Line Diversification, Location Diversification, Channel Diversification, Product Diversification

As shown in table 4.23, business diversification has a weak effect on financial performance of commercial banks ($r=0.152$). The coefficient of correlation is positive indicating that business diversification has positive effect on financial performance of commercial banks. Business diversification explained 2.3% of financial performance of commercial banks ($R^2=0.023$).

The model ANOVA results are presented in Table 4.24.

Table 4.24: Model ANOVA Results for Large Sized Commercial Banks

	Sum of Squares	Df	Mean Square	F	Sig.
Regression	2.211	4	0.553	1.025	.250a
Residual	4.198	15	0.28		
Total	6.408	19			

a. Predictors: (Constant), Investment Line Diversification, Location Diversification, Channel Diversification, Product Diversification

b. Dependent Variable: Financial Performance

Findings in table 4.25 indicate that all forms of diversification namely; channel diversification had, product diversification, and investment line diversification and location diversification had an insignificant effect on financial performance ($p > 0.05$). Thus, for large commercial banks, business diversification does not lead to improved financial performance. This could be the bank having been fully diversified and thus further diversification does not reduce risk or improve financial performance. The model coefficients are presented in Table 4.25.

Table 4.25: Model Coefficients Results for Large Sized Commercial Banks

	Unstandardized Coefficients		Standardized Coefficients		
	B	Std. Error	Beta	t	Sig.
(Constant)	1.379	0.225		6.128	0.00
Channel Diversification	0.08	0.045	0.227	1.774	0.081
Product Diversification	0.723	0.573	0.162	1.262	0.212
Location Diversification	0.361	0.558	0.08	0.647	0.52
Investment Diversification	0.35	0.329	0.132	1.064	0.292

Dependent Variable: financial performance

4.7 Discussion of the Findings

The study sought to establish the effect of business diversification strategies on the financial performance of the banks. To determine the relationship that existed between business diversification and the performance, chi square test was undertaken. Based on the chi square results, all the diversification strategies namely; product diversification, channel diversification, location diversification and investment diversification strategies impact positively and

significantly the financial performance of the small sized banks. However, the effect dwindles as the size of the bank increases.

4.7.1 Channel Diversification and Financial Performance

The study sought to determine how channel diversification impacts on the financial performance of commercial banks in Kenya. Agency banking and mobile banking were established to influence the financial performance to a large extent whereas internet banking and ATMs were established to influence the financial performance to a small extent. This may be due to the increased importance in technology advancements. To determine the relationship that exists between channel diversification and financial performance chi square was used. For small sized banks, channel diversification had a p-value of $0.035 < 0.05$. Therefore, channel diversification had a significant positive effect on business diversification. Therefore, adoption of channel diversification by small banks will lead to increase in financial performance. These results were confirmed by both the chi square test and multiple regression results. These findings compare with those of Markides (2016) who found that channel used by a particular business is essential in determining its success in undertaking operations. For medium and large banks, channel diversification did not have significant effect on financial performance of commercial banks which could be due to the banks being fully diversified.

4.7.2 Product Diversification and Financial Performance

The study sought to determine how product diversification impacts on financial performance of commercial banks in Kenya. Collateral financing, Emergencies loans products, Investment products, clustered current account, Asset financing products, Insurance products, Unsecured loans products, Bank Assurance and Long term saving Products fixed deposits were determined to impact on the financial performance moderately. While children saving product and short term

saving products impacted to a small extent. This showing that none of the product diversification impacted on the performance either to a large or very large extents. This may be due to the implementation processes not being very effective. To determine the relationship that exists between product diversification and financial performance, chi square test was undertaken. For small sized banks product diversification had a p-value of $0.000 < 0.05$. Therefore, channel diversification had a significant positive effect on business diversification. Therefore, adoption of product diversification by small banks will lead to increase in financial performance. These results were confirmed by both the chi square test and multiple regression results. For medium and large banks, product diversification did not have significant effect on financial performance of commercial banks which could be due to the banks being fully diversified.

4.7.3 Location Diversification and Financial Performance

The study sought to determine the influence that location diversification strategy has on the financial performance. The number of branches and the investment in other companies were all determined to influence the financial performance to a very large extent. For small sized banks location diversification had a p-value of $0.000 < 0.05$. Therefore, location diversification had a significant positive effect on business diversification. Therefore, adoption of channel diversification by small banks will lead to increase in financial performance. These results were confirmed by both the chi square test and multiple regression results. Chi square tests results also indicated that location diversification significantly affects performance of small and medium sized. For medium location diversification had significant effect on financial performance of commercial banks in Kenya. For large banks, location diversification did not have significant effect on financial performance of commercial banks which could be due to the banks being fully diversified.

4.7.4 Investment Diversification and Financial Performance

The study sought to determine the relationship between investment diversification strategy and financial performance. Chi square results indicated that investment diversification has significant and positive effect only on small banks. For small sized banks Investment diversification had a p-value of $0.023 < 0.05$. Therefore, investment diversification had a significant positive effect on business diversification. Therefore, adoption of channel diversification by small banks will lead to increase in financial performance. These results were confirmed by both the chi square test and multiple regression results. For medium and large banks, investment diversification did not have significant effect on financial performance of commercial banks which could be due to the banks being fully diversified.

4.7.5 Business Diversification and Financial Performance

The study aimed at establishing the effect that business diversification on the financial performance. This was achieved through chi square analysis and regression analysis that was undertaken on the variables. The findings indicated that business diversification has positive and significant effect on financial performance of small sized commercial banks only. For medium sized banks, only location diversification had significant effect on financial performance of commercial banks. For large banks, no, form of diversification had significant influence on financial performance. Based on the responses obtained, 50% of the respondents stated a large extent of influence, 22% for a very large extent, 11% for a small extent, while 8% for both no extent and moderate extent respectively.

On the relationship that exists between the diversification strategies and financial performance, the Coefficient of Multiple Determination (R^2 Square) obtained was 0.223 implying that that the

regression could explain only 22.3% of the variation performance. The remaining 77.7% of the variation could be due to other predictors not in the model.

The findings both from the questionnaires and inferential statistics thus concur that various forms of business diversification do have an influence on the financial performance of the banks. The chi square tests and multiple regression analysis further illustrated that the nature and strength of the relationship depends on the size of the banks small banks will positively be affected by business diversification that includes channel diversification, product diversification, location and investment diversification. However, for medium sized banks, only location diversification has significant effect on financial performance of commercial banks. For large banks, no form of diversification could impact on financial performance. This could be due to the fact that large banks are already fully diversified and hence any further diversification will not improve financial performance by eliminating risks.

Markides (2016) concluded that a firm may achieve benefits from low to moderate levels of diversification through the sharing of activities. The findings also compare with those of Lee (2009) who established the same in his study. On the contrary, the results obtained tend to contradict other studies conducted that established minimal to negative relationship between diversification and the bank performance such as Ibrahim, and Kaka, (2007) who investigated the impact of diversification on the performance of UK construction firms; and Jackson, *et al* (2010) who conducted a study on understanding the dynamics of diversity in decision-making teams.

CHAPTER FIVE: SUMMARY, CONCLUSION AND RECOMMENDATIONS

5.1 Introduction

The study sought to investigate the effect of business diversification on the financial performance of commercial banks in Kenya. This chapter presents the summary of the findings, conclusions and recommendations of the study.

5.2 Summary of the Findings

5.2.1 Channel Diversification and Financial Performance

The study sought to determine how channel diversification impacts on the financial performance of commercial banks in Kenya. Agency banking and mobile banking were established to influence the financial performance to a large extent whereas internet banking and ATMs were established to influence the financial performance to a small extent. This may be due to the increased importance in technology advancements. To determine the relationship that exists between channel diversification and financial performance chi square was used. The study found that channel diversification had effect only on small sized banks. These findings compare with those of Markides (2016) who found that channel used by a particular business is essential in determining its success in undertaking operations.

5.2.2 Product Diversification and Financial Performance

The study sought to determine how product diversification impacts on financial performance of commercial banks in Kenya. Collateral financing, Emergencies loans products, Investment products, clustered current account, Asset financing products, Insurance products, Unsecured loans products, Bank Assurance and Long term saving Products fixed deposits were determined to impact on the financial performance moderately. While children saving product and short term

saving products impacted to a small extent. This showing that none of the product diversification impacted on the performance either to a large or very large extents. This may be due to the implementation processes not being very effective. To determine the relationship that exists between product diversification and financial performance, chi square test was undertaken. The study found that product diversification had significant effect only on small sized banks. For medium and large banks, product diversification had insignificant effect on financial performance.

5.2.3 Location Diversification and Financial Performance

The study sought to determine the influence that location diversification strategy has on the financial performance. The number of branches and the investment in other companies were all determined to influence the financial performance to a very large extent. Chi square tests results indicated that location diversification significantly affects performance of small and medium sized banks and not large banks.

5.2.4 Investment Diversification and Financial Performance

The study sought to determine the relationship between investment diversification strategy and financial performance. Chi square results indicated that investment diversification has significant and positive effect only on small banks. Medium sized and large banks were not significantly affected by investment diversification.

5.2.5 Business Diversification and Financial Performance

The study aimed at establishing the effect that business diversification on the financial performance. This was achieved through chi square analysis and regression analysis that was undertaken on the variables. The findings indicated that business diversification has positive and

significant effect on financial performance of small sized commercial banks only. For medium sized banks, only location diversification had significant effect on financial performance of commercial banks. For large banks, no, form of diversification had significant influence on financial performance. Based on the responses obtained, 50% of the respondents stated a large extent of influence, 22% for a very large extent, 11% for a small extent, while 8% for both no extent and moderate extent respectively.

On the relationship that exists between the diversification strategies and financial performance, the Coefficient of Multiple Determination (R^2 Square) obtained was 0.223 implying that that the regression could explain only 22.3% of the variation performance. The remaining 77.7% of the variation could be due to other predictors not in the model. Kiweu (2012) explained the reduced effect of diversification on financial performance of commercial banks to be due to economic and financial shocks which naturally reduced the potential for diversification benefits.

5.3 Conclusion

Based on the findings, the study concludes that business diversification improves significantly financial performance of small banks. However, as the bank become bigger, business diversification continues to affect the performance of the banks to a less extent. This is supported by the findings that under medium sized banks, only location diversification has significant effect on financial performance and for large banks, all forms of business diversification do not affect commercial banks financial performance. Generally, without specifying the size of the bank, diversification positively affects financial performance of commercial banks. However, the effect is not very strong although significant. This could be due to economic and financial shocks which naturally reduced the potential for diversification benefits.

5.3.1 Channel Diversification and Financial Performance

The study has established that various channels have been put in place by the banks so as to facilitate service delivery. These channels include agency banking, mobile banking, internet banking and ATMs of which agency and mobile banking had the most impact. The study concludes that product diversification significantly affect financial performance of small sized banks only. For medium and large banks, product diversification has insignificant effect on financial performance.

5.3.2 Product Diversification and Financial Performance

The findings indicated that the product diversification positively affects financial performance of small banks only. This study therefore concludes there exists a positive relationship between product diversification and financial performance of small sized banks. As such, the more the diversification of products, the more profit potential for small sized commercial banks. Product diversification does not however affect financial performance of medium sized and large banks.

5.3.3 Location Diversification and Financial Performance

Location diversification is concluded to influence the financial performance of small and medium sized commercial banks in Kenya. This is due to it contributing to an increase in the consumer coverage hence increasing its market share. However, large commercial banks will not be affected by location diversification which could be due to increased overheads as a result of having many branches.

5.3.4 Investment Diversification and Financial Performance

The study established that investment diversification is important in improving the banks performance. This is through acquiring the necessary resources. The study thus concludes that investment diversification has a positive relationship with the financial performance. This is supported by the positive coefficient obtained from the regression analysis. Hence so as to improve the banks' performance, the banks should invest more in its assets both internally and externally.

5.3.5 Business Diversification and Financial Performance

Various diversification strategies have been established to be put in place by the banks. This includes channel diversification strategy, location diversification strategy, product diversification strategy and investment diversification strategy. All forms of business diversification are concluded to positively affect financial performance of small commercial banks in Kenya. However, under medium sized banks, only location diversification affects financial performance of medium sized banks. Large banks are not affected by any form of diversification since they are fully diversified.

The responses obtained from the questionnaires established a positive relationship. However, the diversification strategies had moderate levels of impact which could be due them not being implemented fully or evaluated after they are put in place. On the effect of bank size on the financial performance was perceived to positively affect financial performance of commercial banks in Kenya.

5.4 Recommendations

5.4.1 Managerial Recommendations

Business diversification was found to improve financial performance of small commercial banks. As the bank size increases from medium to large, the effect of business diversification continue to reduce. Under small banks, all forms of business diversification significantly affects financial performance. Under medium sized banks, only location diversification that significantly affects financial performance while under large banks, no form of diversification affects financial performance.

The study therefore recommends that business diversification should be a target for all small commercial banks that seek to increase their financial performance. The small bank management should target to invest on product diversification, channel diversification, location diversification and investment diversification since this will enhance their financial performance. However, medium sized banks should target at enhancing location diversification since this form of diversification will improve financial performance. Large banks on the other hand should not focus much on business diversification since they are already fully diversified but should focus more on enhancing the existing forms of diversification. This will enrich the products, services and investments made by the banks and consequently sustainable profitability.

5.4.2 Policy Recommendations

The study recommends that the banks should come up with policies on how to select the different product portfolios, client segments and product managers who will be entrusted with the management of specific product lines. By so doing, the banks will ensure maximization of benefits from products and enhance their overall earnings. The researcher also recommends that

the management of the banks should institute appropriate internal policies to ensure that there is constant review of existing products, development of new products and overall alignment of all product decisions with the expected earnings and wealth maximization objectives of the organizations.

The study established that the location plays a big role in enhancing the financial performance of small and large banks. The study recommends that banks should first develop firm-specific capabilities in their home-region market before they operate, if ever, in global markets. Also, the banks should carefully evaluate its customer base before deciding to venture in a particular place. The study also recommends that policies should be set by the government so as to regulate where banks are set up so as to minimize overcrowding.

5.5 Areas for Further Research

The study focused on business diversification and financial performance of commercial banks in Kenya. Financial performance was measured by CAMELS model which is a composite index of various measures. The study therefore recommends for a study on business diversification and financial performance of commercial banks where financial performance could be measured using other financial measures like return on assets, return on equity, liquidity among others.

A repeat study is also recommended where the diversification and financial performance statistics will be measured on quarterly or monthly basis. The data should be independently collected for the study since the information published by the banks is usually affected by the purpose to which it is published. This will enable evaluation of the accuracy of the information provided which couldn't be established by this study.

5.6 Limitations of the Study

The study was limited by access to information being sought by the study. Some of the respondents approached were reluctant to give information due to confidentiality concerns. The researcher addressed the problem by having an introduction letter from the University and assured the respondents that the information obtained was to be treated confidentially and it would be used purely for academic purposes.

The study was also limited by the methodology used by the study where only commercial banks were studied. Therefore, the findings may not be representative of all organizations in Kenya or other counties. Additionally, the study was limited by the form of data used by the study where primary data was used. The accuracy of primary data collected using questionnaire may not be verified. The data provided may also be subjective and biased. To ensure that the data is reliable, Likert scale was used and snow balling technique was used to minimize biasness. Leading questions were also avoided.

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APPENDICES:

Appendix I: Letter of Introduction

STRATHMORE UNIVERSITY,
P.O BOX 59857-00200
NAIROBI, KENYA.

May, 2017.

Dear Respondent,

RE: REQUEST TO CARRY OUT A RESEARCH STUDY.

I am a Master of Commerce student at Strathmore University doing a research on **The Effect of Business Diversification on Financial Performance of Commercial Banks in Kenya**. The study is in partial fulfillment for the requirement of the award of the degree. I request for your participation in the study which will go a long way in making this study a success. Kindly respond to the questions as accurately as possible. Your identity and information provided will be treated with utmost confidentiality and will not be used for any other purposes other than this academic paper. Your participation and cooperation will be highly appreciated.

Thank you in advance.

Yours faithfully,

DANIEL TAMALE

Appendix II: Questionnaire

1. Please indicate your gender?

Male ()

Female ()

2. Please your department at the commercial bank?

General Management ()

Marketing ()

Strategy ()

Investment ()

Finance ()

3. What is your ranking?

Director ()

Senior Level Manager ()

Middle Level Manager ()

Lower Level Manager ()

Other () Please specify.....

4. How long have you worked with the commercial bank?

Less than 3 years ()

3 years to 5 years ()

Over 5 years ()

5. Which category does your bank falls in terms of size as classified by Central Bank of Kenya?

Small ()

Medium ()

Large ()

6. To what extent does the following classes of business diversification affect financial performance of your bank measured by capital adequacy, asset quality, management, earnings and liquidity?

i. Channel Diversification

To which extent do you think channel diversification significantly influences the financial performance of your bank? Please use a scale of 1 to 5 where 5 is to very large extent, 4 is to large extent, 3 moderate extent, 2 small extent and 1 to no extent.

Channel Diversification	5	4	3	2	1
Agency banking					
Mobile Banking					
Internet Banking					
ATM Banking					
Other channel (Please specify)					

ii. Product Diversification

To which extent do you think product diversification significantly influences the financial performance of your bank? Please use a scale of 1 to 5 where 5 is to very large extent, 4 is to large extent, 3 moderate extent, 2 small extent and 1 to no extent.

Product Diversification Aspects	5	4	3	2	1
Short term saving products					
Long term saving Products-Fixed deposits					
Children saving products					
Clustered current account (eg Gold, silver, pay as you go etc)					
Emergencies loans products					
Unsecured loans products					
Asset financing products					
Collateral financing					
Investment products eg share trading products					
Insurance products					
Bank Assurance					

iii. Location Diversification

To which extent do you think location diversification significantly influences the financial performance of your bank? Please use a scale of 1 to 5 where 5 is to very large extent, 4 is to large extent, 3 moderate extent, 2 small extent and 1 to no extent.

Location Diversification Aspects	5	4	3	2	1
Number of branches					

iv. Investment Diversification

To which extent do you think business line diversification significantly influences the financial performance of your bank? Please use a scale of 1 to 5 where 5 is to very large extent, 4 is to large extent, 3 moderate extent, 2 small extent and 1 to no extent.

Business Line Diversification Aspects	5	4	3	2	1
Investment in other Companies					

7. How else does business diversification affect financial performance of commercial banks?

.....

.....

8. To what extent does size affect financial performance of your commercial bank in Kenya?

- Very large extent ()
- Large extent ()
- Moderate extent ()
- Small extent ()
- No extent ()

9. What are your recommendation is respect to commercial banks financial performance and business diversification?

.....

.....

Thank you for your time

Appendix III: List of Commercial Banks

No	Bank
1	Barclays Bank of Kenya Ltd
2	Commercial Bank of Africa Ltd
3	Co-operative Bank of Kenya Ltd
4	Diamond Trust Bank (K) Ltd
5	Equity Bank Ltd
6	Kenya Commercial Bank Ltd
7	Standard Chartered Bank (K) Ltd
8	Bank of Africa (K) Ltd
9	Bank of Baroda (K) Ltd
10	Bank of India
11	CfC Stanbic Bank (K) Ltd
12	Citibank N.A. Kenya
13	Ecobank Kenya Ltd
14	Family Bank Ltd.
15	Housing Finance Ltd
16	I&M Bank Ltd
17	National Bank of Kenya Ltd
18	NIC Bank Ltd
19	Prime Bank Ltd
20	African Banking Corporation Ltd
21	Consolidated Bank of Kenya Ltd
22	Credit Bank Ltd
23	Development Bank of Kenya Ltd
24	Equatorial Commercial Bank Ltd
25	Fidelity Commercial Bank Ltd
26	First Community Bank Ltd
27	Giro Commercial Bank Ltd
28	Guaranty Trust Bank Ltd
29	Guardian Bank Ltd
30	Gulf African Bank Ltd
31	Habib Bank A.G. Zurich
32	Habib Bank Ltd
33	Jamii Bora Bank Ltd
34	Middle East Bank (K) Ltd
35	Oriental Commercial Bank Ltd
36	Paramount Universal Bank Ltd
37	Sidian Bank Ltd
38	Trans - National Bank Ltd
39	UBA Kenya Ltd
40	Victoria Commercial Bank Ltd

Source: CBK (2017)