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The effect of financial due diligence on financial performance of commercial banks listed in Nairobi securities exchange

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Abstract

This study sought to establish the relationship between financial due diligence and financial performance of commercial banks listed at Nairobi Securities Exchange. The study provided useful information to policy makers and regulators to design target policies and programs that stimulate the growth and sustainability of commercial bans listed (NSE). The study findings benefited management adherence and its effect on risk mitigation in operation of banks,add value to researchers and scholars, academicians and researchers for further research, investors for setting up commercial banks or grading investment to commercial banks listed and financial analysts and consultants enabled them improved financial services on investment decisions. The study failed to includes some of objectives which are vital when handling financial due diligence in commercial banks. The specific objectives were: to determine the effect of liquidity level, and debt management on financial performance. This study employs a descriptive research design. The sampling technique of this study was drawn from eleven commercial banks listed at (NSE). Secondary data was collected from website of CBK and published banks annual financial performance. The target population comprised of the 11 commercial banks listed (NSE). The data was analyzed using descriptive statistics techniques and multiple regression analysis, correlation analysis and t test value analysis. The study found that liquidity level had positive and not statistically significant on financial performance. The study recommends that the team should developed strategies, policies and rules to avoid the poor financial performance.

Key words: *Financial due diligence; Financial performance; Commercial banks; Nairobi Securities Exchange*

1.0 Introduction

The financial due diligence consists of detailed investigation of financial statements of the past and current years from all aspects before making a decision. According to Pannedy, (2010) financial due diligence is the scope of financial projections, plausibility of the bank's planning reviewed, this review looks at past developments as a major point of reference, the assumptions on which the banks planning are based are analyzed carefully.

Financial due diligence has help the supervisors in the banks are increasingly recognizing the importance of ensuring that their banks have adequate controls and procedures in place so that they know the customers with whom they are dealing, adequate financial due diligence on new and existing customers is a key part of these controls, without this financial due diligence, banks can become subject to reputational, operational, legal and concentration risks, which can result in significant financial cost(Arif and Nees, 2012).

In Germany, financial due diligence has the primary objective of understanding bank's actual liquidity situation, and forecasting its future financial situation (Yildirim and Philippatos, (2007). According toAjibike and Aremu (2015) the basis for the financial party's current valuation of the target banks, for strategic investment decisions, as well as for providing a necessary foundation for formula banks financial performance of banks plan and integration program, the target bank's liquidity level and actual situation of operational managements must be initially understood.

In India, current system of employing debt management by public accountants, yet to establish any specialized standards pertaining to financial due diligence, completing this engagement efficiently and to a high standard, displaying a bank's professional competency, and promoting a high level of customer satisfaction are a bank's predominant concerns when receiving requests for financial due diligence engagement (Decker 2010).

In Tanzania, financial due diligence is one of the basic process related on financial performance. Gul, Faiza and Khalid, (2011),said that, the result and quality of the examination have an enormous impact on decisions made by people responsible for the course of the transaction in that they make it possible for both parties to the transaction to make sure that they have the same perceptions of the object of the transaction, its financial results, as well as the way it operates. Also listed banks financing decisions were identified involving a wide range of policy issues, at private, such decisions affect liquidity, debt management and banks risk of banks.

Pandey, (2010), noted that, financial performance measures how well a firm is generating value for the owners. It can be measured through various financial measures such as return on assets and return on equity that is generally accepted. Rahaman, (2010) argued that, financial performance of a firm normally originates from the financial position and structure of the firm. Khrawish, (2011), said that, financial statement evaluate the financial position and performance of a firm. These statements are prepared and produced for external stakeholders for example: shareholders, government agencies and leaders.

Ayele, (2012), opined that, the motives behind financial due diligence are to improve revenues and profitability, faster growth in scale and quicker time to market, and acquisition are perceived as effective methods of improving corporate performance. The researcher therefore recommended a study on effect of the financial due diligence on financial performance of commercial banks listed at securities exchange.

1.1 Statement of the Problem

Profitability of banks very poor translating to closer of many banks, despite financial due diligence the soundness of a commercial sector is closely connected to the soundness of the financial due diligence is omitted to improve profits (Lipunga, 2014). This has been evidenced in 2011 profits after tax which was sh. 911,116, in commercial banks in Kenya (CBK 2011), decreasing in 2015, profit after tax was sh.8,790,016, indicating declining trend in most commercial banks in Kenya (CBK 2015). Based on the annual CBK Supervision Report, the pace of growth of commercial banks has been slowly increasing in Kenya.

There is need to determine the effect of debt management on financial performance in commercial banks listed at Nairobi Securities Exchange failed to include liquidity level. Therefore, the study assessed how financial due diligence affected financial performance of commercial banks listed at Nairobi securities exchange.

1.12 Objectives of the study

(i) To determine the effect of liquidity level on financial performance of commercial banks listed at the Nairobi Securities Exchange (NSE) in Kenya.

(ii) To examine the effect of debt management on financial performance of commercial banks listed at the Nairobi Securities Exchange (NSE) in Kenya.

2.0 Theoretical Literature Review

The theories reviewed the Shift ability theory which was started by Maaka in 2013. This theory posits that a bank's liquidity is maintained if it holds assets that could be shifted or sold to other lenders or investors for cash. This point of view asserts that a bank's liquidity could be improved if it always has assets to shift and provided the Central Bank and the discount market stands ready to purchase the asset offered.

Pandey, (2010), noted that, thus this theory recognizes and contends that shift ability, marketability or transferability of a bank's assets is a basis for ensuring liquidity. Kimani, (2015),opined that, this theory further contends that highly marketable security held by a bank is an excellent source of liquidity, the goal of financial due diligence is to test the reliability of a company's information, policies, practices and procedures.

Decker, (2010), Government regulations require that certain financial institutions undergo independent financial due diligence. Brumermeier, (2009), said that, financial due diligence functions are oriented and can be loosely structured. The functions also can vary considerably, depending on the area of a company under financial due diligence and the type of business model, financial due diligence must be carefully manage thoroughly investigation in the firm to make understand the risks.

2.1 Empirical Literature Review

2.1.1 Liquidity level and financial performance

ArifNaumanAnees (2012),analysed the effect of liquidity on financial performance of non financial companies in Kenya. The study aimed to examine the effect of asset quality on financial performance and to determine the effect of capital leverage on financial performance, using a sample size of 20, the study was analyzed using mean and regression analysis. The study found that there is effect of liquidity on financial performance; study further recommended that the management team to set up strong strategy.

Pandey, (2010), analyzed the effect of liquidity on financial performance of commercial bank in Kenya. The study aimed to find out the effect asset quality on financial performance and to determine the effect of credit ratio on financial performance, using a sample size of 30, the study was analyzed using mean and regression analysis. The study found that liquidity has positive effect on financial performance of banks, the study further recommended that the banks manager should set a policy to follow strictly in the banks to help in improves banks performance.

Sohaimi(2013),analysed the effect of liquidity on financial performance of Insurance companies in Kenya. The study found that will be a more useful in future, the study recommended that the liquidity to be used by bank should be match with the risk a bank expose, this will help to improve the financial performance of banks.

2.1.2 Debt Management and financial performance

Data, (2010), analyzed debt management on financial performance of insurance sector. The study aimed to evaluate the effect of bank size on financial performance and to examine the effect of credit ratio on financial performance of 8 insurance sectors out of 8 of insurance sectors in Kenya. Multiple regression and correlation was used to analyze data. The study found that the debt management affecting insurance sector performance. The study recommended that insurance sectors should apply strategy approach to improve insurance sector performance.

Maritala, (2012), analyzed the effect of debt management on financial performance of insurance sectors in Kenya. The study aimed to determine the effect of gross ratio on financial performance of 30 companies. Least square Dummy Variable model analysis was used. The study found that debt management affect the financial performance of insurance sectors in Kenya. However, this was argued by Akorsu, and Anyapong, (2012), who analyzed the effect of debt management on financial performance of insurance sectors in Kenya. The analyzed data was done by cross-section and panel data analysis. The study found that debt management has positive and significant effect on return on equity. The study further recommended that high debt management increase the financial performance level in the insurance sectors.

2.2 Research Gap

Sohaimi (2013),analysed the effect of liquidity on financial performance of Insurance companies in Kenya. The study aimed to evaluate bank size using a sample size of 18, the study was analysed using mean and regression analysis. The study failed to apply correlation analysis which is important in measuring association of variables.

Akorsu, and Anyapong, (2012), analyzed the effect of debt management on financial performance of insurance sectors in Kenya with 9 of insurance sector. The study was analyzed using cross-section and panel data analysis. The study used a smaller simple size of 8 which is not wider enough to give a good result for research and also the study failed to use correlation analysis, and aggression analysis. The financial performance of financial due diligence depends on the interrelationships of the independent variables which include: Liquidity level and Debt management. Thus, the explanatory variables are a result of financial due diligence in this study.

2.3 Conceptual Framework

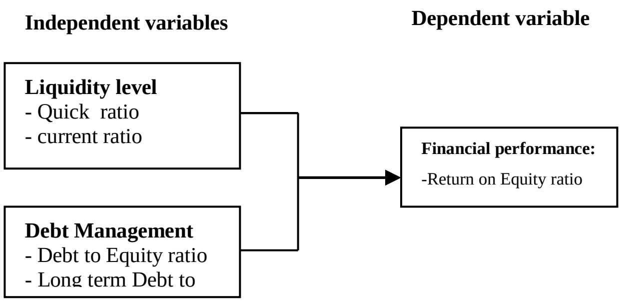

Fig. 2.1: Conceptual Framework

Figure 2.1 Conceptual framework

Figure 2.1 shows the conceptualization of the dependent and independent variables was related study. The independent variables of this study indicated the statistics that was used to measured effects of financial due diligence determinants. They included liquidity level, Debt management, and dependent variable financial performance measured by Return on Equity (ROE).

3.0 Material and Methodology

This study adopted a descriptive survey research that aim at analyzing the effect of financial due diligence on financial performance on commercial banks listed in the Nairobi Stock Exchange. According to Bonfirm and Kim, (2011), noted that, a descriptive survey was used to obtained information concerning the current status of the phenomena to describe with respect to variables or conditions in a situation.

The study targeted all bank managers from the eleven commercial banks. Census method was applicable under all the eleven banks were taken study, since the sample size was not large enough to be subjected to calculations. The study used secondary data from published banks annual financial performance from CBK for the five years 2012-2015, using the instrument secondary data was collected to find out the effect of financial due diligence on the performance of commercial banks listed in Nairobi Securities Exchange.

A descriptive statistics technique was applied and Multiple regression analysis to explain the connection between independence and dependence variables. To test the relationship between financial due diligence and financial performance of commercial banks listed at Nairobi Securities Exchange in Kenya, regression model was used:

4.0 Results and discussion

4.1 Liquidity level and finance performance

4.1.1.1Quick Ratio

The study sought to establish the effect of Quick ratio on financial performance.

Table: 4.1 Quick Ratio

	N	Min	Max	Mean	Std. Deviation
Co-operative bank	5	.14	.18	.1640	.01517
Equity bank	5	.21	2.02	.5760	.80724
NIC bank	5	.15	.19	.1680	.01643
National bank	5	.09	1.10	.3360	.42852
Commercial bank	5	.15	.19	.1700	.01581
Barclays bank	5	.19	.21	.1986	.01172
CFC Stannic bank	5	.14	2.56	.6720	1.05602
Diamond trust bank	5	.14	.16	.1540	.00894
Housing Financial bank	5	.01	.09	.0300	.03391
Standard Chartered bank	5	.14	.22	.1880	.03114
Investment bank	5	.15	.21	.1800	.02550
Valid N (listwise)	5				

Source: Nairobi Security Exchange (2015)

The results indicated that the Co-operative Bank had a mean of 0.16 with standard deviation of 0.01517, where minimum of 0.14 with a maximum of 0.18, NIC Bank had a mean of 0.17 with a standard deviation of 0.01643,where minimum of 0.15with a maximumof 0.19,Kenya Commercial Bank had a mean of 0.17 with a standard deviation of 0.01581, where minimum of 0.15with a maximum 0.19, National Bank of Kenya had a mean of 0.34 with standard deviation of 0.42852,where minimum 0.09 with a maximum 1.10, Investment Mortgage Bank with a mean of 0.18with standard deviation of 0.02550, where minimum of 0.15 with maximum of 0.21, Barclays Bank had a mean of 0.20 with standard deviation of 0.01172, where minimum of 0.19 with a maximum of 0.21, CFC Stanbic Holding Bank had a mean of 0.67 with standard deviation of 1.05602, Diamond Trust Bank had a mean of 0.15 with standard deviation of 0.00894,whereminimum of 0.14 with a maximum of 0.16, Housing Finance Co. of Kenya had a mean of 0.03 with standard deviation of 0.03391 where minimum of 0.01 With a maximum of 0.09 value, Standard Chartered Banks had a mean of 0.19 with standard deviation of 0.03114 where minimum 0.14 with a maximum 0.22 and Equity Bank had mean of 0.58 with standard deviation of 0.80724, the minimum value of a mount to and maximum. The study showed that CFC Stanbic Holding Bank had the highest mean of 0.67with standard deviation of 1.05602, and Housing Finance Co. of Kenya had the lowest mean of 0.03 with standard deviation of 0.0339.

4.1.1.2 Current Ratio

The study sought to establish the effect of Current ratio on financial performance.

Table: 4.2Current Ratio

	N	Min	Max	Mean	Std. Deviation
Co-operative bank	5	.17	1.18	.9640	.44411
Equity bank	5	1.20	1.22	1.2120	.00837
NIC bank	5	1.15	1.19	1.1680	.01643
National bank	5	1.09	11.10	3.1360	4.45215
Commercial bank	5	1.15	1.19	1.1700	.01581
Barclays bank	5	1.19	1.21	1.1976	.01078
CFC Stanbic bank	5	.12	1.25	.9880	.48690
Diamond bank	5	.92	1.17	1.1120	.10756
Housing Finance bank	5	1.12	1.17	1.1480	.02168
Standard Chartered bank	5	1.14	12.26	3.3940	4.95630
Investment Morgage bank	5	.12	1.20	.7620	.57264
Valid N (listwise)	5				

Source: Nairobi Security Exchange (2015)

The results indicated that the CFC Stanbic Holding Bank had a mean of 0.99 with standard deviation of 8.48690, minimum0.12 with a maximum value 1.25; Kenya Commercial Bank had a mean of 1.17 with a standard deviation of 0.01581 and minimum1.15 with a maximum 1.19, National Bank of Kenya had a mean of 3.14 with standard deviation of 4.45215 where minimum 1.09 with a maximum 11.10, Diamond Trust Bank had a mean of 1.11 with standard deviation of 0.10756 where minimum 0.92 with a maximum value 1.17, Co-operative Bank had the lowest mean of 0.96 with standard deviation of 0.4441 where minimum0.17 with a maximum1.18, NIC Bank had a mean of 1.17with a standard deviation of 0.01643, minimum 1.15 with a maximum 1.19, Housing Finance Co. of Kenya had a mean of 1.15with standard deviation of 0.02168 where minimum1.12 with a maximum value 1.17,Standard Chartered Banks had a mean of 3.39 with standard deviation of 4.95630 where minimum1.14 with maximum 12.26, Barclays Bank had a mean of 1.20 with standard deviation of 0.01078 where minimum1.19 with a maximum1.21, Investment Mortgage Bank with a mean of 0.76 with standard deviation of 0.57264 where minimum0.12 with maximum value of amount at 1.20, and Equity Bank had mean of 1.21 with standard deviation of 0.00837 which had the minimum value of a mount to 1.20 and maximum 1.22.The study showed that Equity Bank had the highest mean of 1.21 with standard deviation of 0.00837and Co-operative Bank had the lowest mean of 0.96with standard deviation of 0.4441.

4.1.2 Debt Management and financial Performance

4.1.2.1 Debt to equity ratio

The study sought to establish the effect of Debt to equity ratio on financial performance.

Table: 4.3 Debt to equity ratio

	N	Min	Max	Mean	Std. Deviation
Co-operative bank	5	12.35	28.97	18.7540	6.58962
Equity bank	5	1.32	2.23	1.6620	.35745
NIC bank	5	8.97	94.39	59.6280	32.66890
National bank	5	37.55	55.98	44.7140	8.26101
Commercial bank	5	3.86	8.26	5.4280	1.77249
Barclays bank	5	1.08	6.69	3.1500	2.24289
CFC bank	5	1.37	45.23	28.6400	17.84267
Diamond Trust bank	5	24.91	36.49	30.6860	4.88766
Housing Finance bank	5	2.24	15.19	7.4000	5.28545
Standard bank	5	12.97	31.68	18.9600	7.31894
Investment Mortgage bank	5	.46	5.50	3.1840	1.87832
Valid N (listwise)	5				

Source: Nairobi Security Exchange (2015)

The results indicated that the Co-operative Bank had a mean of 18.75 with standard deviation of 6.58962 where minimum 12.35 with a maximum 28.97, NIC Bank had a mean of 59.63 with a standard deviation of 32.66890, minimum 8.97 with a maximum94.39, Kenya Commercial

Bank had a mean of 5.43 with a standard deviation of 1.77249, minimum 3.86 with a maximum 8.26, National Bank of Kenya had a mean of 44.71 with standard deviation of 8.26101 where minimum37.55 with a maximum 55.98, Investment Mortgage Bank with a mean of 3.18 with standard deviation of 1.87832 where minimum 0.46 with maximum value of amount at 5.50, Barclays Bank had a mean of 3.15 with standard deviation of 2.24289 where minimum 1.08 with a maximum 6.69, CFC Stanbic Holding Bank had a mean of 28.64 with standard deviation of 17.84267where minimum1.37 with maximum45.23, Diamond Trust Bank had a mean of 30.67 with standard deviation of 4.88766 where minimum 24.91 with a maximum value 36.49, Housing Finance Co. of Kenya had a mean of 7.40 with standard deviation of5.28545 where minimum 2.24 with a maximum value 15.19, Standard Chartered Banks had a mean of 18.96with standard deviation of 0.79003 where minimum 12.97 with a maximum 31.68 and Equity Bank had mean of 1.66 with standard deviation of 0.35745, the minimum value of a mount to 1.32 and maximum 2.23. The study indicated that Co-operative Bank had the highest mean of 18.75 with standard deviation of 6.58962 and Equity Bank had the lowest mean of 1.66 with standard deviation of 0.35745.

4.1.2.2 long term Debt to equity ratio

The study sought to establish the effect of Long term debt to equity ratio on financial performance.

Table: 4.4 longterm Debt to equity ratio

	N	Min	Max	Mean	Std. Deviation
Co-operative bank	5	7.59	11.98	9.6160	1.85985
Equity bank	5	10.45	10.79	10.6500	.17819
NIC bank	5	13.90	23.76	17.3880	4.09594
National bank	5	147.70	172.77	157.8980	11.74815
Commercial bank	5	103.86	123.56	108.4880	8.46313
Barclays bank	5	12.23	151.91	90.0860	64.97719
CFC Stanbic bank	5	44.04	70.29	54.8580	11.13021
Diamond Trust bank	5	151.44	169.93	161.0700	8.59021
Housing Finance bank	5	17.96	103.42	57.5420	33.30381
Standard Chartered bank	5	14.79	189.17	103.6980	79.66088
Investment Mortgage bank	5	1.54	23.71	11.2600	8.10214
Valid N (listwise)	5				

Source: Nairobi Security Exchange (2015)

The results indicated that the Standard Chartered Banks had a mean of 103.70with standard deviation of 79.66088where minimum, 14.79and maximum 189.17, Housing Finance Co. of Kenya had a mean of 57.54with standard deviation of 33.30381where minimum17.96with a maximum value 103.42, CFC Stanbic Holding Bank had a mean of 54.86with standard deviation of 11.13021minimum44.04with a maximum value 70.29, NIC Bank had a mean of 17.39with a standard deviation of 4.09594, minimum 13.90with a maximum 23.76, Barclays Bank had a mean of 90.09 with standard deviation of 64.97719where minimum12.23with a maximum. 151.91,Diamond Trust Bank had a mean of 161.07with standard deviation of 8.59021 where minimum151.44 with a maximum value 169.93, National Bank of Kenya had a mean of 157.90with standard deviation of 11.74815where minimum147.70with a maximum 172.77,Investment Mortgage Bank with a mean of 11.26with standard deviation of 8.10214 where minimum1.54with maximum value of amount at 23.71,Kenya Commercial Bank had a mean of 108.49with a standard deviation of 8.46313 and minimum103.86with a maximum123.56,Equity Bank had mean of 10.65with standard deviation of 0.17819 which had the minimum value of a mount to 10.45and maximum 10.79, andCo-operative Bank which had a mean of 9.62with standard deviation of 1.85985 where minimum7.59with a maximum11.98.Therefore, the study indicated that Diamond Trust Banks had a the highest mean of 161.07with standard deviation of 8.59021 and that Co-operative Bank had the lowest mean of 9.62with standard deviation of 1.85985.

4.2 Correlation analysis between Financial due diligence and financial performance.

The study indicated that there was a positive correlation between liquidity level on financial performance both in terms of return on asset with a value of 0.038 and Return on Equity with a value of 0.109. The study showed that there were no significant relationship between liquidity level and financial performance of commercial banks listed in Nairobi Securities Exchange

The study indicated that there was a negative and positive correlation in Debt management on financial performance in terms of Return on Asset with a value of -0.141 and in tem Return on equity with a value of 0.087. The study showed that there were is significant relationship between Debt management and financial performance of commercial banks listed at Nairobi Securities Exchange.

4.3 Hypothesis testing based on Return on equity

Table 4.18Hypothesis Testing

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	50.120	9.156		5.474	.000
	Liqudity Level	1.560	1.740	.112	.897	.374
	Debt Management	.121	.059	.283	2.066	.044

a. Dependent Variable: Return on equity ratio

Source: Nairobi Securities Exchange (2015)

4.3.1 Testing Hypothesis I

Ho1: liquidity level does not significantly affect return on equity, based on the table results the hypothesis the first hypothesis was rejected, since the calculated probability value (pv)0.374 is less than0.897t test value. Therefore, the liquidity risk level affects return on equity. Pandey, (2010), noted that, the study found that liquidity has positive effect on financial performance of banks.

4.3.2 Testing Hypothesis II

Ho2 Debt management does not affect return on equity.The results indicated that the calculated probability value,0.044 is less than2.066 t test valueand thus the hypothesis was rejected. This implies that debt management had significant effect on return on equity. The study disagreed with Akorsu, and Anyapong, (2012), said that debt management affect financial performance of insurance sectors in Kenya.

5.0 Conclusion

Therefore, the study concluded that the liquidity risk level affects on financial performance of commercial banks listed at Nairobi securities Exchange. Pandey, (2010), noted that, the study concluded that liquidity has positive effect on financial performance of banks.

The results indicated that the calculated probability value is less than t test valueand thus the hypothesis was rejected. This study concluded that debt management had statistically significant positive effect on financial performance. The study disagreed with Akorsu, and Anyapong, (2012), said that debt management affect financial performance of insurance sectors in Kenya.

5.2 Recommendation

The study recommended that the team need to be trained to use the will not give disadvantage impact on financial performance on commercial banks and they need to have knowledge and skill on how to impact financial performance affect banks objective goal. The study recommends that the team should developed financial performance strategies, policies and rules that ensure to maintain maximum bank's general mission to avoid the poor financial performance.

There is a great deal for banks to exercises smooth flow standard practicing the teams to help eliminate any error or fraud which occur in debt management. By maintaining the level capital adequacy and liquidity level in the banks, banks should try to equipped with knowledge and skill on how avoid a certain error or risk. The study recommends that the capital adequacy should be maintain to maximum, liquidity should reach certain level to avoid to negative result in banks.

The teams in the banks should pay a great attention and avoid the activities which can gives negative result on financial performance of commercial banks listed at Nairobi Securities Exchange. The study recommended that, there should be regularly evaluation and monitoring on financial performance of commercial banks listed at Nairobi Securities Exchange in Kenya, further study also recommends that the management team should maintain financial performance to prevent any negative result.

5.3 Suggestions for further study

The study suggested for a study to be carried out on the problems affecting committee team in commercial banks listed at Nairobi Securities Exchange. Due to limitation factors for examples interest rate, currency exchange and government might change the rulers and regulation; it should be accurate for the future researchers to carry out the same study.

The study suggested that future researchers should conduct out the study in all others commercial banks in Kenya not only commercial banks listed at Nairobi Securities Exchange. This study may help committee teams of commercial banks verifying the validity of the result of findings of the study.

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