A Literature Review on Factors Influencing Banks’ Participation in Islamic Syndicated Financing

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ABSTRACT

The upsurge demand for Islamic financial products has driven the innovation and expansion of syndicated loan into the Shariah compliant financing market known as Islamic syndicated financing. Islamic syndicated financing refers to the participation of a group of financial institutions in a joint financing operation through one of the Shariah permitted modes of financings such as Murabahah and Ijarah. In recent years, Islamic syndicated financing has become one of the important debt funding sources for corporations in need of large financing to finance high value transactions. Despite rising importance, Islamic syndicated financing market share is still low. In the context of Malaysia, Islamic syndicated financing makes up circa 10% contribution of the total syndicated loan volume over the last decade. The smallish contribution is attributed to several challenges such as non-standardization and complexity of documentation, absence of standard methods of syndication, divergence in Shariah approval among participating financiers and nonexistence of same legal platform globally. Besides, there is only a limited body of research on this important form of financing. Owing to these challenges, this study seeks to explore and gather the factors influencing banks’ participation in Islamic syndicated financing. These factors are guided by two theories which are theory of multi-bank lending and theory of financial services marketing by focusing on four out of the seven Ps of services marketing mix. Given the scarcity of academic research on Islamic syndicated financing, this study is therefore conducted based on review of previous work of literature related to factors influencing banks’ participation in syndicated loan to establish depth and breadth on the issues at hand.

Keywords: Syndicated loan, Islamic syndicated financing, shariah compliant financing
1.0 INTRODUCTION

The rise of Islamic banking and finance has created demand for innovative and more complex Islamic financing product to serve the requirements of vast spectrum of banking customers particularly the corporate customers. Typically, a corporate customer is defined by the sales turnover of minimum USD100 million per annum and hiring of more than 250 employees. Corporate customers are perceived as one of the most attractive and important clientele segments to commercial banks. The attractiveness and importance of corporate customers to commercial banks are comprehensible as they offer greater profit opportunities through their wide-ranging and more sustainable banking needs from simple transactional services to huge financing requirements (Watson, 1986).

One of the products which has been gaining popularity among the corporate customers is Islamic syndicated financing. As defined by AAOIFI, ISF is a financing technique that involves a group of Islamic financial institutions working together to provide funds to a customer. Typically, one bank will act as the lead arranging bank but for a larger deal, there could be a few lead arrangers. Islamic syndicated financing is normally proposed by the banks in order to cater to the large capital expenditure, permanent working capital, refinancing or project financing requirements in the corporate world. A plain vanilla Islamic syndicated financing transaction involves a group of financial institutions extending financing under a common set of financing documents to a single corporate customer or to a single group of customers under the same financing package.

This package, depending on the client’s preferences, can be split further to incorporate multiple funded and non-funded facilities for multiple purposes such as the refinancing of existing debt, expansion of business and working capital requirement. As such the share of financiers under these respective facilities is subject to the transaction structure. Usually, one of these financiers acts as the facility agent, acting as the communication and cash flow hub between the client and the financier pool. Commonly, in large ticket transactions such as project financing, separate conventional and Islamic facilities are structured which are then linked up through a common terms agreement at the top with separate facility agents and cash flow streams.

According to Dealogic, the number of Islamic syndicated financing deals obtained by corporates has increased between 2016 and 2017. A total of 30 deals worth USD13.18 billion were signed in 2017 compared to 28 deals amounting to USD9.38 billion in the preceding year. Malaysia is leading the pack with a market share of 50%, followed by the Kingdom of Saudi Arabia (KSA) with 23% market share (Islamic Finance News, 2018). Bulk of the proceeds from the Islamic syndicated financings are utilised to finance three main sectors which are energy and utility, oil and gas as well as real estate and property development. This growth is expected to continue, driven, in particular, by strong economic growth in countries with large, and relatively unbanked, Muslim populations which include the Shariah compliant corporates (International Monetary Fund, 2017).

Despite being a market leader of Islamic syndicated financing globally, at country level in Malaysia, Islamic syndicated financing market share has been relatively low. Islamic syndicated
financing makes up circa 10% contribution of the total syndicated loan volume over the last decade. In fact, most of the syndication deals have been raised through conventional syndicated loans. The smallish contribution from Islamic syndicated financing market is attributed to several challenges such as non-standardization and complexity of documentation, absence of standard methods of syndication, divergence in Shariah approval among participating financiers and nonexistence of same legal platform globally (CIMB, 2017).

In addition, Islamic syndicated financing is exposed to a lot of challenges since its inception for mainstream acceptance and is still navigating through the ever-changing landscape. The greatest challenge in this regard is the pricing capacity of Islamic banks which has been affected by the liquidity constraint. Moreover, Islamic syndicated financing involves series of transactional lags, incorporates substantial documentation, applies structuring requirements and requires operational efforts from the client and the facility agent which together act as a deterrent for clients looking for a less time-consuming and structurally simpler solution (Islamic Finance News, 2018).

Furthermore, there is only a limited body of research on this important form of corporate financing. Islamic syndicated financing concept and practices are not well understood by the majority public, remain largely unexplored and not formally documented in the academic literature. The dearth literature on Islamic syndicated financing is critical in such a way that this particular important market is ignored by the academic researchers (Farbood Hutan, 2009). Most of the previous literature were mainly focused on issues and variables related to conventional syndicated loan in the western world with almost complete absence of formal academic research on Islamic syndicated financing. Therefore there is a pressing need to explore further factors influencing banks’ participation in Islamic syndicated financing by deducing the variables through review of previous work of literature related to factors influencing banks’ participation in syndicated loan to establish depth and breadth on the issues at hand.

2.0 LITERATURE REVIEW

The study develops the theoretical framework on factors influencing banks’ participation in Islamic syndicated financing by reviewing four relevant theories namely theory of multi-bank lending, theory of financial services marketing, theory of bank liquidity management and theory of bank risk portfolio diversification.

i. Theory of Multi-bank Lending and Islamic Syndicated Financing

Definition

Multi-bank lending refers to an arrangement whereby a number of banks act jointly to extend financing facilities to a borrower (Mugasha.A, 2007). Multi-bank lending is frequently used interchangeably with syndicated lending. Simons (1993) describes syndicated lending as a group of banks making a loan jointly to a single borrower. Correspondingly, Jones (1999) defines syndicated lending as pieces of large loans with a minimum limit of USD50 million or more by
which the originating bank typically carves up and subsequently syndicates the carved-up portion to a group of banks.

Wild (2004) further explicates syndicated lending as a loan facility that is provided by two or more banks that makes up a syndicate, grounded on common terms. Each lender who participates in the syndicate, usually called a participant, makes a commitment to provide a given proportion of the total loan amount and has a right to receive the same share of all payments from a borrower. Likewise, Nini (2004) views syndicated lending as an arrangement that involves a collection of banks jointly extending a loan to a particular borrower based upon a single loan contract. At the onset, the loan contract is negotiated by a small number of arranging banks and subsequently participated by a larger number of participant banks.

On the other hand, Mullineaux (1999) asserts that syndicated lending has the criterion of both commercial banking and investment banking. This is further elaborated by Boot and Thakur (2000) who explain that syndicated lending is as a mix of “relationship loans” and “transactional loans” as the former carries information specific to the borrower and bank while the latter is equivalent to debt sold in a capital market. These elements are embedded in syndicated lending in such a manner that the lead arranger screens and monitors the borrower in a relationship like context and subsequently underwrites or sells a portion or all of the loans in a capital market like setting.

In the context of Islamic financing, a similar arrangement has been engineered into an instrument known as Islamic syndicated financing. According to AAOIFI (2014), Islamic syndicated financing refers to participation of a group of financial institutions in a joint financing operation through one of the Shariah permitted modes of financings. Technically, Islamic syndicated financing functions in a similar way to that of a conventional syndicated loan by which it applies the same commercial considerations as the former. However, as most of Islamic finance, there are some distinguishing features between the two transactions (Khaleq et al., 2016).

This includes the manner through which Islamic syndicated financing is structured. Islamic syndicated financing must be structured based upon Islamic principles and jurisprudence which are derived from a number of sources, including, primarily, the Quran and the Sunnah (together referred to as the Shariah). The structure has to be in accordance with Shariah principles and these principles must be adhered to when determining the acceptability of a proposed Islamic syndicated financing structure.

**Phases of Multi-bank Lending**

Conceptually, multi-bank lending is two-phased. The first phase involves primary syndicated loan exercise. In a primary syndication setting, each bank is a direct lender to the borrower, with every member’s claim evidenced by a separate note, although there is only a single loan agreement contract (Gorton & Pennachi, 1995). Similarly, in a primary Islamic syndicated financing, each financier will directly engage with and finance the customer based on an agreed shariah concept such as Ijarah or Commodity Murabahah and grounded upon mutually
negotiated common terms agreement. Typically, a mandated lead arranger originates and put together the financing facility, a bookrunner keeps the records and distributes the financing facility to participating financiers, an agent bank administers the financing facility and the participating financiers provide the funds (Agasha Mugasha, 2007).

The second phase engages secondary loan market practices. This practice is more prominent for conventional loan than Islamic financing due to unsettled controversy around prohibition of selling of debt at premium or loss on the latter. In a secondary loan market, the banks offload the loan from their books by selling down to other banks. The common practices in doing so are the sub-participation, loan participation, loan trading, credit derivatives and collateralized loan obligation. Gorton and Pennachi (1995) emphasize that syndicated lending is different from that of loan sales. Characteristically, loan sale involves a “participation contract” which grants the buyer a claim on all or part of a loan’s cash flows. The buyer of a participation is an “indirect lender” with no relationship to the borrower.

In summary, syndicated lending and Islamic syndicated financing are forms of financing mechanics that have been developed to meet a large financing requirement of a corporate firm extended by more than one bank which make up a syndicate, the latter participation in syndication exercise are driven by various factors including financial and non-financial motives as well as internal and external constraints exist within a particular banking environment. However, specifically for Islamic syndicated financing, the transaction must be done in accordance with the requirements set under the Shariah precepts which include prohibitions against riba, gharar and maisir.

Besides, banks as the investors in Islamic syndicated financing are not allowed to invest in products and services that are forbidden by the Shariah. Nonetheless, both syndicated lending and Islamic syndicated financing are more popular forms of multi-bank financing method compared to loan sales or sub-participation as primary syndication engages corporate customers directly whilst secondary loan sales merely serves as a platform for banks to manage their balance sheet by allowing transfer and assignment of loans to other banks or trust funds.

ii. Theory of Financial Services Marketing Mix and Islamic Syndicated Financing

Financial services refer to the economic services provided by the finance industry, which encompasses a broad range of businesses that manage money, including credit unions, banks, credit-card companies, insurance companies, accountancy companies, consumer-finance companies, stock brokerages and investment funds (International Monetary Funds, 2012). Marketing is defined as a human activity directed at satisfying human needs and wants through an exchange process (Kotler, 1994). Services is described by The American Marketing Association as activities, benefits and satisfactions which are offered for sale or are provided in connection with the sale of goods. Marketing mix is the set of controllable tactical marketing tools that the firm blends to produce the response it wants in the target market. It consists of everything a firm can do to influence the demand for its product (Kotler 2008: 109). Together, financial services marketing mix can be concluded as the act of influencing the demand for
financial services through application of seven marketing tools or more known as the seven Ps - Product, Price, Promotion, Place, People, Processes and Physical Evidence, targeting at various client segments within the finance industry in meeting their financial needs and wants through an exchange process.

Similar to syndicated lending, Islamic syndicated financing is marketed to two types of customers. Firstly, Islamic syndicated financing is targeted at corporate customers looking for sizeable financing facility whom otherwise could have tapped capital market for the same motive (Osman, 2011). Secondly, depending on the types of syndication be it fully or partially underwritten, best-effort basis or club deal, Islamic syndicated financing needs to be marketed to other banks and subsequently to be fully subscribed to make the syndication happens (Caouette, & et.al, 1998).

Given relatively nascent development of Islamic syndicated financing market, this study particularly looks into application of marketing mix to attract a niche group of customers and how these could be applied towards effective marketing of Islamic syndicated financing. Due to limitation of information, this study discusses the marketing of Islamic syndicated financing from the standpoints of only four primary marketing mix which are Product, Price, Promotion and Place.

**4Ps Marketing Mix for Islamic Syndicated Financing**

**Product**

The first component of marketing mix is the product. In the context of Islamic syndicated financing it refers to the financing solution and services provided through this instrument. For a product or services to be successfully marketed, it must emphasize the merits to the buyers and investors (Ancuța, 2016). However, Islamic syndicated financing remains unpopular compared to its conventional syndicated loan counterpart. In the last ten years, Islamic syndicated financing has been gaining slow traction that has translated into smallish market share on average of 10% of total syndicated loan market volume except in 2015 which saw sudden spike of new origination of Islamic syndicated financing. This however was not due to an organic push but rather incentive driven which was the cessation of stamp duty discount for financing obtained through Islamic structure that has caused corporate customers rushed to enjoy the incentive while it lasts (CIMB, 2017; Bank Negara Malaysia, 2018).

Haron and Wan Azmi (2005) suggest that Islamic banks in Malaysia do not aggressively market their products including Islamic syndicated financing. They suggest that Islamic banks should have a better understanding of the needs, preferences and behaviour of their target customers. This is because religion is not the only important factor that drives customers to use the Islamic banking facility. Therefore, depending on religion alone is not effective to attract customers. In fact, non-Muslim customers will also use the Islamic banks if they find that the service is good and meets their expectation.
Howcroft (1985) studies the reasons for the dramatic emergence of primary syndicated lending in the 1970s by examining the main technical and legal aspects of marketing a syndicated loan. He finds that the success of the syndicated loans market during the studied period is due to its flexibility in raising large amounts of credit at very short notice for a wide variety of borrowers. This flexibility has been largely based on the close personal contacts that exist between the major participating banks, and the very clear guidelines that exist within international banks regarding acceptable minimum spreads and exposure to major borrowers. Besides, syndicated lending has enabled the banks to satisfy unprecedented high levels of demand for credit whilst simultaneously managing a diversified loan portfolio.

Armstrong (2003) assesses the rapid development of the syndicated corporate loan market in the 1990s. He finds that syndicated loan market is a hybrid of the investment banking and commercial banking and that a significant change in large corporate lending occurred during the period as a result of replacement of old bilateral bank-client lending relationships with a much more transaction-oriented and market-oriented offered by syndicated loans.

Thus, for an Islamic syndicated financing to be a viable alternative to syndicated loan on a grander scale it must provide the same competitive features as that of syndicated loan. This include fast service turnaround in closing the syndication exercise. To this day, Islamic syndicated financing lags way behind syndicated loan due to the absence of uniform international Shariah principles that can assure borrowers and investors that their transactions and structures are Shariah compliant and differing Shariah approval process which results to longer turnaround time (Khaleq, Llp, Meher, & Office, 2016).

**Price**

Price is crucial in influencing the prospect of being mandated by the corporate customer and subscribed by the potential participant banks to make an Islamic syndicated financing a success. There are to types of prices in an Islamic syndicated financing which is similar to syndicated loan which are spreads and fees. Therefore, the formulation of pricing strategy becomes significant. However, the pricing of Islamic syndicated financing differs from syndicated loan, the latter pricing is by charging interest based on various pricing benchmarks such as cost of funds, LIBOR and KLIBOR. On the contrary, Islamic syndicated financing cannot deduce pricing in an exact manner as syndicated loan as it must adhere to the prohibition of Riba under the Islamic laws (ISRA, 2010)

As explained by Godlewski and Weill (2012), charging of spreads or margin for Islamic syndicated financing is based on a specific Shariah contract applied to give lawful effect to the transaction. There are two contracts that are widely used in Islamic syndicated financing namely Murabahah and Ijarah. Murabaha is essentially a mark-up sale; the financiers buy the good and sells it to the customer in exchange of a price that includes the original cost and a specified margin. The price can be paid in several instalments. While Murabaha at first instance looks like a simple loan with interest, there are differences. The first is the absence of interest in the sense that the “return” applies to the sale of the good and not the sale of money. The second is the prohibition against charging a penalty for default.
Ijarah is an Islamic form of leasing. The financiers buy the good and leases it to the customer for a given period and a given rent. The financiers do not make money from money in line with the prohibition against interest as it converts money into tangible assets to make the transaction. As resolved by the Shariah Advisory Council BNM (2003), an Ijarah contract, the rate of rental of an asset is negotiable between the lessor and the lessee. It can be a fixed rate for the whole tenure until maturity or a flexible rate that varies according to a certain method. In order to avoid any element of gharar (uncertainty), an agreed method must be determined and described upon concluding the contract. Subsequently, both contracting parties are bound by the terms until the maturity date of the contract. Any changes to the agreed floating rate shall be deemed as the risk willingly taken by both parties based on an upfront mutual agreement. In addition, the rate of rental must be known by both contracting parties. The determination of the rate may be made for the whole lease period or in stages. The rate may also be fixed or floating depending on its suitability as acknowledged by both lessee and lessor (AAOIFI, 2007).

The other pricing element is the fees. On top of earning a spread over a floating rate benchmark on the portion of the loan that is drawn, banks in the syndicate receive various fees (Allen (1990), Table 1). The arranger and other members of the lead management team generally earn some form of upfront fee in exchange for putting the deal together. This is often called a praecipium or arrangement fee. The underwriters similarly earn an underwriting fee for guaranteeing the banks.

**Table 1: Fees in Syndication**

<table>
<thead>
<tr>
<th>Fee</th>
<th>Type</th>
<th>Remarks</th>
<th>Islamic Syndicated Financing</th>
<th>Syndicated Loan</th>
</tr>
</thead>
<tbody>
<tr>
<td>Arrangement Fee</td>
<td>Front end</td>
<td>Also called praecipium. Received and retained by the lead arrangers in return for putting the deal together</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Legal Fee</td>
<td>Front end</td>
<td>Remuneration of the legal adviser</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Shariah Advisory Fee</td>
<td>Front end</td>
<td>Remuneration of the shariah adviser Price of the commitment to obtain financing during the first level of syndication</td>
<td>Yes</td>
<td>No</td>
</tr>
<tr>
<td>Underwriting Fee</td>
<td>Front end</td>
<td></td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Participation Fee</td>
<td>Front end</td>
<td>Received by the senior participants</td>
<td>Yes</td>
<td>Yes</td>
</tr>
</tbody>
</table>
The same bank can act in various capacities in a syndicate. For instance, the lead arranger can also act as an underwriter and allocate a small portion of the loan to itself and therefore also be a junior participant (Gadanecz, 2004). To the participating banks, syndication provides them with financing opportunities that have low marketing costs and chances to participate in future group financing. In developing countries, commercial banks which have less experience and exposure in loan syndication are assisted by the multilateral agencies who would typically provide additional security feature such as guarantee and standby letter of credit (Sein, 1996). Despite of the presence of additional securities, in general the transaction costs involved make Islamic syndicated costly. Its success depends on a well-designed credit agreement that provides for diverging interests of parties to the syndicate.

Cai, Saunders, & Steffen (2010) suggest that lead arrangers choose banks that have a similar focus in terms of lending expertise typically their close competitors and give these banks more senior roles in the syndicate and hold large portion of loan shares. Such organizational design of syndication benefits the borrowers by paying lower interest spreads. Reason being, syndicate members that are close to lead arrangers are delegated some monitoring responsibilities and thus can lower the overall loan syndication costs.

**Promotion**

Promotion includes a variety of communication activities to educate customers, increase awareness, increase demand, build brand value and recognition and provide differentiation. It
also refers to the methods applied to advertise and sell products and services. Pare (1990) states that the best promotional tool banks have available to them is the vast amount of information they have about their customer. In relation to Islamic syndicated financing, it is vital for banks to have built strong relationship with a corporate customer to be stand a high chance of winning a mandate to be the lead arranger for an Islamic syndicated financing exercise.

Zineldin (1996) further elucidates that it is important to understand how corporations are motivated in selecting the type of relationship is important for the bankers because it enables them to identify future corporate needs more effectively and to improve their ability to communicate with existing or potential corporations and to obtain the confidence of clients by showing how the bank understands their point of view. Because most banks offer the same core products and services, a differentiation strategy will be of great importance to those banks wishing to gain a competitive edge. Each bank should therefore develop and create differentiated products/services according to its resources and strengths. A competitive bank-key corporate client strategy provides banks with significant benefits.

Besides, Islamic syndicated financing should enhance its visibility through commercial advertisement. Although the first Islamic bank in Malaysia has been in existence over the last two decades, its presence in the market is either not really seen or significant. In fact, it is very uncommon to watch the advertisements of the Islamic bank products being broadcasted on television compared to other conventional banks (Kamarulzaman & Madun, 2013).

In addition, promotion of integrity, fairness, efficiency and liquidity through adoption of common standards for Islamic syndicated financing will help to improve market penetration of this product (Fabozzi, 1998). Besides, banks have incentives to report Islamic syndicated financing and syndicated loan data because in the syndicated loan market, league tables are a powerful marketing tool for both primary syndication and secondary loan sales (Carey, Post and Sharpe, 1998; Ivashina, 2005; Gopalan, Nanda, & Yerramilli, 2009). Lasinvolvement with development financial institution, multilateral agencies and international banks are critical in promoting Islamic syndicated financing (Star, 2014)

**Place**

The widespread global geographical footprint of banks matters in Islamic syndicated financing as cross-border facilities help to enhance the marketability of a syndication exercise by allowing the lead arranger to reach wider pool of investors or potential participant banks. Gadacecz (2004) finds that the syndicated loan market allows a more efficient geographical and institutional sharing of risk. Large US and European banks originate loans for emerging market borrowers and allocate them to local banks. Euro area banks have expanded pan-European lending and have found funding outside the euro area.
iii. Factors Influencing Banks’ Participation in Syndicated Loans and Islamic Syndicated Financing

There is an established body of academic literatures that investigates determining factors influencing banks decision to participate in syndicated loans (Altunbas, Gadanecz, & Kara, 2005; Dennis & Mullineaux, 2000; Panyagometh & Roberts, 2002; Pavel & Phillis, 1987; Pennacchi, 1988; Simons, 1993). These quantitative studies shared consistent findings which emphasized that regulatory capital, liquidity constraints and portfolio diversification as the three main factors effecting the syndication decision. Besides, banks’ decision to participate in syndicated loans is driven by the prospect of churning fee based income especially if a bank acts as the mandated lead arranger (Altunbas & Kara, 2011).

On the contrary, there is a dearth of academic literature examining the same from an Islamic syndicated financing standpoint. Nevertheless, Godlewski and Weill (2012) assert that Islamic syndicated financing shares several similarities with conventional syndicated loans. They are also provided by a syndicate of banks, and do not differ on the type of banks involved in the syndicate; i.e. Islamic syndicated financing does not exclude conventional banks. Most of the differences between Islamic syndicated financing and conventional syndicated loans relate to the principles of Islamic finance. Hence, deducing the variables from syndicated loan literature is justified.

**Portfolio Diversification**

A. Mugasha (1992) studies banks’ motives to lend by way of syndication. She finds that the principal motives relate to the diversification of the lending risk and the improvement of the bank's capital position. Due to huge loan size extended to some borrowers, their failure to repay the loan would endanger the financial stability of a single lending institution. The risk which banks seek to spread by entering into a syndication may emanate from an individual borrower, a geographical area such as a country or a region, or a specific industry (B. Howcroft and C. Solomon, 1985).

Besides, bank is motivated to participate in syndicated lending as it serves as an effective means of risk management because it spreads the risk of the loan over several lenders and reduces the likelihood of over exposure to a single borrower (Altunbaş & Kara, 2011; Godlewski, 2008). For larger banks more readily associated with arrangers, the syndication of a large loan is a method of risk management because it effectively spreads the risks of the loan over several lenders. As such, it decreases the lender’s exposure to a single borrower but simultaneously allows the lender to maintain an important relationship with the borrower.

Banks’ motivation to syndicate a loan instead of keeping it on their own books is mainly to reduce excessive single name exposure while maintaining the relationship with the borrower. The syndication process allows the bank to tailor its credit risk, adapt to requirements in regulations, reduce the overall cost of loan origination and earn fees (Bank of Norges Investment Management, 2014).
Dennis and Mullineaux (2000) study the factors affecting the decision to syndicate a loan. In particular, they found that the more transparent the borrower is, as evidenced by the existence of a credit rating or by being listed on a stock exchange, the more likely the loan is to be syndicated and sold in greater proportions rather than being kept at the banks’ books.

According to Loan Market Association (2013), a lender may consider that its loan portfolio is weighted with too much emphasis on a particular type of borrower, geography, industry or maturity. By selling its commitment in this loan, it may lend elsewhere, thereby taking advantage of new lending opportunities and diversifying its portfolio. Syndicated lending was applied to enhance credit quality of the bank’s loan portfolios. Smaller banks participation in a syndicated loan helps to develop new business and diversify their loan portfolio by extending credit to the sort of large borrowers that they would not normally do business with (Howcroft et al., 2014).

**Additional Fee Income**

Syndicated lending was used to improve the bank’s transactional returns (Howcroft et al., 2014). In comparison to a bilateral lending, syndication is a more competitive structure as it reduces the rate of lending costs, hence the return to the loan originator is greater and the borrower’s cost of financing is lower (Wild et al., 2004).

Besides, A.Mugasha (1992) suggests that banks are attracted to be managers of syndicated loans due to substantial fee that can be earned for managing that syndication. The syndicate manager (the bank that arranges the syndicate) earns an attractive management fee for syndicating the loan. This fee is in addition to interest and other fees that the bank may earn as a member of the syndicate. In a general scheme of fee distribution, a flat, front-end fee known as the syndication fee or management fee is paid to the syndicate manager for distribution to the management group, if any. Where the syndicate banks can easily be divided in two tiers of manager(s) and other banks, the management fee is retained by the manager(s). Where there are several tiers of banks and different categories of managers, however, the management fee will usually be split among the different tiers of managers.

**Access to New Markets and Clients**

Syndicated loans are predominantly a cross-border lending mechanism that allows banks to access new markets and clients (Gadanecz, 2004). Syndicated lending was an alternative to bilateral loans when banks were targeting growth or looking to utilise potential capital surpluses (Howcroft et al., 2014). In smaller syndicated loan markets, banks transfer external finance cross border while in larger markets, they are more inclined to take on riskier projects (Rainer.H, Paul.W, 2009).

**Leveraging of Resources and Expertise**

Smaller participant banks may be motivated to enter into syndicated loans in order to economize on these costs (Armstrong, 2003). Altunbas et al. (2005) and Jones et al. (2005) have argued that for larger credits, in particular, syndicated lending allows arranger banks to leverage the business
on the basis of their brand name and worldwide expertise/reputation. Another consideration is that because syndicated loans are publically announced, they might be beneficial as a means of advertising the activities of banks in the financial markets. This is important because having a presence in the market with higher visibility can be a key determinant of future business prospects (Howcroft, 1984). Besides, syndication also allows smaller participant banks to hinge on the arranging and monitoring expertise of larger banks. Institutional investors who do not have monitoring expertise disproportionately purchase loan tranches originated by banks able to offer both loans and underwriting services to firms (Neuhann & Saidi, 2016).

Agency Problem and Information Asymmetry

A syndicate is characterised by asymmetric information between the lead arranger and the participant lenders. Sufi (2007) examines how information asymmetry between lenders and borrowers influences syndicate structure. Consistent with moral hazard in monitoring, he finds that the lead bank retains a larger share of the loan and forms a more concentrated syndicate when the borrower requires more intense monitoring and due diligence. When information asymmetry between the borrower and lenders is potentially severe, participant lenders are closer to the borrower, both geographically and in terms of previous lending relationships. He further finds that lead bank and borrower reputation mitigates but does not eliminate information asymmetry problems.

Gopalan, et al. (2011) examine to what extent poor performance damages the reputation of the lead arranger and find that it does. Identical contractual conditions do, however, not mean that all members of the syndicate earn the same return. Hallak and Schure (2011) examine such return differences and find that large lenders typically receive a larger percentage of the upfront fees than smaller lenders and interpreted this is an indication that the fee structure incorporates anticipated costs associated with borrower illiquidity, notably the costs of coordinating the workout and providing liquidity insurance.

Bushman and Wittenberg-Moerman (2012), investigate the role played by the reputation of the lead arrangers of syndicated loans in mitigating information asymmetries between borrowers and lenders. Consistent with prior research (e.g. Sufi 2007, Ross 2010), they measure bank reputation based on lead banks’ market share in the syndicated loan market. They document that higher lead arranger reputation is associated with higher company earnings and cash flow persistence, and with corporate earnings that more strongly predict future credit quality of the borrower.

Chaudhry & Kleimeier (2013) find that information asymmetry has a substantial impact on the structure of loan syndicates. In particular, both the degree of information asymmetry by itself and its timing are important in determining the type of financial contract signed between the bank and the borrower.
Regulatory Capital & Liquidity

Mullineaux & Dennis (2000) study the factors that motivate loan syndications and identify that capital regulations play an important part in the syndication decision. Regulator typically limit the maximum size of any single loan to a bank’s equity capital and participants therefore use loan syndications as a method of managing debt concentration to be in compliant with regulatory requirements. They also found a banks liquidity position affects the syndication decision as banks in a tight liquidity position opting to syndicate loans.

This is because, a bank's ability to lend is subject to both internal and external requirements to retain a certain percentage of its capital as cover for its existing loan obligations. The secondary loan market is becoming an increasingly important tool for lenders to actively manage their loan portfolios to comply with regulatory capital requirements. If the loan is a long-term facility, a lender may need to sell its share of the commitment to realise capital and improve its liquidity to be able to take advantage of new lending opportunities (Loan Market Association, 2013).

Hubbard et al. (2002) investigate whether capital constrained banks charge higher yield spreads, and argue that the cost of borrowing from capital constrained banks will be higher than from well capitalized banks, particularly for borrowers facing substantial costs in switching to alternative bank lenders because of high information costs. His finding suggests that syndicated loans can be used by banks to alleviate regulatory capital constraints (Author, Hubbard, Kuttner, & Palia, 2002).

Jonathan et al (2015) confirm that in the event of an increase in capital requirements, firstly banks gradually rebuild the buffers they hold over the regulatory minimum so they remain constant. Secondly, in the year following an increase in capital requirements, banks, on average, cut (in descending order based on point estimates) loan growth for commercial real estate, for other corporates and for household secured lending. Loan growth mostly recovers within three years. These results may help quantify how changing capital requirements might affect lending in a macro-prudential policy framework.

Arranger Certification

Casolaro (2003) finds that interest rates decrease in the share of the facility retained by the arranger. This certification effect is greater for smaller, more opaque loans where screening and monitoring are more valuable.

Stefani & William (2008) show that certification by prestigious lead arranging banks creates economic value by reducing overall loan spreads compared to loans arranged by less prestigious arrangers. Banks participating in these loan syndicates, rather than the project sponsors, are the parties that pay for certification and do so by allowing top-tier arrangers to keep larger fractions of the up-front arranging fees, though overall fees are reduced when a prestigious bank arranges a loan.
Champagne & Coggins (2011) assert that the characteristics of the lead arrangers have been shown to be significant determinants of syndicate structure. For example, the proportion of the loan that is retained by the lead arranger has been shown to be negatively related to the reputation of the lead. The quantity and quality of information about the borrower have also been shown to have an impact on the syndicate structure; they are negatively related to the share retained by the lead lender and positively related to the number of lenders in the syndicate. There is a negative relation between loan rating and lead share. Loan syndicates can also imply a free riding problem which reduces each lender’s incentive to monitor and renegotiate if necessary.

4.0 CONCLUSION

Based on the above literature review, it can be concluded that there are seven factors that will influence banks’ decision and motivation to participate in syndicated loan and Islamic syndicated financing. These are risk and portfolio diversification, churning additional fee-based income, getting access to new markets, leveraging on lead arranger’s resources and expertise, agency problems and asymmetry information, regulatory capital and liquidity, and arranger certification. These factors should be considered well in the marketing mix strategies of banks when introducing Islamic syndicated financing to corporate customers and new investors particularly conventional investors. For Islamic syndicated financing to be a viable alternative to syndicated loan on a grander scale it must provide the same competitive features as that of syndicated loan. This include fast service turnaround in closing the syndication exercise. However, the challenge of reducing the cost of funds and the operational documentary efforts under each transaction remains. Besides, capital and intellectual rigor should be invested to build strong market platform for Islamic syndicated financing to function and unleash it potential at optimum level.
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