EFFECT OF SELECTED INTERNAL FACTORS ON FINANCIAL PERFORMANCE OF COMMERCIAL BANKS IN KENYA

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DECLARATION

This research project is my original work and has not been submitted for examination in any other university.

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D61/5427/2017

This research project has been submitted for examination with my approval as the university supervisor.

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DEDICATION

This thesis is affectionately dedicated to my mother whose sacrifice and interest in this, as in all my endeavours, was never less than my own.

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ABSTRACT

The banking sector in a nation plays a significant character in the distribution of economic resources and thus contributes to the growth in the economy through the provision of resources to lenders and the deepening of finance in the nation. From the finding, the financial performance of a bank is critical not only for the investors, but also for the entire economy of a nation and interdependent countries. The aim of the study was to determine the internal influences affecting the financial performance of commercial banks in Kenya. Explanatory variables of the study representing inner factors comprise of liquidity, bank size, loan advancement and financial risk. The financial performance of commercial banks was evaluated by the return on capital. The research was based on a descriptive research design and the study population was 40 commercial banks in Kenya. The research used secondary information from the financial statements of commercial banks for the period 2014 to 2018. Data from 30 commercial banks with data available for the five-year investigation period were analysed using descriptive measures of mean and standard deviation. The results of the study illustration that there is a constructive and important relationship between the liquidity, cost-income ratio and the commercial banks financial performance in Kenya with p-values of 0.04 and 0.01 correspondingly.

In addition, credit risk and organisation size had a constructive relationship with financial performance, although the relationship was negligible since their p-values were smaller than the cut-off point. Nevertheless, the loan advances were found to have a destructive and negligible relationship with the quality of commercial banks in Kenya. Considering the combined influence of the variables on the financial performance of the banks, the cost-income ratio had the highest positive influence, while the company scale had the least positive impact. The study found that the combined effect of the variables on the performance of commercial banks was 11.4%.

ABBREVIATIONS AND ACRONYMS

ANOVA	-	Analysis of Variance
CAR	-	Capital Adequacy Ratio
CBK	-	Central Bank of Kenya
CIR	-	Cost to Income Ratio
CMA	-	Capital Market Authority
EU	-	European Union
GDP	-	Gross Domestic Product
IT	-	Information Technology
NPL	-	Non-Performing loans
OLS	-	Ordinary Least Squares
ROA	-	Return on Assets
ROE	-	Return on Equity

CHAPTER ONE

INTRODUCTION

1.1 Background of the Study

The banking sector plays a significant function in the distribution of economic resources and therefore helps to enhance development of economy through the provision of funds to borrowers and by increasing the deepening of finance in the country (Ongore, 2013). Banks have the capacity and scope for preparing monetary assets and assigning them to profitable portions of an economy through their loaning framework and subsequently, changes in supply of credit directly influence the investment tasks and budget imperatives of firms and hence spending choices (Messai & Jouini, 2016). This indicates that when the profitability of commercial banks increases, it does not benefit shareholders alone, but the entire country as a whole. The commercial banks' efficiency is influenced by among others, internal bank factors. The available resources in form of assets, management of loan advances, operating expenses and the effective management of the day-to-day risks is potentially projected to influence the general bank performance. Banks should therefore seek to establish factors that determine its performance, because efficient and profitable banks will increase the sum of investment funds, while improving the performance of customer services (Saona, 2013).

The research was anchored on two theories, namely; Risk-Return theory, Market-Power theory, Loanable Funds Theory. The risk-return theory (Bhattacharya & Thakor, 1993) opines that there is a constructive relationship between a bank performance and its levels of capita. The concept suggests that a high level of leverage will likely result in high expected returns and therefore implying that if a bank reduces its equity to resources ratio, then the effectiveness of the bank will growth.

The Market Power theory (Bresnahan & Lau, 1982) argues that, the commercial banks performance is influence by the marketplace structure of the business, such that a market concentration increases a bank profitability. A bank market power affect affects the industry market structure which further influences the bank performance. Similarly, the Loanable Funds Principle recommends that the price of a loan is similar in comparison to the value of modern consumption and funding above and past modern-day earnings. As a result, borrowers like commercial banks that can problem money prolong their stability sheets by means of simultaneously increasing their financial belongings and liabilities through the created deposit (the borrower's income).

The Kenyan commercial banks' performance has revealed mixed results in the last five years (Cytonn, 2018). While the top five commercial banks, in asset and customer numbers, registered profits that cumulatively form 78% of the total profits that all the banks recorded in 2018, the other 36 commercial banks could only generate the balance of 22%. This means that there is a high concentration of profitability in to a few banks. The question that comes into the fore is whether the performance particularly in financial domain of these banks is as a result of its internal resources or due to better strategies that the banks have adopted. The banks' management have control over their assets, cost efficiency strategies, capital adequacy, and liquidity level and management utilization of the resources at its disposal to generate improved income to its shareholders. This therefore called into the need to try and establish the influence of internal features on the financial profitability or loss of Kenyan banks.

1.1.1 Internal Factors

Previous researchers have recognized various factors that may affect bank performance either positively or negatively and have categorize them into two main groups; external and internal factors. The internal variables that influence company profitability are defined by Owoputi, Olawale and Ademola, (2014) as variables that are affected by leadership strategy, goals and decisions. Ahmad (2014) differentiates them into two, namely management and bank specific factors while defining internal factors that define the general output or bank performance. The impacts resulting from the management are the outcomes of variations in leadership strategies, decisions, goals and behaviour expressed in the variations in banks ' operational performance, including profitability. Zimmerman (1996) noted the significant contribution made to the performance of banks by management decisions, in particular on loan fund concentration. Furthermore, The aspects that come from profit-and-loss and/or balance sheets accounts in bank and refer them as internal aspects that had an influence to the performance of commercial banks (Huizinga 2000)

In most cases, the management team is responsible for the internal factors of a bank which are thought to have an impact on bank profits (Gul, Irshad & Zaman 2011). The cost regulation is one of the main factors in internal market aspect that affect bank profitability, since the influence of bank expenditure can increase profitability, providing banks with the opportunity to regulate it. In most cases, there are exterior and interior aspects that impact the financial performance of the bank because financial managers are committed to maximizing the wealth of shareholders. Management control is not governed by outside aspects like GDP, inflation rate, currency

fluctuation and the political environment of one country. However, the leadership can manage internal variables such as costs and leverage levels. Hence, as the Resource Based View suggest, a firm performance will foremost be influenced by the effective management of internal resources.

A number of internal factors have been proposed by numerous researchers, which affect a bank's financial performance. Daly and Zhang (2014) notice that the internal factors that affect profitability specifically define the Chinese companies' determinants: price, liquidity and magnitude have a beneficial and substantial effect on their profitability. Guru, Staunton, and Balashanmugam (2012) similarly state that bank size, liquidity, credit, investments, equity and risk management, as well as expense management, are internal factors which are considered to affect bank performance. Thus, Duraj and Moci (2015) have come to the conclusion, in their citation to Wall (1985) that the internal factors of a bank relate to asset management and the liability, the management of the funding activities and the control of non interest costs.

1.1.2 Bank Performance

Borman and Schmit (2015) describe organizational performance as a multidimensional paradigm on which measurement of several factors is based. Aguinis and Kraiger (2012) define firm performance as the point to which a company attains its mission, vision and objectives that is measured in terms of quality service, customer satisfaction and increased profits. In addition, Jiménez-Jiménez and Sanz-Valle, (2016) grouped organizational performance into the following categories; business performance, financial performance and organizational effectiveness. Koontz and Donnell (2010) for their portion, indicated that corporate performance means that a company can achieve such simple goals as elevated profit, enhanced market share, new product

development, excellent fiscal performance and long-term sustainable development over the long term. Further, Moullin (2007) assert that firm performance is a means through which a firm provide value to its stakeholders and therefore is an indication of how well the managers succeed in utilizing firm resources to generate income to the firm.

A bank should endeavour to register positive financial performance for its sustainability to be guaranteed, as well as be in a position to increase its shareholder wealth. A positive financial performance implies that the bank management are able to pay off its expenses and also be in a position to remain with a surplus which can be distributed to the shareholders and finance the organization future investment (Brissmis & Delis, 2005). Moreover, a nation relies on the results of commercial banks for economic stabilization. The importance of a bank's economic results therefore goes beyond a bank's full economy. Sufian and Habibullah (2010) assert that bank profitability acts as an important ingredient of financial development, not only to the individual commercial bank, but rather its relevance spans through to providing necessary macroeconomic stability. At the company stage, greater returns thus largely reduce loan fragility while increasing profitability at the global stage leaves a viable banking industry capable of funding financial growth and development.

Various methods of measuring the performance or success of a company have been used. The success of a company can be evaluated depending on the value creation to the stockholders according to Carton (2004). Multiple measurements of performance are used in previous studies. In order to assess corporate performance, Lumpkin and Dess (1996) used marketing development, market share, profitability and general performance. Mokhtar et al. (2014) used the four measurements of performance: client retention, new brand achievement, marketing development and investment return to evaluate market focus and business results. The proxies

frequently used as total profit-to-equity proportions (profit-to-equity proportions) are included in the prior literature. This study therefore assesses the effectiveness of the Commercial banks on the basis of asset return (ROA).

1.1.3 Effect of Internal Factors on Performance

A bank management's main purpose is to make a profit from its activities as an essential requirement for any undertaking (Bobakova, 2003). The Commercial banks ' performance was found in previous studies, are influenced both internally and externally. However, leadership choices and objectives of the bank leadership influence the internal factors. Athanasoglou et al. (2005) highlight that internal bank factors may be dividable into financial statement variables which are influenced by decisions by management and non-financial statements variables such as branch numbers and the status of banking branches. Indeed, the variables that originating in the bank records are (equilibrium table and/or profits and losses reports) and therefore can be described as micro-based or bank-specific profitability determinants was noted by Demirguc-Kunt and Huizinga (2000). The internal aspects are aspects not associated with the leadership of the bank.

Trujillo-Ponce (2013) indicates that equity sizes, account sizes, liquidity danger, loan risk and governance effectiveness are the inner factors determining loan profitability. As leadership of the bank varies from other strategies in relation to its leadership and control of hazards and objectives related to its activities, the profitability of each bank is anticipated to differ also depending on the variables that have an influence on the hazard and yields of the banks. In

Pasiouras and Kosmidou (2007) it is argued that the reduced expected bankruptcy costs as capital ratios boost companies with a greater output compared with investment. Likewise, Al-jafari and Alchami (2014) indicate that companies which have elevated overhead costs with regard to investments will record decreased profitability, thereby promoting the need for bank executives to manage their operating overall expenses more efficiently. The size of the financial institution as a proxy for total assets generates economies of scale, thus enhancing profitability. Kosmidou (2008) does however believe that big organisations, which could reduce the efficiency of these groups of companies, are often influenced by rigidity, inertia and bureaucracy. With regard to the connection between the internal Bank variables and its impact on financial achievements, the Bank is anticipated to increase its financial performance in terms of high asset ratio, decreased risk, a strong leverage ratio and enhanced cost efficiency.

1.1.4 Commercial Banks in Kenya

The Banking area currently consists of 40 banks, eleven of them listed at the NSE. With respect to market share, Kenya Commercial bank dominates assets and deposits, whereas equity is responsible for loans and penetration (branches and network). Kenyan Commercial banks are governed pursuant to the regulations of the 1995 banking act (CAP 488) with a view to ensuring general soundness and sustainability of Kenya's financial system, which are then provided by the Prudential Guidelines and Regulations. The C.B.K Act, CAP 491, also directs the link between the local banks and the regulator..

According to CBK (2017) annual report, the branch network of Kenyan banks declined by 10%, reaching 2,968 branches in 2016 as compared to 3,289 branches in 2013. This decline in the bank’s branch network is attributed to the banks automating most of their services and therefore

making the visit to physical branches unnecessary. Moreover, bank deposits increased by 18.8% in 2018 as compared to 2017 to stand at Ksh 2.8 trillion as at the end of 2018. Further according to Cytonn investment (2018), the banking sector registered improved efficiency in operations as the cost to income ratio (CIR) deteriorated to 56.3% in the last quarter of 2018 as compared to 59.9% in Q3 of 2017. This enhanced effectiveness was due to interventions such as branch closure, compulsory retirement plans and digitalization policies to reduce operational costs. Similarly, the banking industry has witnessed increased consolidation with seven acquisition registered between 2013 and 2018.

This could be ascribed to the decline of asset worth of the bank with the NPL increasing by 23.8% in 2018 to stand at Ksh 204 billion (Cytonn, 2018). According to CBK (2018), the average profit on equity for the banks increased to 18.8% in 2018 as compared to 16.2% in 2017. Due to diversification of the bank operations, the bank's non-interest revenue as ratio of entire revenue averaged 34.5% in 2018 as compared to 26.5% in 2016, an improvement that can be attributed to improved management efficiency and decisions. Hence, the bank performance has been improving despite the increased inflation in the country during the period, implying that effective management decisions positively affect the bank performance.

1.2 Research Problem

Banking is an essential element of the countrywide economy and can deal with adverse effects and lead to stabilization of the financial scheme. As a result, the efficient functioning and effectiveness of the investment region has turn out to be one of the principal goal of financial policy in many countries (Kenjegalieva & Simper 2015). Commercial banks ' efficiency is affected by countless variables, internally and outward, and so it is crucial for the sector to know

how they influence separately and jointly on their results. Effectiveness of the bank is directly influenced by inner aspect like management, bank size, cost management, risk and equity management, most of which are confidential. Contrary to external variables, the leadership of the individual banks controls internal variables (Gul et al. 2011). Consequently, different banks need to understand how internal banking factors influence their effectiveness and the economy in general.

Over the previous years, Kenyan Commercial banks have been faced with increased competition from within the industry and also from telecommunication companies that have started encroaching to what has traditionally been the preserve of commercial banks. Lending and money transfers is no longer the preserve of the traditional commercial banks but also many other lending institutions that depend on the power of mobile apps to lend to borrowers. This changes as resulted in the drop of the profit, especially for tier 2 and 3 commercial banks (CBK, Supervisory Report, 2017). In addition, the introduction of interest capping law in (2016) has impacted negatively the interest revenues of the banks. Under such operating environment, it is important that banks look inwardly to establish what internal factors will be applied to improve their financial performance.

Bank performance determinants have drawn the attention of various scholars at the international and local levels. The bank-specific parameters that influence the bank's profits, industry and the macroeconomic factor in Nigeria were examined in Owoputi, Olawale and Ademola (2014). The research demonstrated the significant and substantial impact of capital adequacy, bank sizes, productiveness growth and profitability on profitability. But the effect on bank performance as a result of industry-specific variables could not be estimated directly. In Almazari's (2014) study, as opposed to Saudi Arabia and Jordan, more thoroughly examines the impact on banking

profitability of inner variables. In the Saudi banks the ROA, the combined assets and asset returns have had significant beneficial connection. However, the bank's size and net income indicate a destructive correlation with the bank's outcomes. In transition countries in northern and Eastern Europe Djalilov and Piesse (2016) analyse the factors determining banks' profits. The results indicate that the efficiencies of such banks vary from transition economy to premature transition and that bank profitability and that the impact of credit hazard in premature transition countries is favourable.

The financial performances determinants of the Kenyan commercial banks were reviewed by Ongore and Kusa (2013). The findings show that commercial banks' performance in Kenya is substantially impacts by the particular bank factors other than liquidity, although macroeconomic variables at a substantial rate of 5 per cent have not been conclusive. The function of property as a moderating variable was also irrelevant. Kiganda (2014) studied the influence on profit margins of commercial banks on macroeconomic variables in Kenya: Equity Bank Limited Case Study. Macroeconomic variables like as actual GDP, exchange rate, and inflation have had a small influence on Kenya's bank revenues, as shown by the outcomes. The impacts of liquidity on competitiveness of Kenyan commercial banks were researched by Lukorito, Muturi, Nyangan and Nyamasege (2014). Their results show that liquidity has statistically important and beneficial connections with the profits of the banks.

Using the aforesaid studies and earlier investigation on the determinants of bank effectiveness, most studies have studied the effect on the overall commercial banks performance on both internally and externally structured factors. Furthermore, findings on commercial banking performance were uncertain and therefore the effects on the performance banks in advanced nations such as Kenya of internal variables monitored by the Bank Management must be

identified. While a detailed research has been done in Asia, operating conditions and legislative structures differ. Consequently, this research sought to fill this gap by addressing the following research question: what was the impact of internal factors on the output of commercial banks in Kenya?

1.3 Research Objective

To determine the effect of the selected internal factors on the financial performance of Commercial banks in Kenya

The specific objectives were:

i. To determine the effect of liquidity on financial performance of commercial banks in Kenya
ii. To establish the effect of loan advancement on the financial performance of commercial banks in Kenya
iii. To determine the influence of financial risk on the financial performance of commercial banks in Kenya

1.4 Value of the Study

The features that determine the commercial banks performance is not only be beneficial to academics but also to the policy and regulatory stakeholders. Internal factors to a bank is determined based on the risk-return trade off and therefore the study enriches the risk-return theory by establishing how the loans advances need to be balanced with the need to have adequate cash and cash equivalent portfolio to maintain the liquidity of the bank. Also the study increases knowledge on loanable funds theory by seeking to determine the level of loans subject to the customer deposit.

For the regulators, it is more important to come up with policies that will manage both internal and external factors like inflation, exchange rate and political instability. Therefore, the study has helped in setting limits on those regulator policies that affect the lending and capacity of debtors to pay back the loan. This research therefore has significant implication as it will assist banking policy makers in Kenya in developing and implementing potential strategies and policies to improve and maintain the profitability and stabilization of the banking region.

The research might assist commercial banks to concentrate on the outcome of inner variables on performance within management control. The leadership of commercial banks may therefore be easier able to decide on finest internal procedures in an informed manner. This research is also contributing to the wider field of commercial bank since its proposition contributes importance to enhanced bank lending and service quality procedures.

This study also contribution to university investigation in the broader area of credit management. This study is not only used by potential researches as a guide type for future studies but suggests that potential research operations can be explored the outcomes of this research is useful to Kenyan shareholders and bankers who are aiming at increasing the effectiveness of the banks.

CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

This portion entails other researchers working on bank performance determinants, including: theoretical framework, bank performance determinants, empirical reviews, a literature review summary and conceptual context.

2.2 Theoretical Framework

This part contains principles that show the connection between inner aspects that determine the commercial banks' financial performance in Kenya. The investigation is being supported by:

2.2.1 Risk – Return Theory

Bhattacharya & Thakor's (1993) Risk Return Theory argues that the profits and capital of a bank have a positive association with the glassy of its capital. The theory states that bank capital and profits are negatively related, and thus as bank increases its leverage, it is likely to experience a higher projected returns. That indicates that if a bank wants its profit to be increased by raising its leverage, it must reduce the equity to asset proportion (Seelanatha, 2010). The liabilities of the companies, on the other side, are due debts that give the banks an impetus benefit over other intermediaries. This was because a large stage in debt field management risk and financial services commitment was revealed to the Bank by revealing an increased risk of insolvency within the bank's capital structure. In addition, the challenging characteristic of debt improves quality and safety problems by raising cash risks, which stimulates companies to maintain a close watch on their debtors (Olweny & Shipo 2011).

The concept of risk returns also indicates that a bank that has a strong investment value chance can be too risky to decrease its credit risk by incorporating additional labour and physical capital to enhance loan evaluation and credit monitoring (Athanasoglou, 2008). In the context of the proposition of the risk-return theory, it can be held that indeed the level of investment (Assets) held by a bank will determine the performance of the bank since, ceteris paribus, the bank will be able to lend more to borrowers and also that the bank liquidity risk will be lower. With low liquidity risk, investor confidence increases and therefore the returns. The level of over-night borrowing witnessed by the banks will likewise be lower and therefore cushioning the bank against excessive interest charges for such borrowing.

The risk-return concept is important in this study as it promotes the opinion that a bank's equity foundation directly affects companies' efficiency. The essence of a capital structure adopted by a bank is an internal feature of leadership. The leverage position is determined by the bank shareholders through the management and if the leverage position affect the level of risk and therefore returns, then it implies that banks should establish their internal optimal capital structure that achieves an optimal risk-return trade and therefore by extension the bank's performance. Hence this principle is imperative to the current research because it recognizes the role of internal factors in the firm's performance**.**

2.2.2 Market – Power Theory

Bresnahan and Lau (1982) advanced the theory of market power and suggests that commercial banks ' performances are affected by the market structure of the business. The principle stipulates that as market concentration bank profitability reduces if companies in the industry don't have

collusion behaviour. Thus, if the bank profit increases with increasing concentration, it implies that businesses in the industry collude to make oligopoly profit.

Molyneux (1993) stresses that Market Power Theory also provides that a higher concentration in markets can result in high profits from efficient companies due to increased market share and growth in size. Molyneux and Thornton (1992) did however seek to encourage this concept by showing that the bank's ratio of concentration has a good and statistically vital link with the effectiveness of a bank and, consequently, corresponds with the traditional structural behavioral paradigm. On the other hand, research by Staikouras and Wood (2004) shows an adverse and statistically insignificant connection between bank intensity and profit.

The market power theory supports globalized market position that banks operate in presently, the market structure, as defined by the level of market interdependence within the industry players, support sectors – for example, the telecommunication industry and the regulatory environment will influence the internal decisions made by managers. This position held by the theory is therefore valid in the present day business environment that Kenyan banks operate in.

As Kelly (2010) highlights that the market power principle states that the structure of the market of banks affect competitiveness which additionally affects the general bank performance, it is persuasive to argue that if the number of banks is limited to a small number in an economy without compromising on the industry efficiency, then it is expected that the banks will have the ability to register increased profits. Under such an environment, the difference in banks' effectiveness can be expounded by the efficiency level of the banks. This can be supported by the present position whereby banks that have invested heavily in automating its services are associated with increased earning (Njuguna, 2015). Banks that have increased efficiency are

therefore more likely to increase their shares in the market and bank size, leading to excess profit.

2.2.3 Loanable Funds Theory

The concept was advanced originally by Robertson (1936) and further refined by several scholars (Ohlin, 1937; Tsiang, 1956). The theory suggests that a loan price is similar to the current consumption costs and investments that are higher than the current revenue. Therefore lenders such as commercial banks that can issue money are able to expand their balance sheets by increasing their financial assets and liabilities simultaneously through the deposit created (the borrower's its money). The loanable finance theorists therefore believe that increased savings by lower consumption and government deficits would lead to increase in credit supply, higher capital stocks, greater future revenue and low interest rates.

Therefore, the loanable fund theory suggests that a higher expected return on banks ' loans should increase the savings income in banks and this may make individuals to invest less in alternative investments, such as property and corporate assets. As a result, the lower demand for these assets may lower the prices. This wealth of the people who own these assets will reduce, which could affect their spending willingness. This position is plausible in the current research in that the amount of liabilities to the banks due to the customer deposit will result in increased bank liability and there is need for commercial banks to generate higher returns from the fund’s investment in order to create increased shareholder value (Wagacha, 2001).

The loanable funds theory applies to this research as it notes that interest rate fluctuations affect certain assets' value, such as equity prices and real estate. As a result, lower investment interest

rates will rise asset prices and bank valuation. Consequently banks should put in place mechanisms that will lead to a lower interest rate charged on the loans advancement by banks.

2.3 Determinants of Bank Performance

A firm's financial performance is dependent upon different features that range from firm specific, industry dependent and the overall economy factors. According to Mirza, and Javed (2015) the performance of a firm is of importance to investors, stakeholders and the economy and thus, the factors that will impact its performance will be of importance to the same group of stakeholders. Francis (2013) suggested that these variables may be divided into company variables, industrial determinants and macro-specific variables, as regards the different variables which affect a company's efficiency.

2.3.1 Internal Factors

The internal factors are particular to the firm and they impact the revenues and expenses of the firm. Imazari (2014) highlights that profits and capital adequacy, quality of assets, operational efficiency, and development of company investments form popular indices used to evaluate business performance. Therefore, internal factors, like decisions of the management on company dimensions, cost and risk management directly influence profitability, since most of these factors remain confidential and under the control of the company's senior management. Other internal factors which have been found to affect the firm profitability include the firm level of liquidity and the management of its working capital (Yasser, Entebang & Mansur, 2014).

The ownership of a firm has been determined by Mirzaand Javed (2015) to have a major effect on corporate results. By citing Olweny and Shipho (2011)), they assert that the ownership of a firm can either be owner controlled, management controlled firms in which there exist a dominant shareholder and the externally controlled companies in which executives are not the principal stockholders. The agency theory says that if the company has the stakes it can increase the wealth of its shareholders. Sangmi and Tobassum (2010) also states that agency costs increases when the company is managed by external persons and are inversely associated with the concentration of internal ownership but directly related to external ownership. Moreover, enhanced internal ownership is linked to heightened R&D expenses that boost business expenditure and therefore causing an rise in the phase of competitiveness and performance.

The bank-specific factor is the resource that directly impacts the profits of a given bank these factors includes current assets, fixed assets, credit portfolios and other resources. The bank's age or duration of service is frequently connected with growing resources (magnitude) (Athanasoglou, 2005). The bank's credit is the biggest asset which produces the biggest proportion of the companies ' revenue. Loans are the biggest asset commercial banks generate income from. The credit portfolio performance determines banks ' profitability. The performance of the credit package affects the effectiveness of the bank directly. A bank's highest risk is the losses arising from unlawful loans. Therefore, the best way to achieve asset quality is through minimal non-performing credit ratios. Various academicians have used different financial ratios to investigate banks ' efficiency. When the non-performing to total loan ratio is low, this shows the good health of the bank. A small ratio shows that the bank has a high chance of achieving higher profitability.

Wang and Sarkis (2013) argue that the corporate governance procedures that a company leadership follows also affect a company's performance. Various researchers believe that best practices in corporate governance improves the company's performance. The leadership activities are aligned to the shareholder income maximisation goal by corporate governance principles, such as security of shareholder rights, stakeholder privileges, correct reporting and transparency of financial information reports. Berger and Bouwman (2013) endorsed this stance in a research that examined the capital's effect on bank performance, which has found a substantial link between investment arrangement and company productivity.

Sangmi and Tabassum (2010) have recognized that the capital structure of a company have a substantial result on performance. Capital structure relates to the debt / equity finance ratio and it means that in instances of elevated debt funding, there is also some tax and supervisory advantages connected with debt financing that may be confronted by some bankruptcy danger. It also alleviates the dispute between agencies by decreasing the company's free cash flow. Abu-Rub (2012) reports that a company has to define its perfect capital structure which produces highest income for the organisation, as too little equity financing greatly improves shareholders' control. Dang (2011) evaluates the adequacy of the assets based on the resource adequacy (CAR) percentage, which reveals the bank's internal strength for crises resilience. The equity proportion corresponds directly to the bank's crisis resilience. It also impacts the profitability of banks directly by identifying their growth towards hazardous but cost-effective enterprise or sector opportunities (Sangmi & Nazir, 2010).

A company risk management has also had an impact on a company's performance because risk tends to attract only investors taking risks (Ramadan, Kilani & Kaddumi, 2011). The risk-and-return relationship must be managed to ensure that investors get the returns associated with their

risks and are expected to bear them. The performance in a firm has also been influenced by various features of the firm like its size, liquidity, sales and rate of growth. Because companies with a faster pace of development can afford stronger equipment, then they are able to gradually boost the company's asset and size. Large companies are attracting stronger executives and employees who add to the business ' results.

Effectiveness of management is an inner factor in the bank's profitability. The financial ratios are numerous, including general growth of assets, loan growth and earnings growth. Operational efficiency also represents a further aspect of achieving leadership performance, especially in operating cost management. Subjective evaluations of organisational and leadership structures, command structures, quality of staff and others (Sufian & Habibullah, 2009) often qualitatively demonstrate leadership efficiency. Some financial ratios however are a proxy for the effectiveness of management. The management's ability to effectively use its funds, boost profit and lower the operating costs can be analysed using financial ratios.

2.3.2 External Factors

In fact, macroeconomic control variables that prevail in a specific moment determine the output of a company. The prevalent variables comprise of inflation, long-term interest rates and a prevalent level of economic growth in one nation, according to Panayiotis, Athanasoglou, Brissimi and Delis (2008). Similarly, studies have established a link between the macroeconomic variables and firm risk exposure because for a firm that has dealings with partners using different form of currency, then, the changes in the foreign currency rates will increase the volatility of the

asset operations expenses and asset level. In fact, Berger and Bouwman (2013) demonstrated how important macroeconomic factors are in determining banks ' effectiveness.

The outcomes indicates that the effectiveness of the bank in terms of development of Gross Domestic Product is significantly constructive and the parameter of measurement is significant for both the pre-crisis and the sample as a whole. Similar to Li (2007), the research finding from Ramadan (2011) indicate that businesses were not benefiting from economic growth and emerging opportunities for profitability. The introduction of fresh banks into the sector may be one justification, which resulted to more intensive rivalry. The results of Poposki and Pepur (2012) have shown that economic development has an impact on Macedonia's banks profitability.

During the era 1988-1995, Dietrich and Wanzenried (2011) discovered that macroeconomic volatility and laws had significant effects in the bank balance, while trying to identify the determinants of profit margins in six EU and US companies. The outcome was a major trade-off between guaranteeing bank solvency as described by the elevated equity-to-asset ratio and reducing the interest rate to customers by the reduced price margin. In addition the cyclical business cycle nature of firms will have a direct effect on entities such as banks that depend on the individual performance of the client firms. Mirzaei, Moore and Liu (2013) have found, for example, that macroeconomic variables such as the GDP level of increase and inflation expectancy, while using a Panel data method, are critical to determine bank returns over time.

2.4 Empirical Studies

Ismael (2016) has investigated the effects of the profitability management of KSE-100 Index Pakistani firms. For his study, descriptive statistical analysis, analysis of correlation and

multivariate analytical regression tools were used. Results of the analysis show that liquidity factors have considerable beneficial effects on profitability (ROA) and their current ratio and cash alteration series. The study therefore indicates that companies should easily adjust the marketing strategies of their credit sales and create an inventory and collection turnover scheme that is more available to many clients. Although the research examines the liquidity management dimension and its outcome on the effectiveness of the companies, the size of the companies under study is big because of the differences between countries and the particular variables which affect the company's efficiency.

The causality of the liquidity and effectiveness relationship of the Nigerian Money Deposit Banks was investigated by Odunayo and Oluwaféyisayo (2015). By taking a panel research design approach, scientists collected data from 15 banks in Nigeria from 19 of the existing deposits banks. Research findings suggest that there are signs of the unidirectional causality relation between liquidity and profitability for certain companies, while the findings demonstrate that the liquidity and efficiency of these companies exist bidirectional for other banks. The study is different from the current one in terms of the scope and geographic size. In the case of banks quoted on the Lagos security exchange the study focuses on Nairobi security exchange and non-banking companies.

Petria, Capraru and Ihnatov (2015) sought to recognise the determinants of the profits of a bank among countries in Europe. The study used the ROAA and the REROE to establish the bank's efficiency and the determinants were split into bank non-bank variables. The research used correlation and regression techniques to analyse data using SPSS. The results of the research

reveal that loan and liquidity risks and leadership effectiveness, company diversification, concentration and economic development have an influence on banking effectiveness both for ROAA and for ROAE, and have been supported in previous research. Other researchers have suggested the same results (Trujillo-Ponce, 2013; Sufian & Habibullah, 2010).

Al-Jafari & Alchami (2014) tried to observe the features that influence the effectiveness of banks in Syria. In its research, which collected unbalanced data from the 2004–11 panel, the main factors for banking profitability, including bank, industrial and macroeconomic factors, were recognized. The conclusions show that all particular variables of the bank such as the credit risk, liquidity risk, bank size and effectiveness greatly influence the level of bank profits. But the concentration ratio of banks did not affect bank profitability.

Zygmunt (2013) attempted to evaluate the liquidity impact on profitability of registered IT firms in Poland. During the study, the methodology of ordinary least squares (OLS) was used for regressing 26 listed IT companies between 2000 and 2010. The empirical findings demonstrate the liquidity-profitability connection between IT companies. The research could not, however, determine the liquidity / profitability trade-off of the companies.

The research on subject of impact of the liquidity-profit connection between Ghanaian listed banks by (Boadi 2013). The study took a longitudinal time and was of a descriptive nature. Document analysis was the major research method for the collection of secondary study data, covering the time period from 2005 to 2010 in which both bank liquidity and profitability decreased. This result is in agreement with Bourke (1989), who discovered that from 1972 to 1981 90 banks in Europe, North America and Australia had a noteworthy relationship between the liquid capital and bank effectiveness.

Anjum and Malik (2013) evaluated the determinants liquidity on a corporate level basing on cash holdings among 395 listed firms in Pakistani. The research covered the period 2005 -2011 and adopted ANOVA, Pearson correlation, multiple regression and descriptive statistics in its analysis procedure. Excluding sales growth, the results showed a significant linkage between cash holdings and selected variables. But while the study reflects the current study, the effect of bank particular aspects was not linked to the bank performance.

The 2013 research by Ongore and Kusa looked at the economic variables of Kenya's commercial banks. To determine existing relationships, the scientists employed the linear multiple regression system and the least square in panel information. The results illustration that the output of commercial banks is affected significantly by factors specific to the bank except liquidity. However, the effects of macroeconomic variables at 5% were not conclusive. In the same capacity, the study also found that the role of ownership identity as a moderating variable was insignificant. In this context, in Kenya, banks' performance is primarily run by decisions made by the management of specific banks, whereas macroeconomic variables make an insignificant contribution to banks ' performance in Kenya.

2.5 Conceptual Framework

It is a diagrammatically oriented study instrument designed to help the researchers to develop and interact consciousness and knowledge of the topic under review. The research aims at determining how the particular internal bank aspects influence the commercial banks performance in Kenya. Therefore, Figure 2.1 expresses the relationship.

Independent variables	**Dependent Variable**

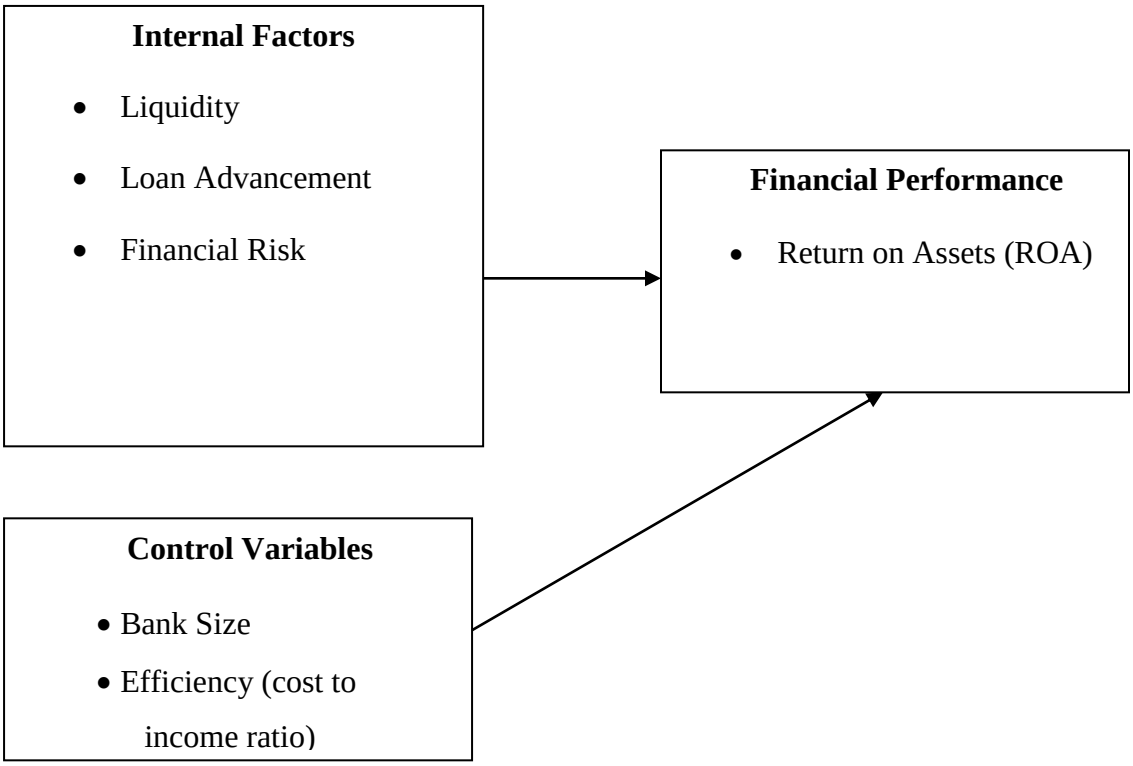


Figure 2. 1 Conceptual Model

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Introduction

In this segment the core subject of discussion was the methodology that was accepted in the research with the aim of attaining the objective of the investigation. Therefore the section focus on research design, target population, procedures for data collection and analysis of data.

3.2 Research Design

A descriptive approach research was used in this study since the key intention of the investigation was to recognize the nature of existing relationship between the variables

considered in the research. Descriptive research allows collection of independent information from the respondents without manipulation or altering the environment. The reason for using this design is that descriptive research reports and determines the way things are (Cooper & Schindler, 2007). Hence the data/ information was composed and analysed the way it is without researcher manipulation.

3.3 Population and Sample

The examine population consisted of all business banks working in Kenya. Consistent with the (CBK), as on the end of 2018, there were 40 banks running in Kenya (appendix ii). This advanced the population of the investigation.

3.4 Data Collection

The secondary data that was used in the research was obtained from the commercial banks annual reports and financial reports from 2014 – 2018 and the World Bank data relating to Kenya in the period under review. The researcher collected data that facilitated measurement of the bank liquidity position, investment in loans, leverage position and level of financial risk from financial statements. In particular, the researcher sought to determine the level of cash and cash equivalent, total assets, total equity, net credit facilities and total operating expenses.

3.5 Diagnostic Test

The competency of the information was assessed by the uncertainty test and the presence of the multicollinearity for the variables. In current research, normality is tested using Shapiro-Wilk and Kolmogorov-Smirnov Test. Shapiro-Wilk Test is suitable for sample sizes that are small like in this study. Test of multi-colinearity evaluates the high correlation of independent variables. It is when two or more predictors are extremely linked in the model contributing to inaccurate and uncertain measurements of regression coefficients and therefore bizarre outcomes in studying how easily the independent variable is understood. The Wooldridge F-Statistic Serial Autocorrelation Analysis was performed to check the correlation rate. Serial correlation test was performed to test the correlation level. Heteroscedasticity test was used to inspect if there is dissimilarity in residual variance of the period of observation to another (Godfrey, 1996).

3.6 Data Analysis

The SPSS version 22 was used in analysis of the data. The association between the variables was established with correlation analysis. Also used to delineate variable features were descriptive statistics, for example the average and standard deviations. The regression analysis was used to determine the link between internal factors of banks and their impact on performance.

3.6.1 Analytical Model

The model of analysis took the following form:

$$Y = \beta o + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4 + \beta_5 X_5 + \boldsymbol{\varepsilon}$$

Where:

Y	=	Return on Assets, measured through the ratio of internet profits to complete assets
X_1	=	Liquidity ratio; measured by, = money and cash equal to whole assets
X_2	=	Loan advances Portfolio, as measured by =Net credit score amenities / Total assets
X_3	=	Cost earnings ratio as measured by, Total working prices / Total working income
X_4	=	Credit chance as measured by, Net credit score facilities / whole deposits
X_5	=	Firm dimension = Log of Total Asset
$\boldsymbol{\varepsilon}$	=	Error term

3.6.2 Tests of Significance

The researcher performed an F test, to check the significance of the independent variables in relation to the dependent variables. The value of variables was interpreted at a significance level of 5%. The variable with p-value 0.05 and lower was regarded as significant while the variables with p-value better than 0.05 was considered insignificant.

CHAPTER FOUR
DATA ANALYSIS AND FINDINGS

4.1 Introduction

This part represents the evaluation and outcomes of the investigation with the intention of achieving the investigation objective by following the protocol as described in the chapter 3. The results of the investigation were addressed on the context of the research objective of assessing the outcome of selected inner factors on the financial performance of commercial banks in Kenya. Data are obtained primarily from authoritative sources, mostly from bank audited and published records, including the (CBK) documents.

4.2 Descriptive statistics

While conducting descriptive statistics on research variables, the investigators consider the minim, maximum mean and standard deviations. The Descriptive statistics provide all the general structure of the data collected in a summarized form. The mean of the study variables provides the arithmetic mean of the variables under consideration while minimum and maximum values reports the lowest value and highest value of the variables being studied. The standard deviation on the other side explains the extent at which the data deviates from the overall mean value of the data. It measures the extent of dispersion existing in the data values. Low standard deviations thus imply that the data points were spread and persuaded near to the mean value, while the high standard deviation value implies that the data points are distributed over a larger

data range. The descriptive statistics of the variables under investigation in the present research were untaken in below.

Table 4. 1: Descriptive Statistics

Variables	Minimum	Maximum	Mean	Std. Deviation
Financial performance	2.04	3.23	2.6200	.48379
Liquidity ratio	.0324	.0516	.040360	.0082760
Loan advances portfolio	.4794	.5271	.508480	.0179034
Cost income ratio	.5544	.6101	.578220	.0227213
Credit risk	.6532	.7371	.693920	.0392139
Firm size	7.9844	8.1466	8.074920	.0692904

In Table 4.1, it is apparent that the financial performance indicators as an asset return had a mean of 2.6200 and a SD of.48379. Considering the minimum value of 2.04 and the maximum value of 3.23, it can be stated that the data values were spread evenly above and below the mean value. Low standard deviations suggest that the data values were oriented close to the mean value.

The case is similar with the independent variables which are the liquidity ratio, loan and advances portfolio, cost income ratio, credit risk and firm size. It is seen from the table that the standard deviation values are very low which is an indication that the data values are spread within the mean value of the respective data points. The liquidity ratio had the smallest standard deviation value implying that its data points were closely spread within its mean point.

4.3 Trend analysis

Trend analysis is a technique used in technical analysis that helps in predicting the future trend of a give variable of interest. The analysis is based on the notion that what has previously happened is used to predict the future. The aim of the trend analysis is to identify attractive investment opportunities that currently shows an upward trend and to recognize a downward trend so that appropriate measures and adjustments can be made to avoid unnecessary losses in the business.

The study conducted a trend analysis of the variables considered in the present study and the tabulated summary of the analysis were untaken in table 4.2.

Table 4. 2 Trend analysis

The dependent indicators of the analysis were financial performance, expressed as the return on

VARIABLES	2014	2015	2016	2017	2018	Average	SD
Financial performance	3.23%	2.69%	2.90%	2.04%	2.24%	2.6200%	.48379
Liquidity ratio	0.0516	0.0355	0.0324	0.0357	0.0466	.040360	.0082760
Loan advances portfolio	0.5085	0.5271	0.5179	0.4794	0.5095	.508480	.0179034
Cost income ratio	0.5749	0.5544	0.5607	0.6101	0.5910	.578220	.0227213
Credit risk	0.6803	0.7340	0.7371	0.6650	0.6532	.693920	.0392139
Firm size	7.9844	8.0332	8.0713	8.1466	8.1391	8.074920	.0692904

the asset ratio, measured as net income over total assets. In many circumstances, researchers have found that ROA of any given bank depend on the bank's internal factors and the macro economic factors that are beyond the control of the bank management like government policies and prevailing economic condition. From table 4.2, it is clearly demonstrated that ROA was relatively consistent as far as dispersion is concerned. The standard deviation value (0.48379) is relatively low implying that over the study period, 2014 to 2018, the ROA was close from year

to year. The commercial banks performance in Kenya in terms of return of asset ratio fluctuated between 3.23% and 2.04% between 2014 and 2018 fiscal years. The average ROA value however stood at 2.62%.

The liquidity ratio of commercial banks suggest whether a bank is in risk of encountering loss as the finding of being incapacitated in meeting the minimum cash requirement of which this incapacity is catered for by acquiring funds at a higher cost in order to bring the bank into adequate liquidity level. This ratio was expressed as the cash and cash equal to total asset ratio. The ratio was more consistent in dispersion given a low standard deviation value of 0.008276. The average of this ratio stood at 0.04036 over the study period.

The net credit lines to the total asset ratio to total assets ratio which in the present study was the loan advances portfolio variable was computed and expressed in table 4.2 above. This ratio establishes the target of the bank was to acquire funds from a surplus unit and lend it to deficit units with the key of getting interest revenue. The higher the amount of money that a bank lends, the higher the margin of net interest income. The ratio was consistent over the study period, between 2014 and 2015 with a standard deviation of 0.0179034 and was averagely constant at 0.508480.

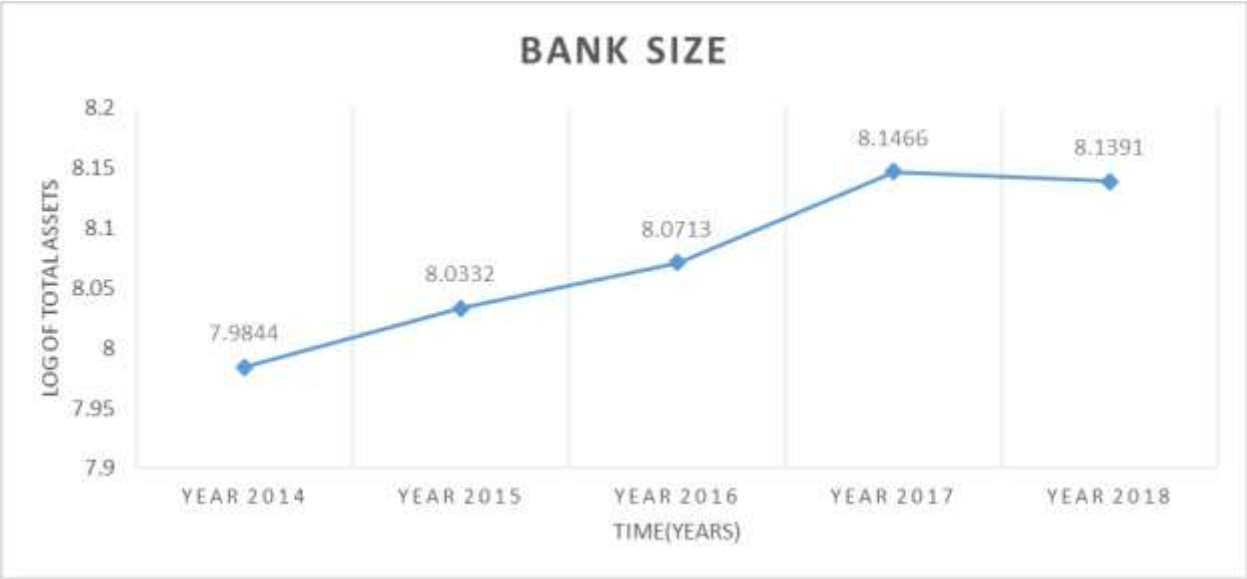
The cost income ratio, expressed as the total functioning expenditures to total income ratio indicates the extent at which profit margin of commercial banks fluctuates. Internal factors such as advanced technology framework particularly in communication, financial and information improves bank profit margin. Moreover, the lower the cost of installing a technology framework, the higher the profit margin. Given the low standard deviation value of 0.0227213, it explains

that the ratio was steady in terms of dispersion from 2014-2018. The average value of the ratio stood at 0.578220 during the entire period of research.

The credit risk of a bank can be low or high depending on the ability of the borrowers to conduct their obligation as required of them. If the debtors fail to pay the loan and the respective interest due, the bank will be at a risk of incurring loss. Therefore there is a tendency of experiencing a destructive relationship between credit risk and bank profits. From the study outcomes, it was found that the credit risk, net credit contributes to total deposits ratio was consistent over the study period with a standard deviation of 0.0392139. The average ratio stood at 0.693920. It therefore implies that the more a bank increase its credit facilities, the more the it is exposed to more risks thus minimizing the probability of a bank getting greater profit margins.

The control variable in the present study was the size of the bank. This variable was computed as the log of total assets. Researchers have found that the larger the bank, the more it enjoys the economies of scale and the more it generates profits. However, as the bank continues growing, it may encounter diseconomies of scale as different challenges may result such as management and surveillance issues hence reducing profitability. In the present study, it was found that commercial banks in Kenya consistently increased in size since 2014 to 2018. This can be attributed to increased population and subscribers of customers. In addition, the growth in size was consistently dispersed since the standard deviation, 0.0692904, was very low. However, the growth rate was constant at an average rate of 8.074920.

Figure 4. 1: Return on Assets



The graphical representation shows that from 2014 to 2017, there was a consistent growth in bank size. There was a slight drop in bank growth of commercial banks in 2018. This can be due to factors beyond the control of commercial banks, such as the effects of the 2017 national elections which led to a repeat of presidential elections that destabilized the state of the economy.

4.5 Diagnostic Test

The appropriateness of the secondary data collected with regard to the variables that spearheaded the achievement of the study objective was established through diagnostic test. Diagnostic test

comprise of test of normality, test for multicollinearity, serial correlation and heteroscedasticity. The tests was undertaken based on 150 data points from 30 banks whose data was collected.

4.5.1 Tests of Normality

Normality test on the study data is important because it gives the researcher the assurance that the data collected will give credible findings if it is normally distributed. This test is done to guarantee that the kurtosis and skewness of the data was checked and to verify whether the data under research was normally distributed. The study used Shapiro-Wilk Test to establish the normality of data because the sample of the research was less than fifty. It is a more reliable method of determining the spread of the data from the sample arithmetic mean. When interpreting the results, 0.05 level of significance indicate that the information values deviate slowly from the normal distribution. If the importance value is greater than 0.05, then the information is usually distributed.

Table 4. 3: Test for normality

	Kolmogorov-Smirnov[a]			**Shapiro-Wilk**		
	Statistic	df	Sig.	Statistic	df	Sig.
Financial performance	.186	150	.000	.624	150	.000
Liquidity ratio	.258	150	.000	.504	150	.000
Loan advances	.262	150	.000	.526	150	.000
Cost income	.279	150	.000	.585	150	.000
Credit risk	.109	150	.000	.939	150	.000
Firm size	.163	150	.000	.912	150	.000

a. Lilliefors Significance Correction

From table 4.3 above, from the significance value of the Shapiro-Wilk test, for all the variables are less than 0.05 that implies that they reject the null hypothesis and infer that the data do not come from a statistical distribution.

4.5.2 Test for Multi-collineariarity

Multi-collinearity occurs when independent variables in a model of regression correlate with each other. Since each independent variable should not correlate with each other, multicollinearity may cause a problem in the model. In addition, if the extent of correlation among the independent variables is high, problems may arise when fitting and interpreting the results of the model. This present study adopted a variance inflation factor (VIF) technique to investigate the degree of multi-collinearity among the variables under research.

Table 4. 4: Multi-collinearity coefficients

	Collinearity Statistics	
Model	**Tolerance**	**VIF**
1 (Constant)		
Liquidity ratio	.949	1.054
Loan advances	.749	1.334
Cost income	.943	1.061
Credit risk	.715	1.400
Firm size	.891	1.122

Model	Collinearity Statistics	
	Tolerance	VIF
1 (Constant)		
Liquidity ratio	.949	1.054
Loan advances	.749	1.334
Cost income	.943	1.061
Credit risk	.715	1.400
Firm size	.891	1.122

a. Dependent Variable: Financial performance

Based on the study coefficients from the statistics on the output presented in table 4.4, the VIF values obtained range between 1 and 10 hence it can be concluded that the symptoms of multicollinearity were not present in the model. Thus, the data values were suitable and were deemed appropriate to give credible findings.

4.5.3 Serial Correlation

Autocorrelation is also acknowledged as serial correlation serial correlation evaluation was carried out to test whether the research variables are associated with their lagged versions in a way over a period of time. Serial correlation tests were carried out and it is clear from the results that there is no correlation. It means that the OLS results are no longer biased. The diagnostic outcomes are found below.

Table 4. 5 :Serial Correlation

Test	Statistic
Durbin Watson	2.023

Source: Research Findings

Though the multicollinearity test indicated that there was collinearity among some variables, the Durbin Watson's serial correlation results as shown a value of 2.023, which is more than 2 suggesting that there is no serial correlation.

4.5.4 Heteroscedasticity

Heteroscedasticity is the condition where the variability of an independent variable is uneven throughout the range of values and the second variable that anticipates it. In this case, the assumption is that if the value of relevance is greater than 0.05, there should be a very minimal problem with heteroscedasticity. The results for tests of Heteroscedasticity were as untaken in table below.

Table 4. 6 Heteroscedasticity coefficients

	Unstandardized Coefficients		Standardized Coefficients		
Model	B	Std. Error	Beta	t	Sig.
(Constant)	.016	.017		.927	.356
Liquidity ratio	.003	.014	.013	.218	.828
Loan advances	.001	.003	.024	.355	.723
Cost income	.011	.001	.668	10.866	.000
Credit risk	.003	.003	.068	.964	.337
Firm size	-.002	.002	-.056	-.880	.380

a. Dependent Variable: Financial performance

The high p-value for liquid ratio, loan advances portfolio, firm size and credit risk imply that heteroscedasticity is not a problem in the present data set. It also suggest that variables vary to a different extent over the entire period of study.

4.6 Regression Analysis

The significance of computing regression analysis is to develop the linear equation that will relate the variables under investigation to each other. The resulting linear equation from analysis of multiple regression helps in predicting the value of the dependent variable, when the coefficients of one or more independent variables are fixed with a given unit value.

Multiple regression analysis was researched with the purpose of checking out the relationship amongst explanatory variables on the impact of inner factors on commercial banks financial performance in Kenya. The arithmetical platform for social sciences (SPSS V 20.0) was used to enter and compute multiple regressions for the variables under study. The coefficient of determination describes the degree at which variations in the outcome variable can be defined through the variation in independent variables or the ratio of variation in the dependent variable which in this case is the financial overall performance of commercial banks in Somalia that is interpreted by all the three structured independent variables (liquidity ratio (X1), loan advances portfolio (X2), credit risk (X3), Cost earnings ratio X4 and Firm size X5). The study model took the following format:

$$Y = \beta_0 + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4 + \beta_5 X_5$$

4.6.1 Summary model

Table 4.7 demonstrates the model summary of regression results where, adjusted R square, R square, and standard error of estimate are presented.

Table 4. 7 Summary model

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.338[a]	.114	.083	.0246490

a. Predictors: (Constant), Firm size, Loan advances, Liquidity ratio, Cost income, Credit risk

b. Dependent Variable: Financial performance

The research findings in Table 4.7 indicates that the inside elements of commercial banks in Kenya had a joint substantial influence on financial performance of commercial banks in Kenya as indicated through R cost which was once computed and discovered to be 0.338. The R squared of 0.114 indicates that the independent variables regarded in the current study accounted for 11.4% of the common bank performance. The discovering on the low percentage effect of the interior bank factors, the study concludes that exterior factors have a higher impact than internal factors. These elements may additionally include government policy, inflation and political conditions that may fluctuate economic stability in the country.

4.6.2 Analysis of Variance

Table 4.7 represented the statistical findings of the investigation of variance explaining the suitability of the model from the likelihood of F-statistic and the value of F statistic.

Table 4. 8 Summary model

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	.011	5	.002	3.709	.003[a]
	Residual	.087	144	.001		
	Total	.099	149			

a. Predictors: (Constant), Firm size, Loan advances, Liquidity ratio, Cost income, Credit risk

b. Dependent Variable: Financial performance

The research results, it is clearly seen that the F statistic was 3.709 and the level of significance was found to be 0.003 which is way below the 0.05. It is therefore concluded that the model fully predict the influence of internal factors on performance of commercial banks. Other aspects not involved in the research may also have an effect on bank performance.

4.6.3 Coefficients of Regression Analysis

Regression coefficients are very important in determining the degree of the effect that every individual independent variable may have on the outcome variable. Table 4.8 therefore displays the coefficient outcomes for the variables of the model, the t-values of every predictor variables as well as the degree of level of significance.

Table 4. 9 Coefficients of regression analysis

	Unstandardized Coefficients		Standardized Coefficients		
Model	**B**	**Std. Error**	**Beta**	**t**	**Sig.**
(Constant)	.010	.031		.334	.739
Liquidity ratio	.044	.024	.145	1.799	.007
Loan advances	-.002	.005	-.034	-.371	.711
Cost income	.007	.002	.287	3.554	.001
Credit risk	.004	.006	.057	.616	.539
Firm size	.001	.004	.024	.287	.775

a. Dependent Variable: Financial performance

Table 4.8 above depicts the coefficients of regression that was computed through regression analysis. The study findings imply that if firm size, loan advances, liquidity ratio, cost income ratio and credit risk factors are kept constant, the overall bank performance may vary by a unit value of 0.010. The study also found that a unit rise in liquidity ratio will cause a negative impact on financial performance by a value of 0.044. Furthermore, it was established from the research results that a unit alteration in loan advances portfolio will cause a negative alteration in financial performance by -0.002 units. The research additionally discovered that a unit increment in size of the bank will prompt an impact in financial performance by a factor of 0.001. Therefore the study outcomes imply that apart from liquidity ratio and loan advances portfolio, firm size, cost income ratio and credit risk will pose a constructive alteration in banks financial performance. Therefore the general regression equation will look as below.

$$Y = 0.010 + 0.044X_1 - 0.002X_2 + 0.007X_3 + 0.004X_4 + 0.001X_5$$

4.7 Interpretation of the Findings and Discussions

The major aim of the investigation was to establish the impact of internal factors on performance of commercial banks in Kenya. The information for statistical analysis was collected from secondary sources and descriptive statistics and the regression analysis was done. As a result of the diagnostic test, the study considered five dimensions of internal factors that made up the independent variables. These variables were the liquidity ratio, credit risk ratio, loan advances portfolio, cost-income ratio and one control variable, the size of the firm. However, the study findings found collinearity among the variables leading to exemption of two variable, cost-income ratio and firm size, due to implications that may have in the regression model and in predicting the outcome variable.

From the study findings, with regard to liquidity ratio, the study found a constructive relationship between bank liquidity and profitability. Additionally, as indicated in our regression model, liquidity had an optimistic relationship with profitability measured by return on asset. These answers were in contract with the outcomes of the research done by Odunayo and Oluwaféyisayo (2015) in Nigeria and established a positive relationship between liquidity and profitability of commercial banks in Nigeria and found that there is a positive relationship.

Loan advances portfolio in the present study was found to have a destructive impact (-0.002) on bank profitability given the negative coefficient of the regression equation. The study attributed this to the fact that non-performing loans that affect performance negatively. The study findings analyzed the relationship between bank loans and effectiveness, by means of Islamic banks from 21 particular nations (Hassam and Bashir 2003). They establish that the higher loan ratio had a detrimental effect on profitability. In contrast to these findings, Ani, Ugwunta, Ezeudu and

Ugwuanyi (2012) researched the effectiveness determinants of Nigerian banks and found that the loan advance portfolio contributes to bank profitability.

The credit risk ratio was also considered as one of the predictor variables in this research. It was found from the findings that the credit risk was positively associated with the profitability of the bank. In contrast, its level of confidence at 95% was found to be slightly above the p-value, implying that its impact was relatively insignificant but to a small extent. The finding is inconsistency with the discovering by Athanasoglou, Brissimis and Delis (2005), that credit score hazard is destructively and extensively linked to bank effectiveness.

Cost income ratio, as a predictor variable in the present study was found to have a positive and significant influence on bank effectiveness. From the results, the significance of the variable was found to be 0.001 which is way low than the p-value, 0.05. This imply therefore that though it contribution to bank profitability is minute, it is however significant in the long run.

The size of the bank also found to have a constructive influence on bank profitability. The findings indicates that due to economies of scale, large banks have enough resources and experience to monitor managers effectively hence resulting in higher profits. The findings corroborate those of Kwan (2003) who established a constructive relationship between firm size and financial performance for Asian economies. Similarly the result confirms the expectation of the study and confirms the findings of Smirlock (1985), Zeitun, Tian and Keen (2007) and Alper and Anbar (2011) that greater banks commonly achieve from greater product and loan diversification chances and economies of scale, leading to multiplied profitability. However, these findings may not be applied in the long run because as the bank increases, its cost of operation also increases and the burden of diseconomies of scale is felt. This assumption may be

true if the research by Ben and Goaied (2010) in Tunisia, which suggested a negative relationship between bank size and profitability, is relevant in the Kenyan economy.

The study suggests that internal factors in a bank for instance, credit risk ratio, liquidity ratio and loan advances portfolio affects performance of commercial banks in Kenya. In addition, the size of a bank affects profitability of banks since the larger the size, the more it enjoys the economies of scale. However, as the bank continue growing, it will encounter diseconomies of scale which hampe profitability since expenses will increase thus reducing net income.

The study also established that internal factors have low have an effect on banks' performance. Internal elements used to be located to have a positive correlation with bank performance. Therefore as much as bank profitability is concerned, internal factors should be effectively monitored to maximize profitability by optimizing financial ratios.

CHAPTER FIVE
SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

5.1 Introduction

The overview of the key findings of the information, the conclusions drawn from the outcomes outlined and the policy recommendations made was presented in this section. The conclusions and recommendations drawn were aimed at answering the study objective which was to establish the influence of selected internal factors on the performance of commercial banks in Kenya.

5.2 Summary of Findings

The aim of the research was to investigate the impact of selected bank internal factors on the financial performance. Financial institutions in Kenya are governed under different bodies of management but are regulated by one body that is the CBK. Therefore internal factors of commercial banks considered in the present study was measured and computed using same formula thus bringing in similarity of data collected. The research show that the asset base of commercial banks and net credit facilities continue increasing from the year 2014 to 2017. However, there was a slight drop in 2018, which the study attributed to the prevailing political temperatures that took place during the national election in the year 2017 hence investment rate went down hence less money was in circulation.

Moreover, the study found a constructive correlation between inner aspects of a bank and performance. In addition, the size of a bank and income-cost ratio found to have a constructive impact on performance of commercial bank but to some level that there was a diminishing return on asset. The output of a bank with regard to bank size was found to depend on economies and diseconomies of scale. The larger the size of a bank the more expenses that accrue thus increasing the total operating expenditure while reducing the profit margin. In terms of the five predictor variables, the bank liquidity level had the greatest influence on the financial performance with a $\beta = 0.044$ while firm size as an internal factor had the least $\beta = 0.001$. The ANOVA results generates a significance position of 0.003 implying that the internal factors variables were a good predictor of the bank financial performance.

Further, the study found that banks have implemented effective measures that ensure credit risk is minimized by reducing the number of loan defaulters. This will maximize the interest income through maximized loan lending and reduced non-performing loans position. Furthermore, information communication technology in banks has been established hence improving the customer service process thus enhancing problem solving process by reaching out to more clients. The findings also suggest that return on assets has been increasing in equal measures with increase in asset base and reduced total operating expenditure.

5.3 Conclusions

Based on the results of the investigation described in Chapter 4 and above, the study found that there is a strong and positive relationship between the internal factors of the bank and financial performance. This is because of the moderate coefficient of determination level and positive correlation. This can be concluded to be due to the real that the bank management has control

over internal policies that guide its lending, risk management, cost management and the asset portfolio. Thus, it important that a bank pays attention to internal resources because of the control over them unlike the external factors such as the country fiscal and monetary policies in which they have no control over of commercial banks in Kenya though it is insignificant.

The liquidity position of the bank was found to be the factor that had the highest impact on the bank financial performance as a real that customer deposit is mostly on demand and therefore a bank should always strive to strike a good balance between its need to remain profitable by investing the funds and also with the need to hold optimal cash and cash equivalent resources.

The bank size was found to be the least internal variable that influenced the financial performance of the commercial banks. It was linked to the fact that return on asset as variable of financial performance represents the performance based on the relative asset position and therefore there are no economies of scale resulting from the use of the bank assets. This means that banks should not bank on their asset base to provide an edge on the bank Thus banks should concentrate on operational competitive as a source of improved performance.

5.4 Policy Recommendations

The study suggests, on the basis of the above conclusion that internal bank factors should be considered as an important aspect influencing the effectiveness of the bank. Considering the strong constructive relationship between internal banking factors and the quality of commercial banks in Kenya, policy makers should effectively consider appropriate internal factors while formulating policy in their respective commercial banks and other micro-finance institutions. Similarly, as a result of increased fraud and loan defaulters experienced in major money lending

financial institutions, the study recommends that an effective measures be set up and implemented that will reduce loan defaulters but increase money lending in order to increase net interest income.

The study further suggest that while computing financial ratios for predicting future commercial banks performance, it is suggested that banks should pick financial ratios that are computed from different items in order to obtain credible results that will effectively predict the future trends and avoid collinearity. In addition, the study findings imply that liquidity ratio is the most vital financial ratio that influence financial performance of a bank positively. Therefore, to avoid acquiring cash funds from different sources at higher cost, commercial banks should sustain a given phase of liquidity that will allow appropriate running of operating activities.

5.5 Limitations of the Study

From the investigation several restrictions can be identified. The range of the research was restricted such that only commercial banks operating in Kenya were covered and like, the finding might not apply on other sectors in Kenya or commercial banks in other jurisdiction whose monetary and regulatory framework differ.

The study also collected data from 30 commercial banks over a five year period covering 2014 - 2018. This period has witnessed capping of the bank interest rates and this might affect commercial banks performance. Consequently, it would have been more representative results if the study covers more time before the introduction of the interest capping law.

The key weaknesses of this analysis were: the information used were secondary data created for other objectives and therefore the relationship between the variables cannot be accurately predicted. The measures used may continue to differ from year to year, topic to the main

situation. For instance, the commercial banks' financial performance was focus to the total assets held by commercial banks. In fact, adjustments in the internal operation of the bank could have had an consequence on the competitiveness of commercial banks.

Another limitation relates to the study concentrating on financial measures but the financial performance of a firm is influenced by non-financial measures such as the leadership style, organization culture and also the nature of the organization structure that might facilitate faster decision making. Similarly, the study used only five variables as a measure of internal factors to a bank and yet these are not the only internal factors.

However, despite the limitations, the research findings remain to be a valuable source of information for management decision making, policy decision making and for future researchers to refer to as a point of reference.

5.6 Suggestions for Further Studies

The study concentrated merely on commercial banks operating in Kenya. Consequently, it is suggested that further research be undertaken on other sectors in the country of commercial banks in other nations to compare the results. Secondly, the research utilized data from the period 2014 – 2018 when interest capping had come into force. It is therefore suggested that a study be undertaken to cover a previous period before interest capping to compare the results and determine whether interest capping had any impact on bank financial performance.

The concentration of the investigation on five internal factors implies that the predictor variables is not exhaustive and hence it is suggested that a study be undertaken involving more variables; both, financial and non –financial internal measures. Similarly, another study can be undertaken

in other sector in the country to try and establish whether the same internal factors will apply on the firms.

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APPENDICES

APPENDIX I:Data Capture Form

Items	**Survey items**	**Variables**	**2014**	**2015**	**2016**	**2017**	**2018**

Y	Financial Performance	Net Income					
		Total Assets					
X_1	Liquidity Ratio	Cash and Cash equivalent					
		Total Assets					
		Ratio					
X_2	Loan Advances Portfolio	Net credit facilities					
		Total Assets					
		Ratio					
X_3	Cost Income Ratio	Total operating expenses					
		Total income					
		Ratio					
X_4	Credit Risk	Net credit facilities					
		Total deposits					
		Ratio					
X_5	Firm Size	Log of Total Assets					

APPENDIX II: LIST OF COMMERCIAL BANKS IN KENYA

Classification	Description	Commercial Banks
Tier I	Banks with a balance sheet of more than 40 billion Shillings in Kenya	1. Barclays bank of Kenya 2. Equity Holdings Ltd 3. Kenya Commercial Bank 4. Standard Chartered Bank 5. Cooperative Bank of Kenya 6. Commercial Bank of Africa 7. Diamond Trust Bank
Tier II	Banks with a balance sheet of less than Kenya Shillings 40 billion but more than Kenya Shillings 10 billion	8. Bank of Africa 9. Eco Bank 10. Family Bank 11. CFC Stanbic 12. NIC Bank 13. I & M Bank 14. National Bank 15. Bank of Baroda 16. Bank of India 17. Housing Finance
Tier III	Banks with a balance sheet of less than 10 billion Kenya Shillings	18. Habib A.G. Zurich 19. Sidian Bank 20. Credit Bank 21. Citibank N.A Kenya 22. Spire Bank 23. Jamii Bora Bank

	24. Fidelity Bank
	25. Development Bank of Kenya
	26. Middle East Bank
	27. SBM Bank
	28. Trans-National Bank
	29. Dubai Bank
	30. Africa Banking Corporation
	31. City Finance Bank
	32. Paramount Universal Bank
	33. Consolidated Bank
	34. Guardian Bank
	35. Habib Bank (k)
	36. Gulf African Bank
	37. First Community Bank
	38. Giro Commercial Bank
	39. United Bank of Africa (UBA)
	40. Victoria Commercial Bank

Source: The Banking Survey by CBK 2018,

VARIABLES	2014	2015	2016	2017	2018	Average	SD
Financial performance	3.23%	2.69%	2.90%	2.04%	2.24%	2.6200%	.48379
Liquidity ratio	0.0516	0.0355	0.0324	0.0357	0.0466	.040360	.0082760
Loan advances portfolio	0.5085	0.5271	0.5179	0.4794	0.5095	.508480	.0179034
Cost income ratio	0.5749	0.5544	0.5607	0.6101	0.5910	.578220	.0227213
Credit risk	0.6803	0.7340	0.7371	0.6650	0.6532	.693920	.0392139
Firm size	7.9844	8.0332	8.0713	8.1466	8.1391	8.074920	.0692904

APPENDIX III: Trend Analysis