

## FACTORS INFLUENCING ACQUISITION OF STRESSED ASSETS AND ASSET SECURITIZATION INTO THE FINANCIAL MARKET IN KENYA

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### ABSTRACT

*Securitization of future receivables has become increasingly popular in Kenya with many Kenyan organizations using this route for raising and investing funds. Banks, financial institutions, insurance firms, stock brokers, housing finance companies, power generators and distributors have already adopted asset securitization. The purpose of this study was to investigate the factors influencing the acceptance of the acquisition of stressed assets (Bad Debts) and asset securitization for the purposes of liquidity mobbing to attain financial stability in the financial market in Kenya. The study was guided by four research objectives: determining the organizational factors that influences the Acquisition of stressed Assets and Asset securitization in the financial market in Kenya; examining the business environment factors that influence acquisition of stressed assets and Asset Securitization in the financial market in Kenya; establishing the effects of Government policies, control, and regulations on acquisition of stressed assets and asset securitization in the financial market in Kenya and to investigate the adequacy of IAS 39 as financial instrument on recognition and measurement. The study adopted a descriptive research design. The population of the study comprised of the finance officers from*

44 commercial banks registered in Kenya as at 31<sup>st</sup> December 2011, 2 Analyst form Financial Regulators, 4 finance managers from Investment banks and 13 finance managers from Insurance Companies. Stratified random sampling technique was used to select 15 commercial Banks according to asset base. The study used both primary and secondary data. Primary data was collected using semi structure questionnaires. The collected data was analyzed using Statistical Package for Social Sciences (SPSS). The data was presented in the form of frequency tables, pie charts and graphs. The study found that Organizational Factors, Business environment factors, Government policies, control and regulations and Adequacy of Accounting Standards IAS 39 affected the practice of securitization. The study recommends that financial market should be used in spreading the risk to more stakeholders. Organizations should understand the environment that the business operates since the environmental factors influence almost every aspect of business. Management structures should strengthen management structures, and information systems. Loan evaluation procedures should be improved especially procedures on loan application and credit rating.

*Key words: Acquisition, Stressed Assets, Asset Securitization, Financial Markets*

### **Introduction**

Securitization was invented in the early 1970; and is one of the major financial innovations to have occurred over the recent decades. Since then the transaction volume has increased dramatically (Horcher, 2005). By the end of 1994, more than \$1.9 trillion securitization securities were outstanding, and more than \$ 500 billion of securitization were done in 1994 alone (Feng, 2004). The US dominates the securitization market worldwide with issuance totaling \$3,023bn in 2005, 2 up to 13% from the previous year. In order for Africans and indeed Kenyans to secure a positive future, where they own a house which they would call a home with all the basic necessary facilities the mortgage interest rates must be brought down. Commercial Banks, mortgages houses all over the world are willing to give loan as this is their core business. However, many loans or mortgage holders for one reason or another have not been able to service their loans or mortgages results to bad debts. In recent years Kenyan banks were compelled by the Central Bank or Kenya to recapitalize and clear staggering amount of bad debts reflected in their Audited Financial Statements (Keng & Ting, 2004).

### **Statement of the problem**

Financial futurologists mostly resident at universities, consulting firms and think tanks believe almost universally that securitization will defeat intermediation as surely as capitalism triumphed over communism. If securitization goes far enough, banks will become little more than managers of mutual funds holding portfolios of liquid securities. Like mutual funds they would mark their assets to their market values (Rinne, 2004). During the last decades the development of the financial system has received growing attention among academics, policymakers and the general public (Rosalan, Shafinar, Antoaneta & Androriou, 2008). The United States has been considered a prototype of a well-functioning economic system, for which a sophisticated financial industry is one of the key factors for a strong economic prosperity. Financial markets and the banking system provide vital services that allow productive enterprises to seize new business opportunities and expand them to desirable levels (Levine, 1997).

Since a growing number of countries that are utilizing securitization as a financing tool, 98% of these complex financial instruments are still being issued in industrialized countries and a mere 2% in developing countries, not many studies have been done on this topic so far in Africa and none in Kenya. . The existing studies are focused mainly on the US and the EU market and report contradicting results. In this study, for the first time, data from Kenya will be used. Consequently Bad debts and securitization is an area that has received minimal attention by Researchers in Kenya. Therefore this necessities a study of this nature to determine the factors that influence the practice of acquisition of stressed assets and asset securitization for the purpose of liquidity mobbing to attain financial stability. Previous studies have argued that because of its importance and impact, it is very important that we study the reasons, the motivations, the consequences and the effects from this so powerful financial innovation. And it is important to study it from as many different aspects as possible. Many questions surrounding asset securitization are unanswered and it is important to answer them sooner. Consequently this study aims to investigate the factors that influence the practice of acquisition of stressed assets (bad debts) and asset securitization into the financial market in Kenya: the purposes of liquidity mobbing to attain financial stability.

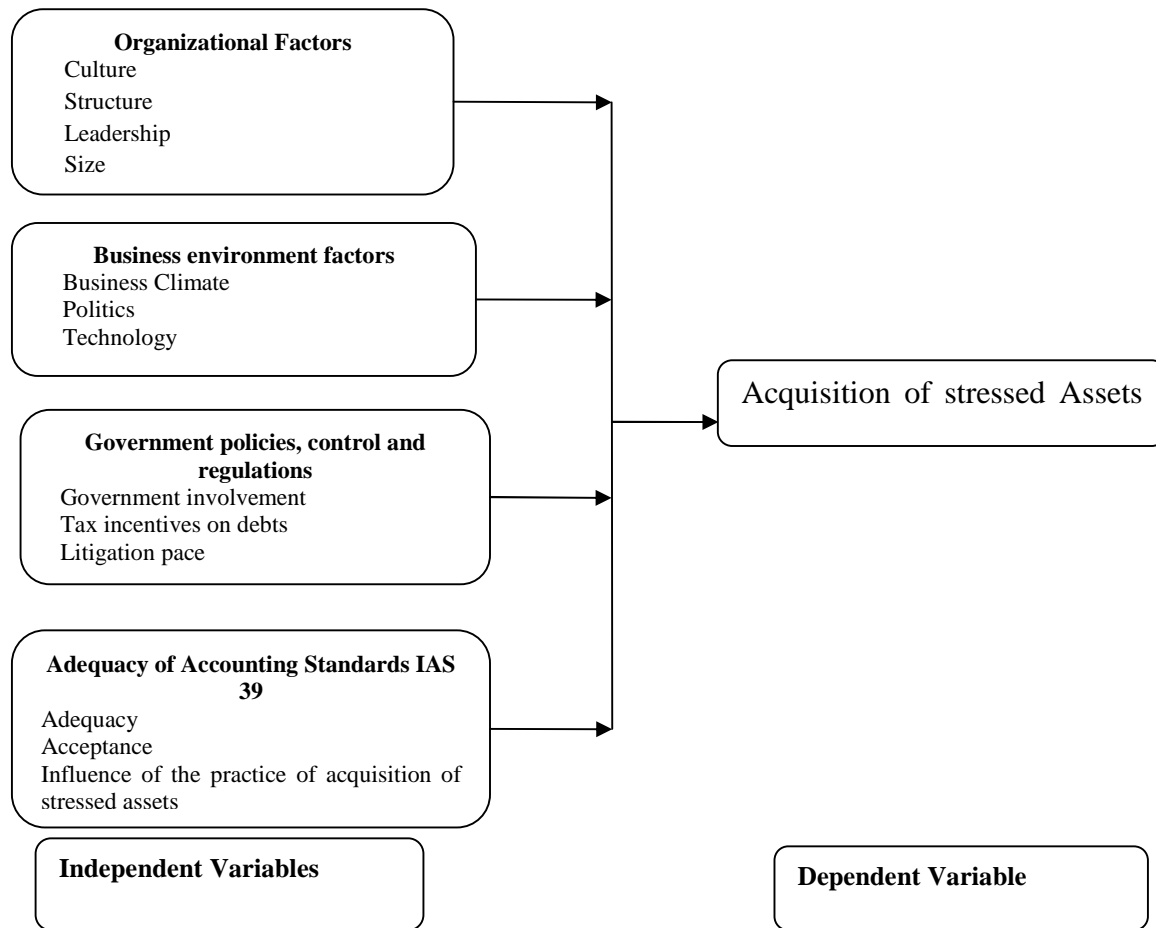
### **Specific Objectives**

The study was guided by the following specific objectives

- i. To determine the organizational factors that influences the Acquisition of stressed Assets and Asset securitization in the financial market in Kenya.
- ii. To examine the Business environment factors that influence acquisition of stressed assets and Asset Securitization in the financial market in Kenya.
- iii. To establish the effects of Government policies, control, and regulations on acquisition of stressed assets and asset securitization in the financial market in Kenya.
- iv. To determine the application of IAS 39 in the Recognition and Measurement of collateralized asset.

### **Conceptual Framework**

According to Bogdan and Biklen (2003) a conceptual Framework is a basic structure that consists of certain abstract blocks which represent the observational, the experiential and the analytical/synthetical aspects of a process or system being conceived. The interconnection of these blocks completes the framework for certain expected outcomes.



**Research Methodology**

The Research design was descriptive. Descriptive studies are concerned with describing the characteristics of a particular individual or of a group. They answer questions of who, what, when, where and how in a given topic (Chandran, 2004). A research design is an arrangement of the conditions for collection and analysis of data in a way that combines their relationship with the purpose of research to the economy of procedures (Chandran, 2004). The studies lead to a profile development of a situation or a group of people by acquiring complete and possible accurate information. According to Bryman (2001), descriptive studies report the way circumstances are; by describing elements such as possible behavior, attitudes, values and characteristics. This study adopted a descriptive research design.

## Population

According to Mugenda and Mugenda (2003) population refers to the entire group of individuals, events or objects having a common observable characteristic. The population of this study comprised of the credit management team at the 44 commercial banks registered in Kenya as at 31<sup>st</sup> December, 2011, 5 financial sector regulators, 12 investment banks and 43 insurance companies.

### Population of the Study

Narrative	Population	Proportion
Commercial banks (Finance Officers/Credit managers)	44	42%
Financial Regulators (Analysts)	5	5%
Investment banks	12	12%
Insurance Companies	43	41%
<b>Total</b>	<b>104</b>	<b>100%</b>

Source: (Capital Markets Authority, 2012)

## Findings

To compute the correlation (strength) between the study variables and their findings the study used the Karl Pearson's coefficient of correlation (r). From the findings, it was clear that there was a positive correlation between Acquisition of stressed Assets and Organizational Factors as shown by a correlation figure of 0.523, it was also clear that there was a positive correlation between Acquisition of stressed Assets and Business environment factors with a correlation figure of 0.614, there was also a positive correlation between Acquisition of stressed Assets and Government policies, control and regulations with a correlation value of 0.746 and a positive correlation between Acquisition of stressed Assets and Adequacy of Accounting Standards IAS 39 with a correlation value of 0.521. This shows that there was a positive correlation between Acquisition of stressed Assets and organizational factors, business environment factors, government policies, control and regulations and adequacy of accounting standards IAS 39.

### Coefficient of Correlation

		Acquisition of stressed Assets	Organizational Factors	Business environment factors	Government policies, control and regulations	Adequacy of Accounting
<b>Acquisition of stressed Assets</b>	Pearson Correlation Sig. (2-tailed)	<b>1</b>				
<b>Organizational Factors</b>	Pearson Correlation Sig. (2-tailed)	.523 .0032	1			
<b>Business environment factors</b>	Pearson Correlation Sig. (2-tailed)	.6140 .0021	.3421 .0014	1		
<b>Government policies, control and regulations</b>	Pearson Correlation Sig. (2-tailed)	.7460 .0043	.1240 .0120	.0621 .0043	1	
<b>Adequacy of Accounting Standards IAS 39</b>	Pearson Correlation Sig. (2-tailed)	.5210 .0172	.3420 .0031	.0000 1.000	.1660 .0031	1

**Coefficient of Determination**

Coefficient of determination explains the extent to which changes in the dependent variable can be explained by the change in the independent variables or the percentage of variation in the dependent variable (Acquisition of stressed Assets) that is explained by all the four independent variables (organizational factors, business environment factors, government policies, control and regulations and adequacy of accounting standards IAS 39).

The four independent variables that were studied, explain only 83.4% Acquisition of stressed Assets as represented by the adjusted R<sup>2</sup>. This therefore means that other factors not studied in this research contribute 16.6% Acquisition of stressed Assets. Therefore, further research should be conducted to investigate the other factors (16.6%) that affect Acquisition of stressed Assets.

**Model Summary**

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
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1	0.913	0.834	0.751	0.4538
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### Regression Coefficient

Further the study conducted a multiple regression analysis so as to determine factors affecting Acquisition of stressed Assets. The study applied the statistical package for social sciences (SPSS Version 21.0) to code, enter and compute the measurements of the multiple regressions for the study.

Multiple regression analysis was conducted as to determine the relationship between Acquisition of stressed Assets and the four variables. As per the SPSS generated table 4.18, the equation

( $Y = \beta_0 + \beta_1X_1 + \beta_2X_2 + \beta_3X_3 + \beta_4X_4 + \epsilon$ ) becomes:

$$Y = 1.308 + 0.558X_1 + 0.785X_2 + 0.620X_3 + 0.731X_4$$

The regression equation above has established that taking all factors into account organizational factors, business environment factors, government policies, control and regulations and adequacy of accounting standards IAS 39) constant at zero, Acquisition of stressed Assets will be 1.308. The findings presented also shows that taking all other independent variables at zero, a unit increase in Organizational Factors will lead to a 0.558 increase of Acquisition of stressed Assets; a unit increase in Business environment factors will lead to a 0.731 increase of Acquisition of stressed Assets; a unit increase in Government policies, control and regulations will lead to a 0.785 increase in Acquisition of stressed Assets and a unit increase in Adequacy of Accounting Standards IAS 39 will lead to a 0.620 increase in Acquisition of stressed Assets. This infers that Government policies, control and regulations contribute most to Acquisition of stressed Assets followed by Business environment factors then Adequacy of Accounting Standards IAS 39 while Organizational Factors contributed the little to Acquisition of stressed Assets.

At 5% level of significance and 95% level of confidence, business environment factors had a 0.0285 level of significance; Organizational Factors showed a 0.0276 level of significance;



Adequacy of Accounting Standards IAS 39 showed a 0.0249 level of significance and Government policies and control and regulations showed a 0.0202 level of significance hence the most significant factor.

### Regression Coefficients

Model	Unstandardized Coefficients		Standardized Coefficients		
	B	Std. Error	Beta	t	Sig.
(Constant)	1.308	1.342		1.623	0.357
<b>Organizational Factors</b>	0.558	0.310	0.172	4.342	.0276
<b>Business environment factors</b>	0.731	0.156	0.210	3.532	.0285
<b>Government policies, control and regulations</b>	0.785	0.322	0.067	3.542	.0202
<b>Adequacy of Accounting Standards IAS 39</b>	0.620	0.245	0.148	3.458	.0249

### Conclusion

The study concludes that organization structure, capital structure affects the practice and leadership structure affects the practice of securitization. Organization culture and loan evaluation procedures in the bank affect the practice of securitization. Business culture affected the practice of securitization to great extent. Organization leadership, organization performance and organization reputation affects the practice of securitization.

The study also concludes that existing business environment, level of interests and the level of customers buying power affect the practice of securitization. The local political condition, regional politics and social environment affects the practice of securitization. Technological advancements affect the practice of securitization; technological provides effective credit rating information useful in the practice of securitization.

The study concludes that government involvement in the securitization enhances the vitality of capital markets; government involvement in the securitization puts structures in place to protect

the general public; government involvement in the securitization enhance investors' confidence; government involvement in the securitization ensures balanced economic growth; government involvement in the securitization ensures continuity of the loans market.

The study found that there is adequate accounting standards on securitization; the existing accounting standards has been fully accepted by the securitization industry in Kenya; accounting standards are observed by all players in the securitization industry in Kenya; loan agreement terms influence the practice of acquisition of stressed assets; and loan documentation influence the practice of acquisition of stressed assets.

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