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INCOME DIVERSIFICATION AND PERFORMANCE: SHOULD BANKS TRADE?

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Abstract

Unprecedented growth in financial innovations, changing customers' expectations, competition from non-banking entities and regulatory pressure have distorted interest income stream. Thus, banks are now searching for new ways of income generation to cushion themselves against dwindling interest income and as a survival strategy. Proponents of portfolio theory conjecture that income diversification reduces income volatility and increase the profitability. It's from this background the study sought to investigate the effect of income diversification on performance of Kenyan commercial banks.

Using 310 observations drawn from a sample of 31 commercial banks and panel data for the period 2008–2017, the study found that income diversification has a positive and significant effect on bank performance. Therefore, commercial banks are advised to consider investing in non-lending activities to better their financial performance. In view of this, the study has implications for bank regulators, scholars and practitioners

Key words: Income diversification, non-interest income, performance, Herfindahl-Hirschman Index