Corporate Restructuring And Financial Performance Of Commercial Banks In Kenya

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Abstract

Corporate restructuring is the process through which an organization modifies its financial operational and/or organizational structure. Regression techniques were used to analyze the valuables of the study. The study established the effect of corporate restructuring on financial performance of commercial banks in Kenya. The study population was 39 commercial banks. The study employed cross-sectional research design. Secondary data was collected using a survey collection sheet. The coefficient of corporate restructuring has negative and significant effect on financial performance of commercial banks. The study concluded that corporate restructuring has a negative and significant effect on the financial performance of commercial banks. It is important for policy makers and management of commercial banks to come up with restructuring policies to improve financial performance of commercial banks. Also, the management of commercial banks should ensure that banks adopt appropriate restructuring structures to improve performance.

Keywords: Corporate Restructuring, Performance of Banks, Kenya

Introduction

Corporate restructuring is the process through which an organization modifies its financial operational and/or organizational structure. Individual firms and economies as a whole carry out restructuring to gain a competitive edge and improve performance or risk losing out to competitors in the dynamic business environment (Kahuko, 2018). It entails provision of new services, invention of more products, ensuring more effective and efficient means to reduce operational costs, and also ensure growth technologically. Corporate restructuring helps commercial banks to initiate innovations that led to improvement of financial performance and quality service delivery.
for customers as well as ensuring stability in the financial system (Magiri, 2017). The relationship between corporate restructuring and financial performance is theoretically underpinned by two theories; agency theory and lifecycle theory. Agency theory asserts that the principal /agent relationship that companies emphasize leads to agency problems and that agency problem may be mitigated by compensations strategies that make agents act in the best interest of the principle (Jensen & Mengling, 1976). Lifecycle theory assets that a firm in its lifecycle determines the choices a firm makes concerning sources of funding for its activities especially during period of financial distress and when in danger of insolvency (Koh & Chang 2015).

Commercial banks have been carrying out restructuring activities worldwide in bid to improve performance. From the global perspective successful commercial banks in world have engaged in restructuring of none-performing loans. For example, Asian banks have incorporated swaps of equity for some debt in corporate debt restructuring (Hawkins & Turner, 2005). Corporate debt restructuring has an advantage of reducing some pressure on corporate borrowing. In Africa, corporate restructuring has been implemented by different commercial banks in form of consolidations, as while as M&A. 14 percent of commercial banks in Sub-Saharan Africa (SSA), have reported consolidations of their activities in 2018 (European Investment Bank, 2018). M & A increase synergy and hence reduce operational costs in an organization. The Kenyan banking sector has encouraged in mergers and consolidations. For example, commercial bank of Africa ltd and NIC bank PLC merged to form NCB bank Kenya PC on November 5, 2019 (Central bank of Kenya, 2018). Mergers and acquisitions have an advantage of increasing market share, competitiveness and profitability.

The restructuring efforts made by banks in various countries, to ensure optimal performance, have however, not resolved the issue of poor performance and consequent failure. Some of the banks that have failed in the recent past include Washington federal bank for savings Chicago, 2017, City national bank of new jersey, Newark, 2019, Trust Cornerstone Bank, king of Prussia, Pa. 2016, Unibank Ghana limited 2012 (Goldberg, 2022). In Kenya, there have been cases of bank receivership and consequent failure. Some banks, for instance, Dubai Bank and Chase Bank failed in a quick succession in 2015 (Central bank of Kenya, 2018). Moreover, profitability declined by 17.2 percent to Ksh 134.1 billion in profit before tax in the year ended June 30, 2020. Declining profitability is an indicator of poor financial performance. Poor financial performance of commercial banks can lead to financial distress and subsequent failure.

The witnessed corporate failure of commercial banks has motivated studies to investigate the effect restructuring on financial performance of commercial banks in Kenya. The results of the studies are however, inconclusive and give mixed results. Some studies (Okoye, et al., 2020); (Harwood, et al., 2016) indicate a positive effect while others (Notanubun, et al., 2019); (Ramdas & kumar, 2015) indicated negative effects. Most reviewed studies are from developed countries. Furthermore, the reviewed studies used different methodologies hence the results are inconsistence. This raises the question of which are the ideal methodologies to study the effect of corporate restructuring and financial performance. The current study thus seeks to fill this gap by
investigating the effect of corporate restructuring on financial performance of commercial banks in Kenya. Specifically the study investigates the effect of assets restructuring, debt restructuring, ownership restructuring and operational restructuring on the financial performance of commercial banks in Kenya.

The study contributes to corporate restructuring literature in many ways. First, the study covers a period of 11 years (2009-2019), which is the period that falls within the post-financial crisis of the banking sector of the 1980’s and 1990’s that witnessed declining economic activities. The banking regulations recommended restructuring of the commercial bank in terms of asset restructuring, debt restructuring, ownership restructuring and operational restructuring. To the best of our knowledge, no study has been done to establish the effect of these variables on the financial performance of commercial banks in Kenya. This study thus provides an empirical investigation of the effect of restructuring variables and gives recommendations that can be used by policymakers and other stakeholders in determining the restructuring policies. Thirdly, the study gives recommendations to the management and other stakeholders regarding the restructuring method that can be adopted to enhance the financial performance of commercial banks.

**Literature Review**

This study is guided by Agency and lifecycle theories. Agency theory Smith (1776) argues that if a firm is managed by persons who are not the shareholders, then there is a possibility that the managers may not work for the owners benefit. Agency relationship arises when the shareholders (principles) engages the management (agent) in day-to-day running of the organization. The assumption of the theory is that, the delegation of authority by the principles usually results into conflicts since agents have different goals as they have more and better information about the organization than do the principles. If the principle and the agent are utility maximizers, the agent may not perform in the best interest of the shareholders (principle) at all times (Jensen & Meckling, 1976). Since many decisions that affect the principle financially are made by the agent, differences of opinion, and even differences in priorities and interest can arise. Band (1992), points out that conflicts of self-interests such as those between shareholders and top management causes some misalignment hence the principle–agent problem. Jensen and Meckling (1976) points out that when a company is trading solvently, shareholders will align their interests with those of the directors as opposed to those of the creditors. Agency theory is important as it identifies how to treat information and risk in the operation of a firm (Eisenhardt & Schoonhoven, 1996). When leading, creditors can insist on signing covenant contracts to ensure safety of their debt so that in case of distress they can force the firm to restructure to improve performance and if necessary distribute the proceeds to the affected creditors. Paterson (2016), confirms that creditors can force a firm in distress into an insolvency process to realize the assets and distribute the proceeds to the beneficiaries. Given the agency theory, this study investigates the effect of debt and ownership restructuring on financial performance of commercial banks in Kenya.
The stages of an organization’s growth exhibit certain differences among different environmental variables such as structure, strategy, and also decision making methods. Lifecycle theory asserts that the characteristics of organizations change according to the life cycle stages (Miller & Friesen, 1984). Lifecycle hypothesis expound on the interesting firm lifecycle attributes at birth, growth, maturity and decline and how these qualities influence the choices a firm makes particularly in circumstances of financial distress and liquidation risk (Koh, Dai, & Chang, 2012). Different decision making patterns and functional specialization are required at each stage if performance is to be achieved. However, life cycle attributes present restricted choices for restructuring to executive, this is particularly so when firms are faced with trouble (Koh & Chang, 2012). The theory underscores the fact the particular lifecycle qualities may influence the restructuring process that the firm may utilize if in financial is in distress. Wruck (1990), confirms that the conditions of finance related problems, such as default, distress and bankruptcy present a fundamental stage in the lifecycle of firms. Therefore, the management should be keen on the choice of the type of restructuring and its appropriateness at each stage. This study investigates the effect of asset and operational restructuring on financial performance of commercial banks in Kenya.

Corporate restructuring is undertaken to address crisis which may result after rapid changes in the environment in which firms operate. When the environment in which firms operate is unfavorable, profit maximization gets at risk promoting restructuring. Profit performance of banks is substantially linked to restructuring of the sector (Lawarence, 2020). Restructuring in firms may take various forms that may include privatization, state interventions and M & A. However, it has been proved by use of Data Envelopment Analysis (DEA) and Stochastic Frontier Analysis (SFA) that 26 commercial banks in Vietnam for the period 1999 to 2015, that privatization of state-owned commercial banks, state interventions and M & A do not substantially improve efficiency and that environmental variables affect performance (Vo & Nguyen, 2018). Commercial banks undertake reforms in order to address issues that may be affecting performance. Assessment of the effect of post-reform era is therefore, an important aspect for the banks. However, 12 commercial banks in Bangladesh by employing panel data regression framework established that financial reforms had no significant effect on ROA and ROE for the banks but the net interest margin (NIM) increased after the post reform era (Robin, et al., 2018). Some restructuring efforts like M&A involve costs which may affect the expected improvement in performance. It has been proved that six banks with specific reference to ICICI bank and bank of Rajasthan using t-test (paired two samples for means) and ratio analysis for a period of three years that M & A helps in long-term growth and sustainability, which may not seem profitable in the short-run because of the costs incurred during the transaction (Ramdas & kumar, 2015). The Kenya banking sector has been carrying out restructuring activities that have impacted on performance. The National bank of Kenya used 18 respondents to prove by the use of linear regression model and Pearson product moment correlation that organizational restructuring positively affects firm performance although not statistically significant (Harwood, et al., 2016). Furthermore, Kenyan commercial banks use various restructuring strategies that have contributed to performance improvement. It has been established using 71 respondents of Kenya commercial bank limited and by use of descriptive
analysis and inferential statistics that financial, portfolio, and organizational restructuring strategies have a positive and significant relationship with financial performance (Chege, 2018). Given agency theory and life cycle theory we hypothesize that:

H01: Corporate restructuring has no significant effect on the financial performance of commercial banks in Kenya.

Asset restructuring entails identification of non-performing parts of a portfolio and separating it from other assets and also writing off of non-performing loans. Identification of non–performing parts of a portfolio and writing off of non-performing loans is essential and can be achieved using various techniques to achieve performance. Using ten models, including: standalone models of multivariate discriminant analysis (MDA), logistic regression (Logit), probit, case–based reasoning (CBR), support vector machine (SVM), and their bagged ensembles, (Li, Hong, & Zhou, 2019), confirmed that adopting more means of asset restructuring leads to a higher performance improvement. However, using generalized method of moments (GMM), banks with higher restructured assets levels witness higher risk and lower profits (Bawa & Basu (2020). Banks assess the strategies to adopt in addition to the many means available to improve performance. Mwangi & Maina (2021), confirmed by use of descriptive statistics firms that use various restructuring strategies to improve performance. However, using linear regression analysis Kithinji, (2019), confirmed that asset restructuring negatively impact financial performance of banks. Risk management and compliance to regulations laid down by regulatory authorities ensures a less chance of financial distress. However, applying data envelopment analysis (DEA) to operations data for 40 commercial banks in Taiwan over a 6-year period 2000-2005, Hsing & Hsiao, (2010) confirmed that banks have lower operating efficiency on average during the reform period compared to the pre-reform period. Wruck (1990), argue that states of financial distress, default and bankruptcy present a fundamental stage in the lifecycle of firms. Therefore, the survival of a firm depends on the ability to make appropriate decisions at each stage. Given the product life cycle theory, the decision on which type of restructuring is suitable for a firm in distress is limited to the life cycle stage the firm is in. We therefore, hypothesis that:

H01: Asset restructuring has no significant effect on the financial performance of commercial banks in Kenya.

Debt restructuring plays an important role in corporate restructuring of preserving the insolvent lender and avoidance of the bankruptcy procedure. Firms should put emphasis on improving their liquidity levels while taking care of the leverage ratio. Using random effect regression model Lotto (2019), confirmed that bank liquidity and capital adequacy have a positive relationship with operating efficiency of Tanzanian banks. Extending credit to new ventures may lead to risk of the loan default where the founders can be forced to offer the leaders partial ownership in the venture in exchange of loan principle by loan principle by swapping their debt for equity (Vinturella & Erickson, 2013). This improves the profitability of the venture by lowering debt services payments while lowering debt on the balance sheet and replacing it with equity. Replacing debt with equity
is critical since financial distress affects firm performance in terms of employment, productivity, investment and survival. Lack of firms’ financial soundness during the period of financial distress of Slovenian firms is a critical factor constraining firm performance (Damijan, 2018). Equity capital is fundamental in capital structure of a firm as it has a positive impact on performance indicator (ROA) while total debt and short term debt have a negative relationship with ROA and ROE (Vătavu, 2015). Additionally, total debt, short term debt and long debt of Malaysian listed firms have a significant negative relationship with performance of the firms (Salim & Yador, 2012). Extending credit may have an implication when time value of money is factored. Utilizing both panel and frontier efficiency analyses in Nigeria, Konboye & Nteegah (2016), established a lesser implication of interest rate on profitability, while the impact of inflation on profitability was positive. Given the agency theory, we hypothesize that:

H₀₁: Debt restructuring has no significant effect on the financial performance of commercial banks in Kenya.

Corporate ownership restructuring of an entity entails change, local or foreign in the ownership of business. Although, foreign institutional investors and domestic private shareholders have special financial incentives to monitor the management and emphasize corporate profitability (Okabe, 2004). Privatization of state owned commercial banks, state interventions and mergers and acquisitions do not substantially improve efficiency since environmental variables affect performance (Vo & Nguyen, 2018). Ownership restructuring plays a fundamental role in corporate restructuring as it can lead to positive influences on the business in the future and an increase in the number of stakeholders/ shareholders especially if there are significant problems that may put the firm in jeopardy. Commercial banks are either private, domestic or foreign owned while among these there are large and small banks. The government usually has the capacity to expand the state –owned banks in the short run; but this can lead to a loss in financial stability in the long run translating to poor financial performance although state owned banks are more stable than private ones but not as they grow in size (Alqahtani, et al., 2021). State-owned commercial banks, create conducive environment for increasing foreign bank entry and allow acquisition of foreign assets by domestic firms. Using a sample of 111 chinese commercial banks (Boateng, et al., 2015) found that foreign banks have better asset quality and overall performance. The environment in which firms operate play a fundamental role in performance enhancement, ignoring such variables can be detrimental in achieving the objectives of restructuring. Vo & Nguyen (2018), established that privatization of state owned commercial banks, state interventions and mergers and acquisitions do not substantially improve efficiency since environmental variables affect performance. Given the views of the agency theory, we hypothesize that:

H₀₁: Ownership restructuring has no significant effect on the financial performance of commercial banks in Kenya.

Corporate operational restructuring involves changes in business strategies, retrenchment and general reorganization of the business entity. Operational restructuring aims at reorganizing the
activities of banks and includes laying off personnel, increasing/reducing branches, increasing/decreasing production lines as well as improving process. Restructuring aims to minimize costs of operation to improve performance. Eby & Buch (2017), contends that restructuring minimizes costs of operations as well as aiding in improved formulation of strategy and implementation. Spread in branch network as a strategy is key in improving access to banking services. With the help of descriptive statistics and inferential statistics Nyatika (2017), confirmed that spreading bank branch networks significantly predicts return on assets. However, the use of agent banking has reduced the number of branches a bank can possibly open. Descriptive analysis, Pearson’s correlation analysis and regression analysis techniques reviewed statistically insignificant positive relationship between agent banking and the profit maximization (Kuboja, 2020). Downsizing workforce is instrumental in addressing cases of distress in firms. According to hypothesis test results of Turkish banks, there is no significant difference between the profitability of Turkish banks before and after downsizing (Ozlem, 2017). However, the random effect estimation depicts that selected commercial banks in Nigeria failed to achieve their objective of increasing overall assets level by way of downsizing its workforce (Ikechukwu, Chijindu, 2016). Given the lifecycle theory that firms make choices depending on the attributes of birth, growth maturity and decline, we hypothesize that;

H₀₁: Operational restructuring has no significant effect on the financial performance of commercial banks in Kenya.

**Research Methodology**

The study utilized cross-sectional research design. The target population was 39 commercial banks that met the criteria of completed audited financial reports for the period 2009 to 2019. A census of all the 39 commercial banks was conducted. Secondary data was collected using a survey collection sheet. Quantitative data was analyzed using linear regression techniques to establish the relationship of the study variables. The dependent variable was financial performance while the independent variables were four types of restructuring methods; namely, asset restructuring, debt restructuring, ownership restructuring and Operational restructuring. Quantitative data was analyzed using STATA.

**Research Model**

This research used linear regression to analysis the relationship between the variables. The dependent variable was financial performance while the independent variables were four types of restructuring, namely, asset restructuring (AR), debt restructuring (DR), ownership restructuring (OwR) and Operational restructuring (OR).

The effect of corporate restructuring on financial performance was tested using the following model:

\[ y_{it} = \alpha + \beta_{1x1i}t + \beta_{2x2i}t + \beta_{3x3i}t + \beta_{4x4i}t + \epsilon_{it} \]
Where: \( y = \text{ROA} \), \( \alpha \) is the constant term, \( \beta_1, \ldots, \beta_4 \), are the regression coefficients, \( x_{1it}, \ldots, x_{4it} \) = asset restructuring, debt restructuring, ownership restructuring and operational restructuring respectively, \( i \) is the income for the bank and \( t \) is the year when the bank earns the income while \( \varepsilon \) is the error term.

**Research Findings and Discussion.**

The fixed regression results suggest that \( R^2 = 0.4486 \); implying that 44.86 percent of financial performance of commercial banks is explained by corporate restructuring. The fixed regression results are shown in table one below.

<table>
<thead>
<tr>
<th>Variable</th>
<th>Indicator</th>
<th>Coefficient</th>
<th>Std. Error</th>
<th>Z-Statistic</th>
<th>Prob.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Constant</td>
<td>Constant</td>
<td>-0.000325</td>
<td>0.0001952</td>
<td>-1.64</td>
<td>0.076</td>
</tr>
<tr>
<td>Independent</td>
<td>AR</td>
<td>-0.0006036</td>
<td>1.9400006</td>
<td>-53.03</td>
<td>0.085</td>
</tr>
<tr>
<td>Independent</td>
<td>DR</td>
<td>1.5600013</td>
<td>9.3100014</td>
<td>1.67</td>
<td>0.043</td>
</tr>
<tr>
<td>Independent</td>
<td>OWR</td>
<td>1.7600013</td>
<td>1.0600013</td>
<td>1.76</td>
<td>0.049</td>
</tr>
<tr>
<td>Independent</td>
<td>OR</td>
<td>-0.0000112</td>
<td>3.4200006</td>
<td>1.27</td>
<td>0.068</td>
</tr>
</tbody>
</table>

\[ R^2 = 0.4486 \]

\[ \text{Adjusted } R^2 = 0.3923 \]

\[ F \text{ Statistics} = 18.242 \]

\[ F \text{ Prob. (P-value)} = 0.000 \]

The results indicate that the coefficient of determination (\( R^2 \)) was 0.4486. This means that 44.86 percent of variation in financial performance was explained by corporate restructuring. The results indicated that the relationship between the independent variable and the dependent variable was significant, since \( F = 18.242 \) \( (P < 0.05) \). This showed that corporate restructuring variables significantly affected the financial performance of Kenyan commercial banks. The results are in agreement with the findings of (Salim, 2018); (Ramdas & Kumar, 2015). The hypothesis that corporate restructuring has no significant effect on the financial performance of commercial banks in Kenya is thus rejected. The study model was fitted as follows;

\[
\text{ROA} = -0.000352 - 0.0006036(\text{AR}) + 1.5600013(\text{DR}) + 1.7600013(\text{OWR}) - 0.0000112(\text{OR}) + (\varepsilon_{it}) 0.0001952.
\]

The results confirm that asset restructuring negatively and significantly affects financial performance of commercial banks in Kenya \( (\text{Prob.} = 0.085, \alpha = 0.05) \). Therefore, \( P > 0.05 \). The results suggest that increase in asset restructuring led to a decrease in financial performance which contributes to poor performance. The hypothesis that asset restructuring has no significant effect on the financial performance of commercial banks in Kenya is thus accepted. The results were in agreement with the findings of (Bawa & Basu, 2020); Kithinji, (2017).
The regression results also indicated that debt restructuring positively and significantly affects financial performance of commercial banks in Kenya (prob. = 0.043, α=0.05). Therefore, P < 0.05. This implies increasing debt restructuring led to an increase in financial performance. The results suggest that banks that restructured debts improved financial performance during the study period. The results were in agreement with the findings of (Lotto, (2019); Konboye & Nteegah (2016). The hypothesis that debt restructuring has no significant effect on the performance of commercial banks is thus rejected. This implies that debt restructuring should be considered if performance improvement is to be achieved. The results further indicated that ownership restructuring positively affects financial performance of commercial banks in Kenya (Prob. = 0.049, α=0.05). Therefore, P < 0.05. The results suggest that increase in ownership restructuring led to an increase in financial performance during the study period. The results were in agreement with the findings of (Boateng (2015); Alqahtani, et al., (2021). The hypothesis that ownership restructuring has no significant effect on the financial performance of commercial banks is thus rejected. This implies that commercial should consider ownership restructuring to achieve optimal financial performance. The results further indicated that operational restructuring negatively affects financial performance of commercial banks in Kenya, (Prob. = 0.068, α = 0.05. Therefore, Prob. > 0.05; suggesting that an increase in operational restructuring led to decrease in financial performance. The results were in agreement with the results of Kuboja, (2020); Ikechukwe, Chijindu, (2016). The hypothesis that operational restructuring has no significant effect on the financial performance of commercial banks is thus accepted. This implies that commercial banks should not consider operational restructuring as a way of improving financial performance.

**Conclusion and Recommendations**

This study determined the effect of restructuring on financial performance of 39 commercial banks for the period 2009-2019. The restructuring variables were asset restructuring, debt restructuring, ownership restructuring and operational restructuring while financial performance as measured by ROA was the dependent variable. The relationship between the variables was carried out using linear regression analysis. The findings established that asset restructuring negatively and significantly affects financial performance. This suggested that commercial banks that restructured assets did improve financial performance during the study period. The management and policy makers should not consider asset restructuring as a means to financial performance enhancement.

The results also indicated that debt restructuring positively and affects financial performance of commercial banks in Kenya. This suggests that commercial that restructured improved performance during the study period. Policymakers should restructure debts to improve performance. The results also demonstrated that ownership restructuring positively affects financial performance of commercial banks in Kenya. This suggested that commercial banks that restructured ownership improved performance during the study period. The management and policy makers should restructure ownership to improve performance. The results also indicated that operational restructuring negatively affects financial performance of commercial banks in Kenya. This implies that commercial banks that restructured operations performed better during
the study period. The management of should therefore, not consider operational restructuring to achieve optimal financial performance. This study demonstrated that corporate restructuring affects the financial performance of commercial banks. Therefore, we recommend that policymakers should come up with restructuring policies to improve financial performance of commercial banks. We also recommend that the management of commercial banks ensure that banks adopt appropriate restructuring structures to improve performance.

The study contributes to corporate restructuring literature by providing insights on the effect of corporate restructuring on financial performance from a developing country perspective. The study also provides an empirical examination of the effect of various restructuring methods adopted by commercial banks and gives recommendations that can be used by policymakers in evaluating and assessing restructuring policies. The study also provides recommendations to managers regarding the restructuring methods that can be adopted to enhance financial performance of firms. We suggest that further research can be conducted to focus on data from different sectors to compare and contrast the effect of restructuring in the various sectors in Kenya.

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References


