

PORTFOLIO DIVERSIFICATION AND PROFITABILITY IN SELECTED COMMERCIAL BANKS IN KENYA

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ABSTRACT

The global trend in commercial banking profitability has taken a hit, especially in the 2023 economic climate. It is intricate to control a bank's portfolio efficiently, concurrently decrease income, lower risks and be bound to managerial and policy constraints. The main problem undertaken by this study was that of the gap that exists in the study of diversification in a portfolio and gainfulness of commercial banks in Kenya. Whereas diversification was seen as a strategy to mitigate risks and enhance profitability, there was limited empirical evidence of its influence on Kenyan commercial banks' profitability. Numerous studies undertaken in Kenya and beyond have examined portfolio diversification. However, there is still a gap in understanding the direct association pitting variation strategies and the success of Kenya-based commercial banks; to seal in the existing literature gap; the study thus sought to investigate the effects of portfolio variation on the gainfulness of Kenya-based commercial banks. The study's general objective was to investigate the influence of product and service variation on the monetary profitability of Kenya's these financial entities. Four particular objectives guided this study: to uncover the effect of sectorial credit, revenue, deposit diversification and diversification of venture on the gainfulness of Kenya commercial banks. This analysis intended to determine the regulating influence of bank vastness on the link pitting banks' multiplication of portfolios and their monetary profitability in Kenya. To guide the study, monetary linkage and delegated monitoring theory, modern portfolio theory, and shiftability theory were used.

The study targeted the money-related data for all 39 commercial banks in Kenya from the year 2018 – 2023. The study further conducted an empirical review of previous literature to identify study gaps. Descriptive and explanatory research designs were used, with data collection methods being secondary sources for quantitative data. Quantitative data analysis involved descriptive statistics; regression analysis was done to scrutinize the impact of portfolio diversification on monetary profitability. Tests for normality, linearity, independence, and homoscedasticity were done before doing regression. The confidentiality and anonymity of participants were upheld and the data was only accessible to the researcher and the supervisor. Regression analysis revealed that sectoral credit diversification, deposit diversification, investment diversification and income streams diversification are all positive and significant. Bank size moderates the relationship between portfolio diversification and profitability of commercial banks in Kenya. The study highlighted the need for further research on the long-term sustainability of diversification strategies, especially in Kenya's banking sector. The study suggested that banks in Kenya should adopt effective loan recovery strategies, consolidate credit information, and cautiously diversify income streams to avoid financial risks. Strategic investments in government securities, real estate, and market securities are recommended. Further research is needed on sectoral credit.

Keywords: Portfolio Diversification, Deposit Diversification, Income Diversification, Investment Diversification,

Credit Diversification, Bank Size and Profitability.

INTRODUCTION

The global trend of Commercial banking financial profitability has taken a hit, especially in the 2023 climate. The influence of inflation, interest rate increases, and international crises like the conflict in Ukraine are among the key trends (CBK, 2023). Although the investment cycle could pick up steam as they take advantage of the low-interest rate, portfolio diversification is still needed to ensure commercial banks properly absorb these shocks (Hailu & Tassew, 2018). Customers' expectations and shifting worldwide trends are key reasons banks seek new revenue streams. Inflation surged again in 2022 and showed no signs of abating, which prompted central banks worldwide to increase interest rates to the highest points they have been in more than ten years. The commercial banking industry is facing significant uncertainty due to the worldwide impact of living calamity, the scarcity of energy, continuing supply chain disturbances, and the conflict in Ukraine.

In the United States, the banking sector has shown a significant inclination towards diversification of assets to mitigate risks and enhance financial performance. Smith and Walter (2018) noted that U.S. banks, particularly since the financial crisis of 2008, have increasingly diversified their asset portfolios, incorporating a broader range of investment products, including derivatives and foreign exchange, as a strategy to stabilize returns and reduce vulnerability to market volatilities. Similarly, in Europe, the trend of diversifying into non-traditional banking activities has been observed as a response to the stringent regulatory environments and competitive pressures (Johnson & Li, 2018). This strategic shift has been linked with improved financial resilience and performance, although it also brings additional complexities and risk management challenges. The Asian banking sector, especially in emerging economies, has followed a similar pattern, focusing on diversification as a key component of financial strategy to enhance performance and competitiveness in the global market (Chen, 2018). These insights provide a valuable comparative framework for examining the dynamics of portfolio diversification in the Kenyan commercial banking industry.

The banking landscape of Africa, presents a contrast to patterns observed in Western and Asian markets. African banks, particularly in regions like Nigeria and Ghana, have been increasingly adopting diversification strategies in their asset portfolios, a move that is largely driven by the need to enhance income streams and mitigate risks associated with traditional banking practices. According to Mwangi and Murigu (2018), the African banking sector, amidst various economic and regulatory challenges, has shown a notable shift towards diversification into non-interest income generating activities. This includes fees and commissions from a range of financial services like insurance, brokerage services, and wealth management. The profitability of banks following such diversification strategies has been a mixed bag. Okeke and Emecheta

(2018), suggest that diversification into non-traditional banking activities has led to improved financial stability and profitability, while others have cautioned about the potential risks and inefficiencies that might arise from venturing into unfamiliar territories. The effectiveness of diversification in enhancing financial gains therefore seems to depend significantly on factors such as the bank's size, managerial expertise, and the regulatory environment.

Kenyan commercial banks have resorted to better handling their operations to reduce risks, increase market share, and increase profits, with diversification being the primary strategy employed (Philita, 2018). In periods of technology adoption in their different products, banks need to have many portfolios because when different portfolios are subjected to other economic conditions, they perform differently with no existing correlation. Banks are currently diversifying their revenue streams to lower portfolio risk and boost profitability, undertaking activities that do not earn them interest, while decreasing their dependence on conventional banking dealings to diversify their sources of earnings. Commercial banks in Kenya have been actively diversifying their services to mitigate the systemic risk that could lead to bank failure. The diversification includes introducing new facilities such as digital banking, representative banking, bank guarantee, and anonymous banking and adding micro-banking into their existing banking systems (Ndungu, John & Muturi, 2019). By reducing this risk, they enhance the stability of the banking system. This strategic move towards diversification is driven by the desire to improve financial performance, especially in light of the numerous regulatory regimes that have impacted the monetary gainfulness of banks for many years. Muturi (2019) indicated that diversification influences commercial banks positively since gains from the other segments can always compensate for financial performance losses from one exposure source.

Portfolio Diversification

An investment portfolio is a collection of investment assets, the composition of which is determined by the investor's perspective on the association of danger and output, as well as the contribution made by each investment asset when it is added to or subtracted from the portfolio to the portfolio's overall risk level and overall return (Obiero, 2019). In the context of commercial banks, diversification extends beyond traditional lending activities into non-interest revenue sources, such as investment in different types of loans, geographic regions, and financial products (ScienceDirect, 2021). This strategy could reduce the variability of revenue streams and increase stability (Shim, 2019). Diversification has long been valued in Kenya to enhance the gainfulness of commercial banks. This is mainly linked to the banking arena's expansive supervisory schemes, which have impacted these businesses' financial performance over time (Garland, 2019). Diversification plays a major part in peril control and, subsequently, in commercial banks' monetary productivity. According to Moudud-UI-Huq et al. (2020), greater diversity reduces the chance of a bank failing and removes the systemic risk associated with a certain industry. The goal of diversifying an investment portfolio is to eliminate the non-systematic component of individual investment risk by allocating money among a variety of asset types. Banks can use a different investing model to diversify their portfolios by adopting an elongated choice in some assets and a brief choice in other assets thought to have a negative correlation (Ngware, Muturi & Olweny, 2019).

Commercial banks use revenue diversification to reduce the risks brought on by relying on a single source of income. Since all sources of income are unlikely to be threatened simultaneously, an income portfolio that reflects a more balanced reliance on income from lending, third-stream activity, governmental financing, and investments is less vulnerable. Therefore, financial stability is essential for commercial banks to operate in this increasingly competitive market. Diversification in implementing bank activities has been proven to have favorable results in international practice because bank activity is associated with various hazards (Abdullayevich, 2023). As a result, diversification in commercial bank operations is now seen as significant and determines the topic's importance. This is the basis of the present study as it sought to look at the consequences of diversifying portfolio on the gainfulness of commercial banks, with the major diversification strategy being sectoral credit, revenue paths, deposit portfolios, and investment portfolios.

Portfolio diversification within the Kenyan banking sector is multifaceted, but the study focused primarily on sectoral credit distribution, diversity in income streams, and the composition of deposit portfolios. Sectoral credit diversification is measured by the extent to which bank loans are distributed across various economic sectors, such as agriculture, manufacturing, real estate, and services. This distribution is crucial in understanding how risk is spread across different industries and the bank's exposure to sector-specific economic cycles (Kipkorir & Mutai, 2018). Diversity in income streams is another critical measure, where the study evaluates the proportion of income derived from traditional interest-based sources versus streams not earning interest like charges, commissions, and investment revenue. This aspect of diversification is indicative of how banks are innovating and adapting their revenue models to mitigate the risks of relying heavily on interest income, which can be subject to market fluctuations and interest rate changes. Lastly, the study considered the diversification of deposit portfolios, examining how banks manage and distribute their deposit base among various types of accounts and customer segments. A diversified deposit portfolio suggests a stable funding base and reduced reliance on any single depositor or group, which is essential for maintaining liquidity and operational resilience (Chepng'eno & Limo, 2018). By analyzing these dimensions of diversification, the study attempts to give a holistic view of the tactics applied by selected Kenyan banks to enhance their financial performance and stability in a competitive and dynamic financial environment.

Profitability of Commercial Banks

Profitability measures how effectively a company can make gains from its dealings. Profitability is the ability to generate income from all of an organization, firm, or company's business operations, and is a popular indicator of monetary productivity among commercial banks. As such, the financial entities' net profit can measure a financial institution's profitability (Bebhora, 2019). It is profitable if a commercial bank has generated greater financial returns from devoted principal. The bank's success is thus assessed based on the earnings it generated within a specific fiscal year. Additionally, profitability demonstrates the connection between the total income and the bank's capacity to repay its customers. Like other parts of the world, Kenya's commercial banking sector is heavily regulated, which makes it difficult for banks to perform to their fullest potential. Kenya's Central Bank reported in 2018

that the restriction of the interest rate has lowered more the quantity of interest that commercial banks can make on advances. These market dynamics have caused a number of banks to fail, notably Chase Bank in 2016 and Imperial Bank in 2015, while other banks reported profit levels that dropped by as much as 25% (Central Bank of Kenya, 2022). In the banking industry, diversification is generally believed to enhance monetary productivity by lowering the volatility of financial returns for commercial banks. Make the case that commercial banks' monetary performance is influenced by financial diversity.

Profitability can be gauged using an indicator like Return on Assets (ROA) that has been utilized for this study. These measures are important for the investors, creditors and the management to evaluate an organization's financial status, productivity and efficiency in generating profits. ROA is a pointer of the level of effectiveness a business uses its properties to realize income is the fraction of its income to its assets or ROA indicates the level of effectiveness that a bank utilizes its available possessions to generate revenue (Kachumbo, 2020). It displays how well bank managers generate income using their assets or investment resources. Simply put, ROA indicates management effectiveness and efficiency by showing how effectively and efficiently bank management uses the firm's wealth to generate profits. A huge ROA proportion is a blatant sign of a banking entity's successful operation or profitability. The present study made use of ROA to assess the monetary gainfulness of Kenyan-based commercial banks.

Bank Size

Bank size relates to all properties owned by a bank. However, this definition can be expanded to include other dimensions such as market capitalization, number of employees, and the scale of operations (both geographically and in terms of product diversity). Empirically, bank size is often applied as a proxy to gauge a bank's ability to manage risks, diversify its portfolio, and its overall market influence. Larger banks, with more substantial asset bases, are typically considered to have greater diversification opportunities, risk management capabilities, and market reach (Berger et al., 2018).

In the context of portfolio diversification and–profitability, bank size acts as a moderating variable. It influences the association of diversification strategies and their outcomes. Larger banks, due to their extensive resource pools and broader market access, might experience different impacts from diversification compared to smaller banks. For instance, larger banks may have the means to invest in more sophisticated risk management tools and access a wider array of investment opportunities, potentially leading to more effective diversification and better profitability. Bank size is typically measured by all possessions, which is a widely accepted and easily quantifiable metric. This measure is justified as it directly shows the bank's capacity to leverage its assets to generate income and absorb losses. Total assets are also indicative of a bank's lending capacity, market influence, and overall stability. In studies examining the banking arena, especially in the situation of upcoming economies like Kenya, the bank's magnitude, as gauged based on its total assets, provides a clear and objective criterion to segment banks and analyze how size impacts their strategic decisions and performance outcomes (Mwangi & Ombuki, 2018).

Bank size plays a significant role in shaping a bank's operational and strategic framework. Larger banks often have diversified operations and a more complex organizational structure, which can affect how they implement and benefit from diversification strategies. Understanding the role of bank size offers deeper insights into the efficacy of using diversification as a tactic to augment monetary productivity in different banking environments.

Commercial Banks in Kenya

Bebbora (2019) describes commercial banks as regulated monetary enterprises that deliver services, including collecting deposits, making business loans, and providing essential investment products operated for profit like a business. They are a crucial component of the banking industry since they play an important function in fostering the economy's expansion by mobilizing resources essential for investment and profitability, which encourage economic growth and development. There are 39 commercial banks, 14 micro-finance institutions, 10 overseas bank subsidiary offices, 72 currency exchange entities, 19 money lending firms, and 3 creditworthiness assessment agencies operating in Kenya. Kenya still needs to be over-banked notwithstanding the proportion improving since there exists numerous banks here than in all of the Central African nations combined. Some of the functions of commercial banks include receiving deposits, approving loans and advances, and issuing financial guarantees, which commercial banks offer. In addition, commercial banks offer business funding tools, such as credit letters, trust documentation, and delivery assurances (Ndungu & Bosire, 2020). They also offer services, including arranging insurance policies, delivering investing counsel, and more. Individuals and entities can find additional credit products within commercial banks, including cards and overdrafts. However, all operations have one thing in common: they all strive to provide a financial service to a person or business.

Kenya has seen an increase in financial inclusion, recording 83.7 percent of grownups currently having access to formal monetary services. Digitalization has played a significant role in this, with Mobile Financial Services (MFS), lending, and transfer being the most popular ways to obtain financial services. The increased usage of mobile banking accounts, from 34.4% in 2021 to 25.3% in 2019, is responsible for the growth in the percentage of banking products, such as wireless banking, which was around 44.1% by 2021 and 40.8% as of 2019 (Cytonn report, 2023). Commercial banks must learn, adapt, and re-position themselves to the evolving settings to maintain their market strength and proficiently undertake their intervention mission. Similar to other industries, the banking sector is experiencing turmoil brought on by greater globalization, internationalization, developments in information, communication, and technology, as well as trade liberalization. Therefore, to achieve a competitive edge, commercial banks should proactively participate in measures that will allow them to respond to environmental concerns, and this study proposes diversification of their portfolios.

Statement of the Problem

Kenya's commercial banks profitability issue has long been plagued by many financial crises, the most significant of which being bank closures and collapses. Because banks are so important to the economy, a banking crisis has the power to collapse any economy. Since 1986, Kenya has seen a number of financial crises that have resulted in significant bank failures (as

of 1998), including the crises of 1986–1989, 1993–1994; 1998 and 2003; and 2015 as a result. The fact that these crises have arisen despite the country's administration having developed measures to stop banking crises is regrettable. Although the number of bank collapses has undoubtedly decreased since different laws have been put in place, Kenya has yet had periodic bank collapses. The global trend of Commercial banking profitability stability has taken a hit, especially in the 2023 climate. Managing a bank's portfolio efficiently, maximizing revenues, and minimizing threats and concurrently subjecting to supervisory and monitoring restraints are complicated. Over the years, the Kenyan banking sector has undergone significant transformations, with banks diversifying their portfolios in response to altering market circumstances and governance situation. From 2018 to 2023, the Kenyan banking sector witnessed various shifts, including regulatory changes, technological advancements, and evolving consumer behaviors.

The 2023's Quarterly Economic Review report by the Central Bank of Kenya projected that the global economy is expected to reduce from 3.4% in 2022 to 2.8% in 2023. This global trend, coupled with domestic factors, has implications for the gainfulness of commercial banks in the country. Furthermore, as of January 2023, the overall unpaid loans to total overall loan proportion were reportedly to be 13.4% in the country's banking sector (U.S. Department of State, 2023). Such statistics indicate potential challenges in the banking sector's performance, raising concerns about the effectiveness of diversification strategies in enhancing profitability. While diversification is seen as a strategy to mitigate risks and enhance gainfulness of commercial banks, there is limited empirical evidence on its effect on the gainfulness of profit-seeking banks in Kenya. Numerous local and foreign researches have spoken to portfolio diversification. However, there is still a gap in understanding the direct association of diversification strategies and the gainfulness of business-centered banks in Kenya. For instance, Arodi *et al.* (2023) explored the state of the financing options a commercial bank opts to use as the main productivity influencer, Ngware, Olweny, & Muturi (2020) sought to determine whether a bank's size balance the connection between banks' diversification of portfolio and monetary productivity of Kenyan banks, Mwanja & Suva (2022) emphasized the financial risks banks face and their implications on performance, while Ndungu & Muturi (2019) explored the influence of product and service variation on the monetary fairing of business-based banks in Kenya. However, these studies do not fully explore banks' diversification strategies to mitigate these risks. The study used relevant data and statistics to investigate the connection that exists among portfolio multiplication and the gainfulness of Kenyan profit-based banks in within this duration.

Objectives of the Study

General Objective

The study's overall focus was to examine the effect of portfolio diversification on the gainfulness of selected Commercial Banks in Kenya.

Specific Objectives

- (i) To establish the effect of sectorial credit diversification on the profitability of commercial banks in Kenya.
- (ii) To determine the effect of revenue sources on the profitability of commercial banks in Kenya.
- (iii) To assess the effect of a deposit diversification on the profitability of commercial banks in Kenya.
- (iv) To evaluate the effect of investment diversification on the profitability of commercial banks in Kenya.
- (v) To determine the moderating effect of bank size on the relationship between product diversification and the profitability of commercial banks in Kenya.

Research Hypotheses

- H₀₁:** Sectorial credit has no significant effect on the profitability of commercial banks in Kenya.
- H₀₂:** Revenue sources do not have a significant effect on the profitability of commercial banks in Kenya.
- H₀₃:** Deposits diversification does not have a significant effect on the gainfulness of commercial banks in Kenya.
- H₀₄:** Investment diversification has no significant effect on the profitability of commercial banks in Kenya.
- H₀₅:** Bank size has no significant moderating effect on portfolio diversification and profitability of commercial banks in Kenya.

Scope of the Study

The study's aim was to give an expansive investigation of the association between portfolio diversification strategies and the gainfulness of commercial banks operating within the Kenyan banking arena. The study centered on data from the years 2018 to 2023. This timeframe was chosen to capture the most recent trends and to provide a contemporary understanding of the subject matter. The choice of timeframe was relevant for this study since 1986, Kenya has seen a number of financial crises that have resulted in significant bank failures (as of 1998), including the crises of 1986–1989, 1993–1994; 1998 and 2003; and 2015 as a result there was an amendment of the Kenyan banking Act 2013 Chapter 488 of the constitution of Kenya. The period of 2018 to 2023 was crucial for the bank operations since it follows the banks operations after massive banking failures and the amendments of bank laws.

LITERATURE REVIEW

Theoretical Review

Modern Portfolio Theory

Modern Portfolio Theory (MPT) was proposed by Harry Markowitz in (1952). One of the primary beliefs of the MPT is that diversification has the capacity to diminish the perilousness

of a portfolio and that by holding a variety of non-correlated assets; the individual risks of each asset can offset one another, leading to a reduction in the overall portfolio risk. Through careful asset allocation, it attempts to optimize portfolio anticipated outcome for some degree of threat to portfolio, or conversely, to lower the threat facing a particular degree of anticipated earnings. The principle underlying Maximum Portfolio Theory (MPT) is that each item in a portfolio should be chosen based on its own merits rather than being chosen separately. According to Markowitz (1952), it is crucial to comprehend the manner in which the expense of every item in the portfolio varies in association with the expenses of the rest. The MPT provides a systematic and quantifiable method for banks to manage and diversify their portfolios, ensuring stability even in volatile markets. By adhering to MPT principles, banks can balance risk and return, ensuring sustainable growth and financial stability.

The Modern Portfolio Theory can guide banks in diversifying their investment portfolios to achieve optimal returns while minimizing risks. By diversifying their portfolios, banks can mitigate risks associated with individual investments, ensuring that gains in another offset potential loss in one investment. MPT brings forth the aspect of the 'efficient frontier,' an assortment of optimal portfolios providing the highest anticipated output for a defined degree of threat (Abdelmalak, 2017). By examining Kenyan banks through the lens of MPT, this research explored whether Kenyan Commercial banks operate near the efficient frontier and, if not, what strategies they have adopted to move closer to this optimal state. MPT emphasizes the importance of considering how different assets in a portfolio correlate with each other (Abdalla, 2012). If two assets are perfectly correlated, they'll move in tandem, either up or down. If they're negatively correlated, one will go up when the other goes down. By combining assets with different correlations, investors and business managers can work out ways to reduce portfolio risk.

Shiftability Theory

The shiftability theory is a proposal by A. W. Moulton (1910), who emphasized the importance of the marketability of bank assets as a means to address potential liquidity crises. The theory argues that the ability of banks to shift or sell assets is more crucial than holding a significant amount of liquid assets, as suggested by the liquidity theory. According to them, banks can manage liquidity crises effectively as long as there's a functioning and efficient market where assets can be sold. The shiftability theory suggests that banks can manage and counteract financial crises or liquidity problems by selling or "shifting" their liquid assets in the market. If the bank has enough liquid wealth that can effortlessly be transformed into money or sold without significant loss, it can weather short-term liquidity crises (Maina, 2012). The theory emphasizes the significance of the salability of assets, signifying that banks can avoid insolvency during financial panics by quickly selling these assets. According to the shiftability theory, banks should prioritize the marketability of their assets. In the context of portfolio diversification, Kenyan banks should have a mix of easily marketable possessions that can be swiftly made to be money. Diversifying the portfolio with a blend of brief and extended period assets, both liquid and illiquid, ensures that banks have assets ready to be shifted in times of need. A diversified portfolio, as suggested by the shiftability theory, allows banks to spread their risks (Ugwu, Ugwoke, Egbere, Asogwa & Orji, 2020). Banks can mitigate the risks

associated with individual investments or sectors by having assets that can be quickly sold or shifted. This is especially relevant for Kenyan banks that might be exposed to specific regional or sectoral risks. A bank's aptitude to supervise its liquidity effectively, as emphasized by the shiftability theory, can boost market confidence. In the competitive Kenyan banking sector, market confidence can influence deposit rates, borrowing rates. This theory is crucial to this study.

The shiftability theory, at its core, emphasizes a bank's ability to manage liquidity crises by "shifting" or selling its liquid assets in the market. When applied to the context of product and service offering multiplication and the monetary profitability of profit-centered banks in Kenya, the theory has hints relating to how banks can strategically manage own asset portfolios to ensure liquidity, maintain financial stability, and optimize returns. Kenyan commercial banks can better navigate economic downturns, regulatory changes, and other unforeseen challenges by ensuring that their portfolios are diversified with assets that can be easily shifted. The shiftability theory provides a lens through which one can evaluate the strategies employed by commercial banks in Kenya in diversifying their portfolios. By understanding and applying the principles of profitability, these banks can optimize their financial profitability, manage risks effectively, and ensure sustained growth in the dynamic Kenyan banking landscape.

The Theory of Optimal Firm Size

Robinson's (1931) developed theory of optimal firm size. The theory refers to the circumstances in which a corporation may manage its business with the least amount of expenditure and the most amount of success. The word "optimum" in its literal definition refers to the circumstances that result in the best possible result. When it comes to preserving the viability of an economy's financial sector, the question of bank size is of utmost importance (Muhindi & Ngaba, 2018). It has been the focal point of debate for a long period because researchers consider it part of the many highly influential factors that shape how well a company performs. Several analyses have been conducted to investigate the manner in which the size of banks affects their profitability (Serrasqueiro & Nunes, 2008). Most businesses use their tangible assets as security for borrowing more debt so as to obtain tax benefits at a lower cost; most scholars hypothesize a positive relationship between tangibility and borrowing.

Empirical Review

Uddin, Majumder, Akter, and Zaman (2022) sought to understand the impact of bank differentiation, particularly asset and revenue differentiation, on the gainfulness of banks located in Bangladesh. This investigation looked at data from 32 banks between 2007 and 2016 applying a dynamic panel data model. The discoveries indicated that possessions and earnings differentiation and bank gainfulness are significantly positively correlated. Diversification's implications on bank profitability in industrialized nations have been well-documented, but little is known about how it affects banks in emerging economies, notably Kenya. Kenya's unique economic, regulatory, and banking environment necessitates a tailored analysis to determine how portfolio diversification influences the monetary gainfulness of profit-seeking banks in the country.

Maranga, Ngali, and Wepukhulu. (2022) researched the impact of product differentiation on the gainfulness of profit-seeking banks listed in Kenya. The investigation established the importance of product diversification employed by profit-seeking banks and other monetary entities to bolster their general gainfulness. But, not all products in their assortments yield success due to the inherent risks associated with each product. The research was driven by theories such as the diversification strategy model, agency theory, and modern portfolio theory. The investigation centered on Kenya's eleven publicly traded profit-seeking banks and used a descriptive evaluation style. The results showed a substantial correlation between product diversity and gainfulness, as influenced by ROA for the profit-seeking financial entities accredited on the Nairobi shares market. Product multiplication was gauged by elements such as bank guarantees, monetary securities, land and buildings, and business funding. There is still an understanding deficit touching on the exact impact of variety diversity on the monetary profitability of these banks, even though the investigation offers thorough insights into the sway of offering multiplication on the gainfulness of Kenya's accredited profit-seeking banks. This gap can be explored further by examining different portfolio diversification strategies beyond just product diversification, which the present study seeks to do.

Berger, Hasan, and Zhou (2021) delved into the impact of banks' earnings differentiation on their gainfulness and steadiness in the course of the COVID-19 epidemic, examining the relationship between income streams that do not earn interest and bank gainfulness and dangers. Their findings noted a direct correlation involving profitability (gauged using gains on possessions and return on equity) and income without interest. Moreover, the study observed that the utilization of noninterest income is linked to reduced risk levels. This advantageous differentiation impact from revenue streams that do not attract interest was particularly evident in the course of the initial stages of the COVID-19 epidemic. The study also highlighted the transformative function of fintech in the banking sector, emphasizing its potential to introduce new revenue streams and reshape traditional banking activities. While the study provides important clues into the effects of revenue differentiation on bank gainfulness, especially in the U.S. context, inadequate understanding exists of how these findings apply to the Kenyan banking sector. Specifically, the influence of types differentiation on monetary profitability of Kenya-based profit-seeking banks, considering the region's unique economic, regulatory, and market dynamics, has yet to be thoroughly explored.

Githaiga (2020) looked at the influence of intellectual wealth on monetary fairing, and the investigation revealed how, in a contemporary knowledge-driven economic landscape, intellectual capital has emerged as a pivotal determinant of financial performance. Numerous theoretical frameworks, including the modern portfolio theory, the resource-based view theory, and the dynamic capabilities theory, were used to prove this. A seminal study conducted on Kenyan commercial banks spanning from 2008 to 2017 sought to bridge this gap. The research revealed that facets of intellectual capital, namely personnel wealth, procedure wealth, invention wealth, and client wealth, exerted a beneficial and noteworthy influence on the monetary profitability of these banks. The scholarly investigation also unveiled that income multiplication mediated this relationship, reinforcing the tenets of the modern portfolio theory, which indicated that diversification could bolster monetary fairing. However, the focus of the

previous investigation was not on how dynamics specifically apply to the broader context of portfolio diversification in Kenyan commercial banks. Given the unique financial landscape of Kenya, characterized by its dynamic regulatory environment and diverse banking practices, it was imperative to delve deeper into how portfolio diversification strategies, influenced by intellectual capital, shape the monetary outcomes of these banks.

Ngware, Muturi, and Olweny (2019) delved into the link of sector-specific credit multiplication and the money gainfulness of profit-seeking banks. The study's foundation was built upon the current balance sheet of banks, emphasizing the constraints they face, especially in ensuring liquidity. The research highlights that banks are at risk of variety multiplication failures if they do not recover loans proficiently. Using a correlational research design, the study analyzed data from 43 profit-seeking banks authorized by the Central Bank of Kenya from 2003 to 2017. A significant indicated that sectoral credit diversification to diverse areas positively affected the gainfulness of banks in the country. The authors recommend that profit-seeking banks in Kenya consolidate credit information to aid in managing and providing credit services to diverse areas of the economy. Despite the fact the investigation gave out valuable hints touching on the connection existing among sectoral credit differentiation and the monetary gainfulness of profit-seeking banks in Kenya, there seems to be a gap in understanding how other external factors, such as regulatory changes, technological advancements, and global economic shifts, might influence this relationship. Additionally, the study primarily focused on data up to 2017. Given the dynamic nature of the banking sector, there is a need for more recent studies that consider the latest trends and challenges in the industry.

Muturi (2019) studied product differentiation influences the earnings of Kenya's listed profit-seeking banks. The Diversification Strategy Model, Agency Theory, and Modern Portfolio Theory were some of the theories that guided the investigation. Using already gathered information from their monetary statements, the study employed a descriptive methodology to scrutinize Kenya's eleven profit-seeking banks that trade publicly. The results showed a strong correlation between these banks' profitability and their product diversification, which includes trade finance, real estate, bancassurance, and financial securities. The investigation arrived at the inference that banks' profitability rose when their product offerings expanded. While the study gives clues into the positive association among portfolio diversification and the profitability of Kenya's profit-seeking banks, there's a potential gap in understanding the long-term

Research Design

This study utilized both descriptive and explanatory research designs within its broader mixed-methods approach. Descriptive Design component of the study entails giving a detailed and in-depth account of Kenya's commercial banks' current states of financial profitability and portfolio diversity. Providing important financial metrics like ROA, examining how investments are distributed among different types of assets, and outlining the asset allocation techniques used by banks. To recap and divulge the data and provide insights into the common patterns and characteristics observed across the banking industry, descriptive statistics like means, standard deviations, and frequency distributions were utilized. Mackenbach (2019)

states that the phrase "explanatory research" suggests the goal of the study is to present an elucidation of the issue under investigation rather than just a description. Therefore, the study's explanatory research design helped explain how knowledge management techniques impact commercial banks' profitability. The goal of the research's explanatory component was to identify the fundamental causes of the monetary fairing and offering multiplications patterns among Kenya's profit-seeking banks. The study determined how much portfolio diversity, in addition to other factors like bank size, liquidity, and macroeconomic circumstances, explains variations in profitability through the application of diverse regression evaluations. The research sought to clarify the causal relationships between portfolio diversification strategies and financial results by utilizing inferential statistics and adjusting for possible confounding variables. Furthermore, by exploring the rationales for banks' diversification choices, the difficulties they encounter, and the perceived effects on financial performance, qualitative interviews with key stakeholders offered insightful information.

Empirical Model of the Study

The model of the study was as follows;

$$Y = C + \beta_1X_1+\beta_2X_2+\beta_3X_3+\beta_4X_4+\beta_5X_5+ e$$

Y = Profitability; β_i = Coefficients to be estimated. X_1 =Investment Diversification; X_2 = Income Stream Diversification; X_3 = Sectorial Credit Diversification; X_4 = Deposit Diversifications; X_5 = Bank Size and e = error

This model evaluated whether bank size has a moderating effect.

$$Y = \beta_0 + \beta_1PD_{it} + \beta_2BS_{it} + \beta_3 (PD_{it} * BS_{it}) + \epsilon$$

Y: Profitability; PD: Portfolio Diversification; BS: Bank Size; β_1 & β_2 = the regression coefficients; (PD* BS): the interaction term that reflects the controlling power of bank vastness on the association pitting board dealings and gainfulness; i: represents the number of observations; t: is the study period = 2018 to 2023 and ϵ : this represents the error.

Operationalization and Measurement of Study Variables

Table 3.1 Operationalization and Measurement of Study Variables

Variable	Operationalization	Measurement	Data collection method	Data Source
Independent Variables				
Sectoral Credit Diversification	Total loans allocated	Ordinal	Database/Observation	Financial statements of Kenyan banks, CBK
Deposit Diversification	Total Deposit mix by type (e.g. savings, time deposits)	Ordinal	Database/Observation	Financial statements of Kenyan banks, CBK
Investment Diversification	Total bank incomes (e.g. government securities, shares)	Ordinal	Database/Observation	Financial statements of Kenyan banks, CBK

Income Streams Diversification	Shareholders fund	Ordinal	Database/Observation	Financial statements of Kenyan banks, CBK
Moderating Variable				
Bank Size	Total assets, Number of branches, Total deposits	Ordinal	Database/Observation	Financial statements of Kenyan banks, CBK
Dependent Variable				
Profitability	Return on Assets (ROA)	Ordinal	Database and calculation based on financial statements	Financial statements of Kenyan banks, CBK

Source: Researcher (2024)

Target Population

This scholarly analysis focused on selected licensed Kenyan commercial banks regulated by the country’s Central Bank. As to the CBK’s data (2023), Kenya presently has 39 accredited commercial banks. These monetary institutions were considered appropriate for investigating the correlation between portfolio diversification and financial viability due to their varied business methods, sizes, and market shares in the Kenyan banking industry. This study intended to offer a thorough analysis that included various strategies and results connected with portfolio diversification throughout the whole sector by incorporating all licensed commercial banks. The study therefore focused on the 39 local commercial banks.

Data Collection Procedures

This study gathered information from secondary sources. It premised on existing details from reputable origins for instance, the Central Bank of Kenya (CBK), yearly statements from Kenyan commercial banks, and academic journals. The data was collected from various databases, including the CBK’s statistical publications, which provided detailed information on the monetary efficiencies of the country’s commercial banks. Financial statements, annual reports, and regulatory filings provided by the Central Bank of Kenya and individual profit-seeking banks were assessed. Additionally, the investigation utilized online databases and academic repositories to gather relevant data from published research papers and articles on the topic. This approach ensured that the data was readily available, reliable, and relevant to the research objectives. The data collection process involved a thorough review of the selected sources to gather relevant data on the portfolio multiplication and gainfulness of all local business-based banks in Kenya. The data was extracted and organized into a usable format for analysis. The investigation delved on data from the duration stretching from 2018 to 2023, which was a significant period for the banking sector in Kenya.

These sources provided comprehensive information on banks' asset allocation across different asset classes, such as loans, securities, and other investments, allowing for the calculation of portfolio diversification metrics. Financial ratio such as ROA was also computed to assess banks' profitability. Additionally, macroeconomic data related to interest rates, inflation, and GDP growth was collected to control for external factors that influenced banks' profitability. By utilizing existing datasets, this approach minimizes the burden on participants and ensures the reliability and consistency of the data across different banks and periods (Mbaka & Kithinji, 2020; Ochieng & Gathogo, 2019).

RESULTS AND DISCUSSIONS

Descriptive Statistics

Descriptive statistics refers to a quantitative technique that provides an overview and characterizes the essential aspects of a dataset. Several observations were made as part of descriptive statistics including standard deviation, mean, minimum, and maximum were computed as shown in Table 4.1

Descriptive Results

Table 4.1: Descriptive Statistics

	N	Minimum	Maximum	Mean	Std. Deviation
Sectorial Credit Diversification (Total loans allocated 'KSHS, M')	39	66904.00	105122.00	80829.3333	14719.85673
Deposit Diversification (KSHS. M)	39	86424.00	65354598.00	10975094.1667	26640409.50015
Investment Diversification	39	8.00	18.00	11.0000	4.38178
Income Streams Diversification (Shareholders Fund Kshs. M)	39	18405.00	25767.00	22353.0000	2546.94429
Bank Size (Assets)	39	114509.00	179128.00	140428.5000	23311.45853
Profitability (ROA)	39	990000.00	2110000.00	1690000.0000	395524.96760
Valid N (listwise)	39				1

Source, Researcher (2024)

Table 4.1 above lays out the descriptive statistics arrived at during the analysis. The total number of observations is 39 banks that had their data obtained and entered for the analysis of results. Under sectorial credit, the highest was 105122.00 while the least was 66904.00, denoting that the mean was 80829.3333, with a standard deviation of 14719.85673. The minimum quantity for deposit diversification was 86424.00, while the maximum quantity for this aspect was 65354598.00, meaning that its mean quantity was 10975094.16, and the standard deviation was 26640409.50. The minimum value of income streams diversification

was 18405.00, while the maximum measure was 25767.00, denoting that the mean value was 22353.0000. However, the standard deviation of this measure was 2546.94429. The minimum bank size based on assets worth was 114509.00, while the maximum measure was 179128.00, meaning that its average value was 140428.5000. The standard deviation level was 23311.45853. The table hints that the minimum value of profitability of the 39 banks, based on returns on investment (ROA) was 90000.00, whereas the maximum measure was 2110000.00, thus, the mean value was 1690000.0000. The standard deviation measure of this measure was 395524.96761.

Correlation Analysis

Table 4.2: Correlation Analysis

		Profitability	Investment Diversification	Income Streams	Sectoral Credits	Deposit Diversifications	Bank Size
Profitability	Pearson Correlation	1					
	Sig. (2-tailed)						
	N	288					
Investment Diversification	Pearson Correlation	.376**	1				
	Sig. (2-tailed)	.000					
	N	288	288				
Income Streams	Pearson Correlation	.137*	.268**	1			
	Sig. (2-tailed)	.020	.000				
	N	288	288	288			
Sectoral Credits	Pearson Correlation	.641**	.026	.076	1		
	Sig. (2-tailed)	.000	.665	.198			
	N	288	288	288	288		
Deposit Diversifications	Pearson Correlation	.755**	.298**	.079	.475**	1	
	Sig. (2-tailed)	.000	.000	.184	.000		
	N	288	288	288	288	288	
Bank Size	Pearson Correlation	.411**	.011	-.038	.671**	.545**	1

Sig. (2-tailed)	.000	.853	.525	.000	.000
N	288	288	288	288	288

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

* . Correlation is significant at the 0.05 level (2-tailed).

Source, Researcher (2024)

The p-values from the findings in Table 4.2 indicate that the correlation test was all positive and significant testing at 1% and 5% significant levels using a 2-tail test where the p-values obtained were lower than 0.005 and 0.025 respectively. The study then reveals that deposit diversification had the stronger correlation with profitability as given by the Pearson value of 0.755 followed by the sectorial credits that had the Pearson value of 0.641 while the least correlation was observed in the income stream variable that gave a correlation of 0.137.

Regression Analysis

Table 4.3: Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.869 ^a	.754	.751	.04918

a. Predictors: (Constant), Deposit Diversifications, Income Streams, Investment Diversification, Sectoral Credits

Source, Researcher (2024)

Table 4.3 contents hint that Deposit Diversifications, Income Streams, Investment Diversification and Sectoral Credits all highlight a noteworthy level of changeability in bank profitability in Kenya, R²= .754 where this implies that 75.4% of the proportion in bank profitability in Kenya is explainable by the selected predictor variables.

Table 4.4: ANOVA

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	2.101	4	.525	217.211	.000 ^b
	Residual	.684	283	.002		
	Total	2.786	287			

a. Dependent Variable: Profitability

b. Predictors: (Constant), Deposit Diversifications, Income Streams, Investment Diversification, Sectoral Credits

Source, Researcher (2024)

Table 4.4 depicts the import of the ANOVA model in which the p-values obtained was below 0.05 testing at 5% importance magnitude when applied a one tail test hinting that the model is noteworthy and can be relied upon. The F-value gotten was 217.211 which is greater than 0.05 testing at 5% significance level using a one tail test indicating that the regression test conducted is a valid test.

Table 4.5: Coefficients

Model		Unstandardized Coefficients		Standardized Coefficients		
		B	Std. Error	Beta	t	Sig.
1	(Constant)	1.178	.126		9.389	.000
	Investment	.341	.039	.289	8.752	.000
	Diversification					
	Income Streams	.056	.008	.212	6.730	.000
	Sectoral Credits	.531	.042	.439	12.766	.000
	Deposit	.345	.028	.444	12.170	.000
	Diversifications					

a. Dependent Variable: Profitability

Source, Researcher (2024)

H01: Sectorial credit does not have a noteworthy manipulation on the gainfulness of profit-seeking Banks in Kenya.

Testing at 5% significance level, the p-value for analysis of variances (ANOVA) is less than 0.05 testing at 1 tail test (Sig. 0.000 <0.05) hinting an annulment of the null hypothesis therefore the study concludes that sectorial credit does have a noteworthy manipulation on the profitability of Commercial Banks in Kenya.

H02: Income streams do not have a noteworthy manipulation on the profitability of profit-seeking banks.

Testing at 5% significance level, the p-value for analysis of variances (ANOVA) is less than 0.05 testing at 1 tail test (Sig. 0.000 <0.05) hinting an annulment of the null hypothesis therefore the study concludes that income streams do have a significant effect on the gainfulness of profit-seeking banks

H03: Deposits diversification does not have a noteworthy manipulation on the profitability of commercial banks in Kenya.

Testing at 5% significance level, the p-value for analysis of variances (ANOVA) is less than 0.05 testing at 1 tail test (Sig. 0.000 <0.05) hinting an annulment of the null hypothesis therefore the study concludes that deposits diversification does have a significant effect on the gainfulness of profit-seeking banks in Kenya.

H04: Investment diversification does not have a noteworthy manipulation on the gainfulness of profit-seeking banks in Kenya.

Testing at 5% significance level, the p-value for analysis of variances (ANOVA) is less than 0.05 testing at 1 tail test (Sig. 0.000 <0.05) indicating a rejection of the null hypothesis therefore the study concludes that investment diversification does have a significant effect on the profitability of commercial banks in Kenya.

Test for Moderating Variable

Table 4.6: Test of Moderating Variable for Investment Diversification

Model		Unstandardized Coefficients		Standardized Coefficients		
		B	Std. Error	Beta	t	Sig.
1	(Constant)	2.945	.159		18.472	.000
	Investment Diversification	.438	.058	.371	7.522	.000
	Bank Size	.358	.043	.407	8.247	.000

a. Dependent Variable: Profitability

Source, Researcher (2024)

Table 4.6 hints that the bank assets have a significant moderating effect on investment diversification as given by the p-value 0.000 which is than 0.05 testing at 5% significance level using a 1 tail test.

Table 4.7: Test of Moderating Variable for Income Streams

Model		Unstandardized Coefficients		Standardized Coefficients		
		B	Std. Error	Beta	t	Sig.
1	(Constant)	3.915	.085		46.214	.000
	Bank Size	.367	.047	.417	7.819	.000
	Income Streams	.040	.014	.152	2.857	.005

a. Dependent Variable: Profitability

Source, Researcher (2024)

The study findings in table 4.7 indicate that the bank assets have a significant moderating effect on income streams as given by the p-value 0.000 which is than 0.05 testing at 5% significance level using a 1 tail test.

Table 4.8: Test of Moderating Variable for Sectoral Credits

Model		Unstandardized Coefficients		Standardized Coefficients		
		B	Std. Error	Beta	t	Sig.
1	(Constant)	3.348	.090		37.301	.000
	Bank Size	-.031	.054	-.036	-.582	.561
	Sectoral Credits	.805	.074	.665	10.855	.000

a. Dependent Variable: Profitability

Source, Researcher (2024)

The study findings in table 4.8 indicate that the bank assets have a significant moderating effect on sectoral credits as given by the p-value 0.000 which is than 0.05 testing at 5% significance level using a 1 tail test.

Table 4.9: Test of Moderating Variable for Deposit Diversification

Model		Unstandardized Coefficients		Standardized Coefficients		
		B	Std. Error	Beta	t	Sig.
1	(Constant)	1.909	.141		13.558	.000
	Bank Size	-.001	.041	-.001	-.016	.987
	Deposit Diversifications	.587	.036	.756	16.328	.000

a. Dependent Variable: Profitability

Source, Researcher (2024)

The study findings in table 4.9 indicate that the bank assets have a significant moderating effect on deposit diversification as given by the p-value 0.000 which is than 0.05 testing at 5% significance level using a 1 tail test.

CONCLUSIONS AND RECOMMENDATIONS

Conclusions

The study explored the impact of sectoral credit diversification on the gainfulness of profit-seeking banks in Kenya. Regression analysis showed that sectoral credits had the highest contribution to profitability, increasing it by 0.531 times, followed by deposit diversification at 0.345 times, investment diversification at 0.341 times, and income streams at 0.056 times. The findings invalidated the initial hypothesis that sectoral credit does not significantly impact bank profitability, as the study concluded that sectoral credit substantially contributes to profitability. The literature review also confirmed a constructive correlation pitting sectoral credit differentiation and returns on assets in the banking industry. Additionally, the study highlighted that sectoral credit diversification enhances profitability and effective loan monitoring while minimizing risks.

The study examined the role of income streams on profitability, showing that income streams had a smaller but significant impact, contributing 0.056 times to bank profitability. This finding invalidated the hypothesis that income streams do not influence profitability, as the evidence pointed to the contrary. Literature review findings showed a constructive correlation between portfolio diversification and bank profitability. However, over-diversification can sometimes lead to diminishing returns. Income diversification, especially during the COVID-19 pandemic, helped banks reduce risk and maintain profitability. The introduction of fintech was also noted to have a transformative impact on the banking sector, offering new revenue streams and enhancing traditional banking activities.

The influence of deposit diversification was another key area of focus. The study revealed that deposit diversification contributed 0.345 times to bank profitability; discrediting the hypothesis that deposit diversification does not significantly affect profitability. Literature review findings further indicated that services like mobile banking, agency banking, and bancassurance contributed to increased profitability through deposit diversification. However, product

diversification was discovered to have an adverse control on monetary fairing, despite income and geographical diversification positively influencing profitability.

The study also examined the impact of investment diversification, which contributed 0.341 times to profitability, disproving the hypothesis that it does not influence profitability. Portfolio diversification, particularly in areas like government securities, real estate, and equity securities, was shown to have a constructive effect on output of equity. The study emphasized the importance of strategic investment decisions in boosting profitability. However, gaps were noted in the literature, particularly concerning the long-term sustainability of diversification strategies and the influence of external factors like policy changes and technological advancements on bank profitability.

Finally, the study highlighted the regulating power of bank size vastness on the interplay pitting offering differentiation and gainfulness. Larger banks, with more diversified portfolios, tended to perform better financially, showing a constructive correlation between financial fairing and the application of diversified equity securities. The researcher called for further studies on the long-term impact of diversification strategies in the Kenyan banking sector.

Recommendations

Commercial banks in Kenya should implement effective loan recovery strategies to avoid risks related to loan defaults. This study found that failure to recover loans properly exposes banks to significant financial risks. Additionally, banks should consolidate their credit information to manage and provide credit services across diverse sectors. While income diversification is essential, banks should be cautious as over-diversification can lead to diminishing returns. The study recommends that Kenyan banks diversify their portfolios through strategic investments in government securities, land and buildings, quoted ordinary shares, and financial market securities. These investment options have been shown to positively influence return on equity, enhancing financial profitability. The study also highlighted gaps in existing research, particularly in understanding the power of sectoral credit differentiation on the gainfulness of Kenyan banks. More research is needed to confirm whether the trends observed in other East African countries apply to Kenya. External factors such as regulatory changes, technological advancements, and global economic shifts may also affect bank profitability and should be studied further. Additionally, the findings pointed to a need for updated research, as much of the existing literature is based on data from 2017 or earlier.

There is limited information on the long-term sustainability of portfolio diversification strategies in Kenyan banks. While the benefits of diversification are well documented, more research is needed to understand its implications over time, particularly in the unique economic, regulatory, and market conditions of Kenya. This research would provide a clearer understanding of the optimal level of diversification that balances profitability and risk. Further studies should also examine how broader diversification strategies, beyond earnings sources, impact the monetary fairing of Kenyan profit-seeking banks. The existing literature focuses primarily on banks in developed nations, leaving a knowledge gap for Kenya's banking sector.

Given the distinct dynamics of Kenya's financial landscape, future research should explore how these diversification strategies influence profitability, specifically in Kenyan banks. In addition, research should investigate how intellectual capital, such as personnel and client wealth, influences the financial outcomes of commercial banks when paired with portfolio diversification strategies. This area remains underexplored, particularly in the context of Kenya's banking sector.

Finally, the study identified the need to examine how various portfolio diversification options, like government securities and financial market securities, affect commercial banks' profitability. While existing research has shown these investments benefit investment companies, their applicability to commercial banks remains unclear. Given the different operational dynamics and risk profiles of commercial banks compared to investment companies, future research should focus on how diversification strategies impact the monetary fairing of Kenya's profit-seeking banks. Understanding these factors is essential for making informed investment decisions that enhance profitability without introducing unnecessary risks.

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