Portfolio Restructuring as a Precursor for Financial Performance of Commercial Banks Listed At Nairobi Securities Exchange

Martin Mabonga Wekesa\textsuperscript{1}, Kongo Yabesh\textsuperscript{2}

\textsuperscript{1}Department of Economics, Accounts & Finance, Jomo Kenyatta University of Science & Agriculture, P.O. Box 62000-00200, Nairobi, Kenya.

\textsuperscript{2}Department of Economics, Moi University, P.O. Box 3900-30100, Eldoret, Kenya.

Abstract: Good financial performance is a prerequisite for non-delisting of companies on the securities exchange. Some of the listed companies have recorded persistent losses as well as low profits which are impediments against continued listing on the securities exchange. There is evidence of companies which have been either delisted, put under receivership and others declared bankrupt in the past. Restructuring has been adopted by companies including those listed on the securities exchange but after restructuring exercise, some of the companies have ended up earning high profits; others earn low profits while others make high losses. It is on the basis of this purview that the current study sought to examine the effect of portfolio restructuring on financial performance of commercial banks listed at Nairobi Securities Exchange. The specific objective was to find out the effect of portfolio restructuring on financial performance of the banks. The study used longitudinal research design in data collection. A study population of 11 commercial banks was considered in the study. The data was then analyzed using simple linear regression model and Pearson product moment correlation. The study found that portfolio restructuring positively affects firm performance although not statistically significant ($\beta = .442$, $p>0.05$). The conclusion of the study was that portfolio restructuring positively affects financial performance although not statistically significant. The study recommended that the banks should try to practice liquidation, divestitures, asset sales and spin-offs with the objective of achieving set financial targets of the firms. Commercial banks should opt for significant changes in the asset mix of the firms’ when they are not performing well.

Key words: Kenya, portfolio restructuring, financial performance, return on assets

I. Introduction

Companies around the globe are supposed to be financially viable so as to maintain their listing on the securities exchange. A precursor for the going concern of any company in both developed and developing countries is growth in profits or reduction in losses which are attributes of good financial performance (Anyona, 2017). Financial performance is of paramount importance to organizations because it provides an overall assessment of how well a company is doing with regard to its mission, vision and objectives (Abor, 2005). It goes without mentioning that, companies as well as other business entities faces a myriad of challenges within the business environment, these calls upon organization leaders to use financial performance as one of the measures used to guide decision making on whether any changes are to be made (Murthy, 2015). This is because assessment of financial performance identifies the financial strengths and weaknesses of the company’s by establishing relationships between the items of the financial position and income statement (Chandler, 2015). According to Sami (2013), several corporate failures among listed companies have occurred throughout out the world in the last one decade.

Delisting is not a new or rare occurrence; more than 7,300 firms have been delisted from US stock exchanges from 1995 to 2015, with nearly half of these being involuntarily delisted by their respective exchanges (Plourd, 2019). Also, in 2008, the New York Stock Exchange (NYSE) and the NASDAQ delisted 139 firms which had fallen into a financial crunch (Krantz, 2008; Plourd, 2019). Glaudier and Underdown (2011) opines that an early warning signal of probable corporate failure would enable both management and investors to take restructuring as a preventive measure against corporate failure. Delimiting the study on the banking sector, large shocks to foreign exchange and interest rates, and a general economic slowdown, has led to the financial sector in Kenya and around the world into experiencing a large number of defaults and an increase in the rate of non-performing loans. Countries with longer term financial distress and other structural problems are
often accompanied by depressed asset prices such as equity. This prompted the financial sectors to restructure with actions affecting both the liquidity and solvency situation of the banks.

Most Local studies on restructuring focused on mergers and acquisition strategy for example Ireri (2011); Kiplangat (2006) both authors recommend further studies into other industries on the real effect of portfolio restructuring on financial performance. In all the mentioned studies, none considered the role and effects of portfolio restructuring strategy adopted by Kenyan organizations more so in the banking industry. Most studies focused on general restructuring strategies yet some firms might just have undertaken a single restructuring strategy for example portfolio restructuring. To date, there is no comprehensive theory to explain how firms in Kenya ensure survival especially in relation to asset base. This study seeks to address the inherent gap on what is the effect of portfolio restructuring on financial performance of commercial banks listed at Nairobi Securities Exchange.

1.2 Statement of the Problem

Financial performance measures whether a corporate entity is on the path of corporate success. Some of the companies listed at the Nairobi Securities Exchange in Kenya are no longer offering services due to inability to raise sufficient financial resources to meet their financial obligations. According to CMA (2018), share prices of some listed companies have also fallen below the par value, putting investors’ wealth at risk. According to Anyanzwa (2018), portfolio restructuring should prevent firms from delisting, failure, illiquidity, low profitability margins by providing an opportunity to recapture competitive advantage and gain profits by shifting around modes of corporate restructuring. However, this has not been the case at all times. Delisting and suspension from trading dents investor confidence due to inability to attract new listings. Some of the listed banks have recorded better financial results after restructuring while others have not. Therefore this study intends to find out whether portfolio restructuring affects the financial performance of banks listed at the Boer. Empirically, few studies exist that have assessed the effect of portfolio restructuring on financial performance of commercial banks listed at the Nairobi Securities Exchange. Therefore, this study seeks to fill this knowledge gap by examining the effect of portfolio restructuring on financial performance of commercial banks listed at the securities Exchange. The remainder of this article paper is organized as follows. Section 2 covers review of past studies and defines the main hypothesis. Section 3 covers materials and methods. Section 4 covers the results and discussion. Section 5 presents the conclusion and recommendations.

II. Review of past studies and Hypothesis Development

2.1 Financial Performance

Financial performance is a subjective measure of how well a firm can use its assets from its primary role of conduct of business and its subsequent generation of revenues. Financial performance is also used as a general measure of a firm’s overall financial status over a given period of time, and can be used to compare similar firms across the same industry or to compare industries or sectors in totality. The financial performance is measured using accounting Key Performance Indicators such as Return on assets, Return on sales, Earnings before interest and tax, Economic value added or Sales growth (Crabtree & DeBusk, 2008). The advantage of these measurements is their general availability, since every profit oriented organization produces these figures for their yearly financial reporting (Chenhall et al., 2007). This study adopted the use of Return on assets since it measures the income available to debt and equity investors per dollar of the firm’s total assets (Brealey et al., 2011). That is, it measures financial soundness of the firm in terms of its assets. It was therefore used in the regression model as a measure of financial performance. Specifically, it is the ratio of revenues generated over a firm’s total assets.

2.2 Portfolio Restructuring and Financial Performance

Portfolio restructuring is the process of making significant alterations or modifications in the composition of assets owned by an organization or the product lines of companies in which a company controls (Maria, Angel & Javier, 2015). It also involves the sale of assets no longer needed or wanted and the purchase of different ones. According to Wu and Delios (2017), portfolio restructuring is concerned with the re-composition of a portfolio’s asset mix by selling off undesirable asset types such as equities, debt, cash or specific securities within that class, while simultaneously buying desired types or securities. This may include liquidations, divestures, asset sales, demergers, acquisitions and spin offs (Ruigrok, Pettigrew, Peck & Whittington, 1999). Liquidation is the process of bringing a business to an end and distributing its assets to claimants. It is an event that usually occurs when a company is insolvent, meaning it cannot pay its obligations when they are due. As company operations end, the remaining assets are used to pay creditors and shareholders, based on the priority of their claims (Kenton, 2019).
Divestures concerns the reduction in the scope of business activities. Asset sale is a non recourse cash sale of assets from a bank or government agency to a third party. The purpose of an asset sale is generally to increase cash flow, reduce bad debts risk and liquidation of assets. If the sale of the assets does not give the buyer complete control after payment has been made, the transaction is not considered a true asset sale (Bowman et al., 2009). Configuration of portfolio of assets of a company might increase its stream of cash inflows, hence improvement in financial performance.

Savovic (2016) researched on post-acquisition organizational and portfolio restructuring and performance of acquired companies in the Republic of Serbia. The study period considered in the study was between 2002 and 2011. This research was conducted in Serbian companies that were the subject of domestic and crossborder acquisitions during the period 2002-2011. The sample size for the study was 208 respondents. Thirty companies were selected and contacted, taking into account that the companies should be subject of domestic and cross-border acquisition and from different branches. By using multiple regression analysis, the researcher assessed the effect of portfolio restructuring on post-acquisition performance. The results of analysis indicated that portfolio restructuring has a negative non-statistical significant effect on post-acquisition performance. The changes in fixed assets to total assets ratio was not considered in the study which the current study seeks to incorporate.

Bergh (2018) researched on product-market uncertainty, portfolio restructuring, and performance. The author investigated whether portfolio restructuring undertaken in response to changes in product-market uncertainty had implications for financial performance. A model that integrates information-processing and resource-based theories was applied to data from a panel of 168 Fortune 500 companies. Secondary data was the main source of data and it was obtained from the individual 168 Fortune 500 companies. The study findings were presented using both inferential statistics and descriptive statistics. Inferential statistics adopted in the study were correlation analysis and regression analysis while the descriptivestatistics used in the study were mean and standard deviation. The results of the study indicated that portfolio restructuring actions influenced the financial performance of the companies.

Byerlyla, Lamontb and Keaslerc (2013) researched on business portfolio restructuring, prior diversification posture and investor reactions. This study examined firm performance in market reaction to two types of business portfolio restructuring announcements: refocusing and repositioning. The researchers predicted that market performance effects for these two types of strategic structurers would be moderated by prior diversification posture. Market-based performance measures were used to reflect the immediate performance effects that follow announcements in that they mirror perceptions regarding value of future earnings. A standard event study methodology was used to determine market and investor reactions to announcements of these restructuring strategies across the complete range of diversification postures. In this approach, performance effect, the dependent variable, was captured as abnormal variations in a firm’s stock price at the time of the announcement of the restructuring effort. Study results revealed that prior diversification posture poses a significant contingency factor in restructuring firms’ strategic choices. Further, the market tended to respond more favorably with this sample to repositioning restructuring choices. Changes in fixed assets to total assets ratio was not considered in the study which the current study seeks to incorporate.

Maroro, Kamau and Koinma (2018) assessed the effect of portfolio restructuring on return on equity of financially distressed commercial banks in Kenya. This study employed a longitudinal research design. The target population comprised of 24 financially distressed commercial banks in Kenya that restructured their assets during the period 1992 -2016. The study employed secondary data extracted from the audited financial statements and annual reports of the commercial banks over the 25-year period, 1992 to 2016. The unbalanced panel data regression model was adopted in data analysis. Restructured loans, non-performing assets and written off assets were the subconstructs of portfolio restructuring while ROE was the dependent variable. The study found that portfolio restructuring had a positive and significantly effect on return on equity of financially distressed commercial banks in Kenya. Changes in fixed assets to total assets ratio was not considered in the study which the current study seeks to incorporate.

Mbogo (2013) examined the effect of portfolio restructuring on share prices of companies quoted at the Nairobi Securities Exchange in Kenya. This study adopted a descriptive survey research design. The target population was all the companies quoted at the Nairobi Securities Exchange as at 31st December 2013. A sample of 10 companies quoted at the Nairobi Securities Exchange was selected using stratified proportionate random sampling technique. Secondary data was obtained from published annual reports of the individual firms’ listed at the Nairobi Securities Exchange. The study period considered in the study was between 2009 to 2013.
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Primary data was collected using questionnaires. Quantitative data was analyzed using descriptive statistics while qualitative data was analyzed using content analysis, through developing a thematic framework from the key issues, concepts and themes. Regression analysis was used to test the effect of portfolio restructuring on share prices of companies listed at the Nairobi Securities Exchange. Changes in fixed assets to total assets ratio was not considered in the study which the current study seeks to incorporate.

Waithaka and Kimencu (2018) researched on portfolio restructuring strategy and the performance of commercial banks in Kenya. The study was delimited to Kenya Commercial Bank. The study was guided by Contingency theory, Resource Based Theory and Transaction Cost Theory. The study adopted a descriptive design and it targeted 235 employees in KCB headquarters in Nairobi. The sample size was 71 respondents selected using stratified random sampling technique. The primary data was collected through use of a questionnaire. A panel of peers was used to check for the validity of the research instrument while reliability of the questionnaire was tested through Cronbach’s alpha test. The data collected was analysed through descriptive and inferential statistics. The study found that portfolio restructuring strategy has a positive and significant relationship with performance of the bank.

Riany, Musa, Odera and Okaka (2012) examine the effect of restructuring on organization performance of mobile phone service providers in Kenya conclude that portfolio restructuring had the greatest impact on firm performance. Mbogo and Waweru (2014) in their study on the corporate turnaround response by financially distressed companies listed on the NSE, surveyed companies that were listed for the entire period of the study (2002-2008). The survey found that portfolio restructuring was the most preferred turnaround strategy being carried out by 50% of the companies.

Dong, Putterman, & Unel (2004), the implications of restructuring on financial performance in Chinese context assert that performance improvements is realized upon restructuring. This is supported by inconclusive evidence from Wen (2002) study which shows portfolio restructuring results in better profitability. Ngige (2012) examined the implication of restructuring on the performance and long-term competitiveness within the Kenyan banking sector and further, the significance of different modes of restructuring adopted by the banks in influencing performance. Findings revealed that generally, restructuring resulted to improvement in performance in terms of market share growth, competitiveness, growth in quality of products, geographical spread and customer retention. Further findings revealed that banks used different strategies of restructuring which had different motives in influencing performance. The study found mixed and inconclusive results as in the case of portfolio restructuring the study showed an increase in the year of restructuring and the year after. The literature reviewed led to the formulation of the following hypothesis statement:

\[ H_0:1 \text{ Portfolio Restructuring has no significant effect on financial performance of commercial banks in Kenya} \]

III. Materials & Methods

Research philosophy is a belief about the way in which data about a phenomenon should be gathered, analyzed and used (Coopers& Schindler, 2011). It also refers to the development of understanding that is assumed by the researchers (Saunders et al., 2009). For this study, a positivistic research philosophy will be adopted. The choice for the positivistic research philosophy is supported by the principle underlying this philosophy. According to the principles of positivism, the philosophy depends on quantifiable observations that lead themselves to statistical analysis (Kothari,2004). It is noted that positivism is in accordance with the empiricist view that knowledge stems from human experience (Singh, 2006). This principle conforms to the nature of the study in that it deals with the quantifiable observations. With regard to the progression of this study, it will be guided by the hypotheses in attempt to show the association between independent variable and dependent variable. All these attributes of the study apply for the positivism research philosophy hence its choice as the ideal research philosophy.

Research design is a plan and structure of investment conceived so as to obtain answers to research questions (Coopers& Schindler, 2011). In this study, the study was carried out using a longitudinal research design, employing secondary quantitative data for Five years (2014-2019). Panel data for fivefinancial years i.e. between 2014 and 2019 was considered. Panel data is associated with time series studies which are concerned with multiple observations which are made over time. This will yield data that is very useful in bringing out any trends in the financial performance of the cohort considered in this study which was commercial banks listed at the Nairobi Securities Exchange in Kenya. The data was obtained from Nairobi Securities Exchange Handbooks and Published books of accounts of the companies listed in the Nairobi Securities Exchange.

Target population is the total collection of elements about which inferences are made and refers to all possible cases which are of interest for a study (Sekaran & Bougie, 2016). In this study, all commercial banks...
were considered. After ascertaining the target population, the study population or accessible population was then identified. It is a subset of the target population. It is from the accessible population that researchers draw their samples. The study population was 11 commercial banks listed on the Nairobi Securities Exchange. A census survey was carried out for the study and only commercial banks with all the data for the five years considered in the study were considered. Secondary data was used in the study.

As noted by Baltagi (2008), panel data helps to control for individual heterogeneity; allows for more information in the data set, more flexibility, less risk of collinearity between variables; easier to study “dynamics of adjustment”; easier to create and test more advanced models. Panel data usually gives the researcher a large number of data points, it therefore increases the freedom in one hand and decreases the collinearity on the other hand, these means that efficiency of econometric estimates will be achieved or improved (Hsiao, 2015). A secondary data analysis sheet will aid in data extraction from the audited financial statements. Secondary data collection sheet will be developed and adopted to collect quantitative secondary data using document analysis method.

All the data was collected by review of documents, annual reports of the companies, the Nairobi Securities Exchange Handbooks and published books of accounts. Data analysis is the application of reasoning to understand the data that have been gathered with the aim of determining consistent patterns and summarizing the relevant details revealed in the investigation (Zikmund et al., 2012). Data was analyzed by use of the statistical Package for Social Science (SPSS) Version 25. The inferential statistics were used in data analysis that is, Pearson product moment correlation and regression model. Pearson product moment correlation was used to assess for significant association between dependent variable (ROA) and the independent variable (Portfolio Restructuring). The regression model was as follows:

\[ ROA = \beta_0 + \beta_1 X_1 + e \]

Where; \( X_1 \) = Portfolio Restructuring; \( e \) = error term; \( \beta_0 \) = intercept; \( \beta_1 \) = coefficient of \( X_1 \).

### IV. Results & Discussion

Pearson product moment Correlation was used to assess for significant correlation between dependent variable (ROA) and the independent variable (Portfolio Restructuring). The study used a 95% confidence level. The results showed that there was significant correlation between Portfolio restructuring and financial performance as measured by ROA \( (r = .782, \ p = .042) \) as shown in Table 1. The results indicate that portfolio restructuring explained 78.2% positive relationship with firm performance. Further the findings elucidates clearly that Portfolio Restructuring is indeed a determinant of firm performance.

<table>
<thead>
<tr>
<th>Table 1: Correlation Results</th>
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<tbody>
<tr>
<td>n=20</td>
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<td>---</td>
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<tr>
<td>Portfolio</td>
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<tr>
<td></td>
</tr>
<tr>
<td>ROA</td>
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**Regression**

Simple linear regression model was used to predict financial performance in the study. The prediction was carried out basing on the effect of portfolio restructuring on financial performance. The findings indicated that the model adjusted R square was 0.026 which indicated that 2.6% total variation of financial performance of the banks is explained by portfolio restructuring as shown in Table 2.

<table>
<thead>
<tr>
<th>Table 2: Regression model summary</th>
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<tr>
<td>Model</td>
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<tr>
<td>1</td>
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</tbody>
</table>

a. Predictors: (Constant), PRTR

The research further found that portfolio restructuring recorded coefficient estimates of \( \beta = .442 \) (p-value =.242 which is more than \( \alpha = 0.05 \)) as shown in Table 3, hence the study fails to reject the null hypothesis \( (H_0) \) and conclude that portfolio restructuring has a positive effect on financial performance of commercial banks listed on Nairobi Securities Exchange. The research found similar results to Wen (2002), Ngige (2012), Riany et al., (2012).
Table 3: Regression coefficients

<table>
<thead>
<tr>
<th>Model</th>
<th>Unstandardized Coefficients</th>
<th>Standardized Coefficients</th>
<th>T</th>
<th>Sig.</th>
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<tbody>
<tr>
<td>(Constant)</td>
<td>B</td>
<td>Std. Error</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Portfolio</td>
<td>.422</td>
<td>.365</td>
<td>1.547</td>
<td>.140</td>
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</table>

a. Dependent Variable: ROA

V. Conclusions & Recommendations

The study findings affirm that portfolio restructuring positively affects a firm’s financial performance. This implies that the more the bank restructures the better the performance of the bank although the extent of the effect caused by portfolio restructuring is statistically insignificant. All the banks listed at the Nairobi Securities Exchange had used portfolio restructuring and subsequently it had affected the financial performance of the banks positively. There are other forms of restructuring that the commercial banks can adopt besides portfolio restructuring. The commercial banks may also opt for organization restructuring or financial restructuring and/or implement both portfolio restructuring, financial restructuring and organization restructuring at the same time. Commercial banks should opt for significant changes in the asset mix of the firms when they are not performing well. The banks should change the lines of business which the firms operates to maximize on profitability. The banks should try to practice liquidation, divestitures, asset sales and spin-offs with the objective of achieving set financial targets of the firms.

References

[30]. New Age International.