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# RELATIONSHIP BETWEEN PARTNERSHIP FINANCE AND FINANCIAL PERFORMANCE OF SELECTED COMMERCIAL BANKS IN KENYA

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## Abstract

*Though Kenya was the first country to amend the Law to allow Sharia'h law in the commercial banks, there is a declining growth rates and profitability in Islamic banks. Therefore, the study was conducted to investigate the relationship between Islamic financial contracts and financial performance of selected commercial banks in Kenya. The study was guided by five research questions as follows; what is the relationship between partnership finance (Musharaka) and financial performance of the selected commercial banks in Kenya? The study was anchored on the stakeholders'. It adopted correlational research design. The study targeted management employees in 2 banks that is First Community Bank and Gulf Africa Bank commercial banks. Census approach was employed. Document analysis was used to collect data. Content and face validity was used to validate the research instruments. Test-retest technique through a pilot study was adopted to validate the research instruments. Descriptive statistics were analyzed in form of means and standard deviation. Pearson correlation analysis and multiple regression analysis was employed to test the hypotheses. The regression coefficients showed that there is no significant relationship between Musharaka (Financial partnership) and performance* *(p=0.000). The study concluded that Musharaka (Financial partnership), influences the financial performance of commercial banks. The study recommended commercial in Kenya to sensitize its customers on the need to promote partnership through financing business ideas, selecting key financial and other indicators to monitor programs based on statutory requirements on Islamic banking products and to develop systems for managing future performance based on the statutory requirements.*

*Keywords: Partnership Finance, Musharaka, Sharia'h law, Islamic banks, Financial Performance*

## INTRODUCTION

According to the World Islamic Banking Competitiveness report by Ernst and Young (2012), Islamic banking assets with commercial banks globally grew to $1.3 trillion in 2011, suggesting an average annual growth of 19%. The growth raised plenty of questions as to whether Islamic finance and banking was successful and efficient as opposed to the conventional banking systems. Due to the banking sector's significant role in the wellbeing of any economy, it is vital to constantly monitor and evaluate banks' performance; to ensure that the financial sector is strong and efficient. Syed and Hayes (2012) highlighted that the continuous assessment of bank performance is fundamental in order to protect the banking operations against its inherent risks or poor management that could threaten the entire financial system of any country. According to Jamali, Shar and Ali (2012), bank performance is very important to all the banks' stakeholders including customers, investors and the general public.

Kenya was the first country in Eastern and Central Africa to amend the banking laws to accommodate Islamic finance (Shariff, 2013). There are three levels of Islamic banking institutions in Kenya that is the Full-fledged Islamic commercial banks, Islamic banking units of commercial banks and Islamic Co-operative Societies. Fully fledged Islamic banks commercial banks were First Community Bank (FCB) and Gulf Africa Bank. Commercial banks providing Islamic banking units are Barclays Bank of Kenya, National Bank of Kenya, Standard Chartered bank and Chase bank of Kenya. They offer both account based and loan based services on financial contractual bases. According to Munawar and Philip (2005), these contracts represent the contracts of sale, leasing, partnership, deposits, fees, agency, transferring of debt, gift and collateral just to mention but a few.

The first Islamic bank in Kenya was Gulf African Bank which started its operations in 2008. Islamic banking is noted as the fastest growing segment of the credit market in Muslim countries that have Islamic banks and their market share has risen from 2 percent in the late 1970s to about 15 percent, as measured by assets in the banking system. Banks that offer Islamic financing are said to have less credit risk. There are a number of reasons why Islamic financing may be associated with lower credit risk (Syed and Hayes, 2012). First, the assets of Islamic banks are mostly debt resulting from sale-based financing while their deposits are on a *mudaraba* (profit-sharing) basis. Thomi, (2010) argued that this feature enables Islamic banks to shift the risk of debt default to investment depositors in proportion to their amount of principal invested, rather than to capital alone.

This principle of profit sharing has, in fact, offered an important cushion for bankers at times of recession and he cites the experience of Pakistani banks as an example. Merchant (2012) further elaborate that on the liability side of Islamic banks, saving and investment deposits take the form of profit sharing investment accounts and demand deposits take the nature of qard hasan (interest-free loans) that are returned fully on demand. While on the asset side, banks use Murabaha (cost plus markup finance), bai-muajjal, istisnaa, salam and Ijara (lease finance) and PLS modes of financing (Musharaka (Financial partnership) and mudaraba).

Olson and Zoubi (2011) argued that without an efficient capital market to operate within, Islamic banking will not continue to grow meaningfully. In addition to the many specific risks inherent to Islamic banks, there are a number of more general factors that make Islamic banking riskier than conventional banking. According to a study conducted by Shaista and Umadevi (2013), Islamic banks have fewer risk-hedging instruments and techniques available. This was attributed to the fact that Islamic banks are prohibited by law from using derivatives such as; options, futures and forwards that are regularly used by conventional banks to effectively hedge risks; given that these tools are based on interest and speculation which are non-compliant to Sharia'a principles (Shaista and Umadevi, 2013; Wako, Kamaria and Kimani, 2014).

However the Islamic Banks are haunted by the chronic problem of excess liquidity, because they carry about 40 percent of surplus cash and other liquid assets in comparison to convectional commercial banks due to the serious dearth of long-term Sharia'a-compliant investment tools and avenues (Khan and Bhatti, 2008). According to a study conducted by Iqbal (2012) on the perceptions of Islamic banking customers, Islamic customers have three equal intentions when becoming clients and interacting with banks which include religious, to help Islamic project financing, profit (to look for the highest return) and transaction purposes (to take money whenever needed). The study highlighted that these conditions invited liquidity problems, especially coming from some of Islamic banking depositors who behave conventionally (considering level of interest, expecting regular and competitive deposit returns).

Subsequently, it was vital that Islamic banks take appropriate actions to further educate people on Sharia'a banking concept and practices and redirect their portfolio management to match with the bank’s liquidity and financing management. Islamic banks are here to stay and there are signs that they will continue to grow and expand. The Islamic banks present some innovative ideas which could add more variety to the existing financial network. Consequently, it is essential that IBs resolve all their inherent challenges and come up with practical and feasible solutions to solve any obstacles they face in response to the rapidly changing regulatory and operating environment brought about by globalization and heightened competition.

However, credit risk will increase if they extensively use equity mode of financing such as mudaraba and Musharaka (Financial partnership)(How, 2005; Khan and Ahmed, 2001; Ray, 1995). This isunderstandable for in those financing scheme, the return highly depends on the profit generated on the venture. Banks, as the owner of fund, must bear all or partial loss if the business failed to deliver what was expected. According to Sundararajan and Errico (2002), while profit loss sharing modes may shift the direct credit risk of Islamic banks to their investment depositors, they may also increase the overall degree of risk of the assets side of banks’ balance sheet since the assets under this mode are uncollateralized. Thus, the more Islamic financing is made under *mudaraba* and Musharaka (Financial partnership) scheme, the more the banks are exposed to credit risk.

Islamic financing contract that is predominantly adopted in Kenyan Islamic banking system is Murabaha (cost plus markup finance). In recent years, according to Islamic banks statistics released by Central Bank of Kenya, *Murabaha (cost plus markup finance)h* contract account for, on average, 66% of total Islamic financing given. Ayub (2002) observed that Islamic banks are well capitalized, profitable and stable due to their effective use of resources. In comparison to international standards in banking, Islamic banks are at par with them in terms of profitability ratios but their operations are not cost effective.

While conventional banks earn their money by charging interest and fees for services, Islamic banks earn their money by profit and loss sharing, trading, leasing, charging fee for services rendered and using Sharia’h contracts of exchange (Arif, 2001). Islamic commercial banks are basically meant to promote and encourage Islamic principles while earning money (Alkassim, 2005). The banks operate based on Islamic business law for their basic transactions. They also follow the financial laws and regulations of the countries which they operate. The value of money in Islamic banking is based on increment on projects that money has been invested in (Ajlouni, 2012). While debtor and creditor relationship does exist at times in Islamic banking, the relationship between customer and Islamic bank is based in the Islamic contract in question (Ajlouni, 2012). On investment, although the customer deposits the money in order to earn extra income, for savings, the principal return is not guaranteed, in case the Islamic bank losses money because of unexpected business failure, the bank isn't liable to pay money to its customers (Alkassim, 2005).

The problem of the Islamic banks is also attributed by the fact that there is a lack of knowledge and awareness of the advantageous features of the Islamic form of banking by people and even some governments. This is in light of the fact that the features of Islamic mode of banking are quite not understood by many people in a non-Muslim country like Kenya. Islamic banks are also faced with a myriad of challenges for example Ndung'u (2011) highlighted Islamic banking are faced with challenges such as lack of Shari'ah compliant investment vehicles, lack of an enabling legal and regulatory framework and lack of awareness by majority of the populace that hinder the uptake of these investments. This has resulted to poor uptake of Shari'ah compliant products in Kenya's financial institution which is thought to contribute to poor financial performance of Islamic banks in Kenya, (Oundo, 2009).

In Kenya, banks that are conventionally non-Muslim are offering niche services and products to meet the needs of diverse customer base (CBK, 2014). Among the issues that Islamic banking sector has to content within their business environment include; size of the banks many Islamic banks are considerably smaller than their conventional competitors in their domestic markets, there is growing competition as the number of Islamic banks and financial services is growing in the midst of slowed market growth. Further, standardization and regulation present ongoing challenges for Islamic bank. In addition, most Islamic banks have not been consistently profitable due to global financial associated with the structural factors as far as nature of Islamic banking products is concerned (Kearney, 2014).

Banks have experienced vibrant and extensive changes which are rapidly reshaping and revolutionizing the banking industry (Hudgins and Rose, 2013). These key trends include government deregulation, service proliferation, geographic expansion, an increasingly interest-sensitive mix of funds and many others. One of the most enormous transformations in the field was the initiation of a new prototype of banking, Islamic Banking, which has gained the attention of both Islamic and non-Islamic economies worldwide. Today Islamic banks are operating in all areas of the globe, as a practical and feasible alternative system to the conventional banking system. Srairi (2009) asserts that although it was originally developed to satisfy the requirements of Muslims, at present Islamic banking has currently achieved worldwide acceptance and is documented as one of the greatest rising areas in finance and banking as stated in the Global Finance Report (2012).

Recent studies carried out by Khamis and Senhadji, (2010), Hassan and Dridi (2010), Rashwan (2012), and Merchant (2012) to empirically contrast performance of Islamic banks

(IBs) and Conventional banks (CBs) pre and post the global financial crisis argue that performance of Islamic banks during the 2008 financial crisis was more efficient than their counterpart conventional banks; as their mechanism complying with Islamic Sharia'a proved better resilience to negative profitability and speculation that tremendously affected conventional banks. While other studies have been conducted to investigate the relationship between Islamic financial contracts and performance of commercial banks providing windows in the commercial banks for example Ahmed (2015) and Gitongu, (2015). It is against this background that the study seeks to investigate the relationship between Islamic financial contracts and financial performance selected commercial banks in Kenya.

## Statement of the Problem

At the end of 2016, two Islamic Banks in Kenya, Gulf African Bank and First Community Bank held deposits of Kes.31.374B, representing a 1.09% market share in the Kenya banking sector. Despite the large population of Muslims in the country, the Islamic banks and Islamic windows collectively have few customers, and this includes non-Muslim customers who bank with Islamic Banks. The Islamic banks in Kenya have also shown declining profitability as compared to global growth trend. The Islamic banks in Kenya have reported declining profits with First Community Bank’s (FCB) net profit dropping by nearly half and Gulf African Bank (GAB) reporting slower growth in earnings in 2016 (Herbling, 2014). FCB saw its full-year after-tax profit drop by 45.2 per cent to Sh132.2 million from Sh241.3 million in 2015 (Herbling, 2014). Therefore the study will be conducted to investigate the relationship between Islamic financial contracts and financial performance of selected commercial banks in Kenya.

## Research Questions

What is the relationship between partnership finance and financial performance of selected commercial banks in Kenya?

## Research Hypotheses

$\mathbf{H_{o1}}$: There is a relationship between partnership finance and financial performance of selected commercial banks in Kenya.

## THEORETICAL REVIEW

The study was based on stakeholder theory which was put forward by Edward Freeman (1984). The theory postulates that the duty of managers within bank is not to own shares in the bank, and stand to gain financially from it, but rather to be stakeholders (Clarkson, 1995; Freeman, 1984; Frooman, 1999; Donaldson & Preston, 1995; Jones 1995; Rowley, 1997). Islamic banking places need of neglected stakeholders in a strategic and holistic approach (Freeman, 1984). According to Freeman (1984) there are four key stakeholder groups that consisted of owners, clients, employees and suppliers (Iqbal, 1997; Choudhury and Hussain, 2005; Aribi and Gao, 2011).

Stakeholder theory is based on four core values that presumption of non-egoism that is the businesses have an obligation to other parties beyond themselves which is the core mandate of the Islamic banks through different financial contracts such as partnership finance, lease, welfare loans just to mention but a few. Freeman argues that Islamic banks have duties to maximize the well-being of others, in addition to the welfare. According to Freeman (1984) stakeholder theory is compatible with two moral views that is utilitarianism or moderate deontology. Utilitarianism is the view that we are morally obligated to maximize the well-being of everyone affected by our actions while moderate deontology is the view that we have various moral obligations, and among these are non-maleficence, or the duty to not harm others, and beneficence, or the duty to benefit others. Either of these moral views would give the conclusion that businesses have duties to look out for the well-being of others beyond the business itself (for example employees, customers, and the local community).

Establishing the rules of the game: Once it is established that businesses do in fact have obligations to all of their stakeholders. Freeman suggests six principles. They are: the principle of entry and exit: Any contract with the business must have clear language about the creation, termination, and renegotiation between the business and the other party. This is so that every stakeholder can know that a contract exists between the business and all stakeholders, and also so that they can know what is expected of them. The principle of governance: Any change to the contract between the business and its stakeholders must be unanimously consented by all stakeholders (Herbling, 2014). This is to ensure that all stakeholders are considered fairly. The principle of externalities: If there is a contract between two stakeholders that negatively affects a third stakeholder, the third stakeholder has the right to enter negotiations to ensure that an agreement exists that does not harm them (Ongore, & Kusa, 2013). This is to ensure that any negative effect or cost incurred by any stakeholder is a fair one. The principle of contracting costs: All participating stakeholders must contribute to the cost of creating, changing, maintaining the contract. The agency principle: Each stakeholder must work towards the interest of all stakeholders. The principle of limited immortality: Decisions shall be made with the assumption that the business continues to exist into the future (since he continued existence of the business is in all of the stakeholder’s interests) (Herbling, 2014)

The end result is that each business would have an obligation to consider the interests of all stakeholders, and furthermore an obligation to promote the interests of these stakeholders. And finally, the stakeholders would have the right to take action against the business if it fails to fulfill these obligations. Stakeholder Theory: Freeman is certainly correct when he recognizes that businesses often affect more than just their owners or stockholders (Ommeren, 2011).

With regards to application of the stakeholder theory in the Islamic banking context, two key points make it of significance. Firstly, there are number of critical trends that have occurred and will continue to progress the banking industry with great influence. Altering older "Western" representations of the theory, with regards to the Islamic banking industry, is valuable to those who wish to enhance the banks reaction and flexibility in an industry that has proven to be quickly changing at a global scale and economy (Ommeren, 2011)

The increase of Islamic banks around the world represents significant and influential trends in the banking industry (Khan and Bhatti, 2008; Mellahi and Budhwar, 2010; Chazi et al., 2010). During the past ten years, the success and growth of Islamic banking and finance has increased significantly, especially for stakeholders investing in overseas Islamic projects (Devaux, 2005). Islamic banks, on a global scale, have been well perceived by stakeholders and their reputation continues to improve (Choudhury and Hussain, 2005). Global markets can expect more Islamic banks to appear in the future, with over 500 Islamic financial institutions around the world and with assets exceeding $1 trillion dollars; the industry is striving strong (Akram et al., 2001; Khalid and Amjad, 2012).

The second point arises from the concern regarding morals in the banking industry. The purpose of the stakeholder theory was to create awareness and responsibility that banks have towards both internal stakeholders and external stakeholders. Hence, majority of the Islamic banks responsibility is not limited to the focus of increasing of annual revenues, but for the wellbeing of all stakeholders. Stakeholder theory is appropriate in explaining expansion in Islamic banking based on their moral ethics. Stakeholder theory prove valuable and effective for a better reflection of realities faced in the Islamic banking industry and in assisting banks that wish to develop the responsiveness and flexibility of their bank.

According Werhane (1998), the theory requires managers to articulate the shared sense of the value they create, and what brings its core stakeholders together. It also pushes managers to be clear about how they want to do business, specifically what kind of relationships they want and need to create with their stakeholders to deliver on their purpose. Stakeholder theory is Managerial because it reflects and directs how managers operate rather than primarily addressing management theorists and economists. If Islamic banking is to impact positively on the economic welfare of the targeted people, the managers of the banks must articulate how to serve them and focus on delivering the purpose of these banks ((Ommeren, 2011). This starts by identifying the banks stakeholders who will guide in selection of financial contracts which align with the needs of various stakeholders. To deliver on their purpose, the Islamic bank management should understand the impact they creating to the stakeholders, compare this with the pre-determined goals of the banks and identify any service gap for corrective action.

## EMPIRICAL REVIEW

Ahmed (2015) conducted a study to investigate the effect of Islamic banking contracts on the financial performance of Islamic commercial banks in Kenya. A descriptive and diagnostic survey design was used. The target population for the study was two Islamic banks. A five year data for five Islamic products as well as financial performance based on these products was used. Both descriptive and inferential statistics was used for data analysis. Descriptive statistics generated the amount of various Islamic products and trends in financial performance while inferential statistics provided a correlation and regression analysis between Islamic contracts and financial performance of Islamic commercial banks.

The study findings indicated a notable offer of Islamic contracts within the periods 2009-2013. The amount of Islamic contracts fluctuated from one year to another with Murabaha (cost plus markup finance) contract being the highest and showing steady levels of uptake among the customers. The study also established that the uptake of Islamic contract was based on the nature of the product and extent of compliance with Shariah. Strong positive correlation coefficients of 0.617 was obtained between financial performance and Murabaha (cost plus markup finance) while, Tawarruq showed a weak positive correlation of 0.159, Mudaraba had a weak correlation of 0.038 while Injara showed a moderately weak correlation of 0.397. A variation of 73.6 % on financial performance due to changes in Islamic contracts Murabaha (cost plus markup finance), Musharaka (Financial partnership), Tawarruq, Mudaraha and Ijara (lease finance) at 95% confidence level was obtained. A strong positive correlation of 0.858 exists between Islamic contracts and financial performance. A unit increase in the amount of Islamic contracts would lead to an increase in financial performance by coefficient factors 1.442, 0.739, 0.656, 0.56 and 0.114 respectively.

The study recommended an uptake of Islamic products by all other banks as a financial innovation in the sector, suitable policy to profile Islamic contracts based on their uptake and the government to ease licensing process for Islamic banking. The study was limited to the few Islamic products available among Islamic commercial banks. Further study should be carried out on the factors affecting uptake of Islamic contracts in Kenya and regulatory procedures and their effect of ease of doing business for Kenya’s Islamic banks. The sample size adopted for the study was considered adequate. The inferential statistics that is regression and correlation were considered adequate to establish the relationship between Islamic financial contract and financial performance. Adoption of survey in the study was considered inappropriate since the study ought to have adopted an experimental research design such as *Ex-post facto research design.*

Gitongu (2015) conducted a study to investigate the relationship between financing contracts and financial performance of Islamic banking in Kenya in 2010-2014. The study targeted seven (7) commercial banks that operate Islamic banking in Kenya. The study sought to investigate the relationship between the following financial contracts that is Murabaha (cost plus mark-up), Mudharaba (Equity Finance), Musharaka (Financial partnership) (profit-loss sharing/joint venture), Ijara (leasing), and Tawaruq (reverse Murabaha) on the return on Assets (ROA) as the financial performance.

The data for this study was collected using questionnaires for primary data study and secondary data was obtained from the Central Bank of Kenya annual reports and individual bank statements for unlisted banks. A regression analysis was performed. From the results it was noted that there is a relationship between the financing contracts and performance of Islamic banking. Based on the summary of the findings, the study concluded that if Islamic banking is to have meaningful contribution to profits such banks should adopt a larger proportion of Murabaha (cost plus markup finance) and Musharaka (Financial partnership) in their financing portfolio.

Given that the relationship of the model is positive, increasing proportion of financing contracts offered would affect a bank’s financial performance positively. Similarly, a decline would decrease a bank’s performance. The moderate relationship (moderate correlation) between financing contracts and financial performance implies that there are other factors which affect a bank’s financial performance and not only the financing contracts. The study recommended that banks offering Shariah compliant financial services should pay key attention to the contracts they offer and capitalize on those with greater yields.

This would significantly improve financial performance. The study sought to investigate the relationship between relationship between Financing Contracts and Financial Performance of Islamic Banking in Kenya in 2010-2014 but the researcher used descriptive survey design instead of correlational research design which is the most appropriate research design to test relationship. The use of questionnaire as the only primary data collection method of data collection method was not appropriate the researcher should have focused on the use of document analysis. The use of regression analysis as the method of data analysis was considered inappropriate since the study sought to investigate the relationship and thus correlational analysis would have been the most method of testing the hypothesis.

Brown (2003), conducted a comparative study on Islamic banking in Middle East, North Africa and Asia over the period 1998-2001. The purpose of the study was to examine the Islamic banks efficiency of several banking systems across countries descriptively. The study established that the profitability, which was measured by ROA and ROE, vary among countries for each year. The study also established that the most liquid market, measured by liquid assets divided by customer and short term funding, experienced less profitability as compared to the banks that had less liquidity. The study also established that there was no significant difference between cost efficiency scores compared with the standard ratio cost efficiency measurement. The sample used in the study was very large because it compared the different regions thus it was not clear on how the respondents were sampled out for the study. The researcher thought that this would cause bias when it comes to selecting the respondents. Method used to test hypothesis (ANOVA) data was relevant because the researcher sought to find out the significance of the difference in the performance of Islamic banks in the different region.

## RESEARCH METHODOLOGY

### Research Design

The study employed causal design. The research design also allowed the information obtained to be accurate, because the measurement instrument was designed to address the specific research questions. Causal design was adopted as regression analysis is applied which establishes statistical cause and effect rather than mere correlation among variables.

### Target Population

In this study the target population was First Community Bank and Gulf Africa Bank commercial banks that offer Sharia'h compliant banking in Kenya. The study targeted the two banks because they are the only fully fledged Islamic commercial banks in Kenya. The study targeted the financial statement of the two commercial banks listed in the Central Bank of Kenya.

### Census Design

Census approach was involved in the study. This is because the target population was only 2 banks. The two banks were also involved in the study because they are fully fledged Islamic commercial banks in Kenya. The census method is warranted since the data collected using census can lead towards collection of unbiased data signifying all individuals' opinions in the research population on a study problem (Musau, 2015).

### Research Instruments

The study employed both primary and secondary data. The primary data for this study was the percentage contribution of each contract to the bank's overall financing book. This data was collected through data collection tables. The respondents targeted were credit managers of the banks. The study also used secondary data in the form of annual financial reports of the banks from 2012-2016. Information on the variables to be computed profitability, return of assets and return on equity was sourced from the published financial statements of the banks, income statements, balance sheets and bank reports as well as data from internal sources

### Data Processing and Analysis

Each filled questionnaire was tallied for every response before any other processing was done. The responses were edited, coded and cleaned in case of any abnormalities. It was keyed into the computer and later on uploaded into statistical package for social sciences (SPSS) version 20.0 (cooper & schindler, 2011). The data gathered was analyzed using descriptive and inferential statistics. Descriptive statistics tools used included frequencies, percentages, mean, standard deviation and variance. Inferential statistics included use of product moment correlation analysis and multiple regression (Vance, 2011).

## FINDINGS AND DISCUSSIONS

### Correlation Analysis

The study sought to determine the correlation between the variables. The study findings are presented in Table 1

Table 1 Relationship between Partnership Finance and Financial Performance

| | | Financial Performance |
|---|---|---|
| Partnership Finance | Pearson Correlation | .713** |
| | Sig. (2-tailed) | .000 |

**. Correlation is significant at the 0.01 level (2-tailed).

These research findings showed that the relationship between Partnership Finance and Financial Performance was positive and statistically significant (r = .713; p<0.05). This implies that Partnership Finance positively and significantly influences financial performance of commercial Banks in Eldoret town.

## Regression Analysis

The study sought to establish the relationship between Partnership Finance and Financial Performance of commercial Banks in Eldoret town, Kenya.

Table 2 Multiple Regression Model Summary

| R | R Square | Adjusted R Square | Std. Error of the Estimate |
|---|---|---|---|
| .860[a] | .739 | .712 | .34425 |

a. Predictor: (Constant), Partnership Finance

b. Dependent Variable: Financial Performance

The findings indicate that the relationship between Partnership Finance and Financial Performance of commercial Banks in Eldoret town was positive (Adj $R^2$=0.712). Findings indicated that 71.2% of the variation in Financial Performance of commercial Banks is accounted for by Partnership Finance. The 28.8 % of the financial Performance of commercial Banks in Eldoret town resulted from other factors not investigated by the study.

## Assessing the Fit of the Multiple Regression Model

Multiple regression analysis was conducted to test the influence of predictor variable on Financial Performance of commercial Banks in Eldoret town. The test results are shown in the table 3.

Table 3 ANOVA Results

| Model | | Sum of Squares | df | Mean Square | F | Sig. |
|---|---|---|---|---|---|---|
| 1 | Regression | 9.722 | 3 | 3.241 | 92.346 | .000[b] |
| | Residual | 3.437 | 29 | .119 | | |
| | Total | 13.159 | 32 | | | |

a. Dependent Variable: Financial Performance

b. Predictors: (Constant), Partnership Finance

The findings of the study in Table 3 showed that there was a statistically significant relationship between the independent variable and the dependent variable (F= 92.346; p< 0.05). This, therefore indicates that the multiple regression model was a good fit for the data.

## CONCLUSIONS

Partnership Finance (Musharaka) is a predictor for financial Performance of commercial Banks in Eldoret town. The study also concluded that, Musharaka (Financial partnership) financing is the most vital method to influence the financial performance in the Islamic Economy. In the return rates of investors Musharaka (Financial partnership) raises the marginal efficiency rate and investment increases as well. Musharaka (Financial partnership) influences the quantity of the money supply which increases to make the money supply more flexible therefore improving the banks financial status. Since the investors are in a partnership, the rate of the Islamic financial performance increases since the two individuals will deposit enough money to the banks. Musharaka (Financial partnership) encourages investors to increase the investment as well as to increase the banks savings and investments

## RECOMMENDATIONS

The study recommends commercial banks in Kenya to sensitize its customers on the need to promote partnership through financing business ideas. Commercial banks need to develop systems for managing future performance based on the statutory requirements. The Commercial banks as well need to diversify and increase their Islamic banking products since currently there are very few Shariah compliant products. The Commercial banks should set up education platforms geared towards making its customers aware of the benefits and cost associated with Islamic banking products. Lastly, the study recommends that the management of non-Islamic banks in Kenya that have not yet adopted Islamic banking should consider adoption of Shariah compliant banking policies. The government should ease the licensing process for Islamic banking products in order for such banks to adopt Islamic banking.

## LIMITATIONS

A limitation is an aspect of research which may influence the result negatively (Mugenda, 2008). The researcher encountered some limitations especially when obtaining information. This was because most of the respondents were not willing to disclose information. The study overcame this limitation by having an introduction letter to assure the respondents that information provided was to be used for academic purposes only. The second limitation was delay in returning the questionnaires. To overcome this limitation, ample time was given to the respondents. Frequent calls, mails, texts were also given to facilitate the response rate.

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