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The effects of revenue diversification and cross border banking on risk and return of banks in Africa.

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Highlights

- This paper analyses the effects of revenue diversification and cross-border banking on banks risk and returns
- It employs a sample of 320 banks in 29 African countries to test for two related hypotheses
- First, exploration risk reduces diversification as the level of capital increases
- Banks cross-border when they diversify to generate non-interest income
- Banks in Africa derive absolute benefits from diversification if they cross border and diversify their revenue base concurrently

Abstract
The paper analyses the implications of revenue diversification and cross-border banking for risk and return. We sample 320 banks across 29 African countries and employ System GMM estimator as a methodological approach to shed further light on the diversification-stability nexus by examining the complex interaction between three key variables: cross-border banking, diversification and bank stability. The results suggest that exploration risk reduces diversification as the level of capital increases when banks cross border to diversify across revenue generating activities. Our analyses further show that, banks in Africa derive absolute benefits from diversification if they cross border and diversify their revenue base concurrently. These results are robust to a range of controls including alternative variable specifications, regulatory environment that bank operate and methodology.

Keywords: Banks, diversification, cross-border banking, developing countries
JEL classification G21 G33 D42 C36 N27