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REVENUE DIVERSIFICATION, RISK AND PROFITABILITY OF BANKS: EVIDENCE FROM ZAMBIA

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ABSTRACT

The aim of this study was to evaluate the extent to which banks in Zambia were enhancing their performance as a result of undertaking revenue diversification activities. The study was quantitative in design. Panel data from 12 of the 18 banks in Zambia were analysed using several techniques such as the Herfindahl-Hirschman Index to measure income diversification, Z-Score to measure bank income volatility and the risk adjusted returns on assets to measure profitability. The study indicated that while some banks failed to enhance their profit performance through on-interest income diversification, others yielded better profit performance in some years, but not always. The overarching finding, however, was that non-interest income diversification improves profitability of banks in Zambia. With regard to bank risk, the study suggests that while some banks fail to minimize their income volatility through diversification into non-interest income, others reduce income volatility in some periods, but not always. The overall picture, however, is that larger banks use diversification to minimize their income volatility better that smaller banks. Considering the reduction in bank income diversification activities and the consequent decline in profitability of banks in Zambia, the Bank of Zambia should relax the regulatory regime for banks to encourage revenue diversification. On the other hand, given that bank income diversification is not a panacea for improving bank performance, banks should scrutinise whether their business models support non-bank activities as they make revenue diversification decisions.

KEYWORDS: *Bank Risk, Diversification, Income Volatility, On-Interest Income, Profitability.*

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