EFFECT OF LIQUIDITY ON FINANCIAL PERFORMANCE OF NON DEPOSIT TAKING FINANCIAL INSTITUTIONS IN KENYA

BY

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DECLARATION

This research project is completely unique and has not been submitted or shown to any other school in hopes of obtaining a scholarship or other academic honor.

Signature… Date……7th November 2023…

Diana Kwamboka

D61/39212/2021

In my capacity as the supervisor of the institution, I have given my consent for this research proposal to be submitted for evaluation.

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DEDICATION

I would want to dedicate my endeavor to the Unfathomable God as well as to my parents, who have instilled in me the importance of receiving an education. Thank you all and God bless you.

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LIST OF ABBREVIATIONS

AMFI-K	-	Association of Microfinance Institutions – Kenya
CBK		Central Bank of Kenya
LCR	-	Liquidity Coverage Ratio
MFIs	-	Microfinance Institutions
NSFR	-	Net Stable Funding Ratio
NDTM		Non-Deposit-Taking Microfinance
NPL	-	Non Performance Loans
ROA	-	Return on Assets
ROE	-	Return on Equity
ROI	-	Return on Investments
ROS	-	Return on Sales

ABSTRACT

The study set out to determine how non-banking financial entities in Kenya fare financially in relation to liquidity. This study will mainly center on a bank that does not take deposits. This study set out to answer the research question by looking at how liquidity affects financial performance. Specifically, the study attempted to determine the function that liquidity plays in determining financial success. An approach known as descriptive research was used for the investigation. By using the census sampling approach, the sample size was determined to be 32 individuals who responded to the survey. Information on liquidity and financial performance was derived from secondary sources. Descriptive and inferential statistics were used in the analyses. Methods like as correlation and regression were part of inferential statistics, whereas descriptive statistics included tools such as percentages, averages, and standard deviation. Business size, capital adequacy, and liquidity were shown to have a significant and strong link with financial performance. Conversely, non-deposit MFIs' financial performance was significantly and negatively correlated with non-performing loans. An R-squared value of 0.452 indicates that non-performing loans (NPL), bank size, liquidity, and capital adequacy explained 45.2% of the variation in financial performance (ROA). That leaves 54.8% to be explained by the error term and other factors that were left out of the study. According to the results of the ANOVA, this change was statistically significant. Another finding from the multiple regression study found that non-deposit taking financial institutions' liquidity, capital adequacy, non-performing loans, and bank size changed significantly. That the shift was substantial provided further evidence of this. The study's authors concluded that non-deposit accepting microfinance institutions in Kenya are affected by liquidity, capital adequacy, non-performing loans, and bank size. Corporate governance, capital structure, CSR, and the effect of devolution are additional aspects that the research suggests should be investigated further in order to understand how non-deposit taking MFIs work.

CHAPTER ONE: INTRODUCTION

1.1 Background of the Study

The health and success of a company's finances are crucial. Making as much money as possible, keeping a lot of cash on hand, and increasing the net worth of the owners are all important objectives for any company (Anandasayanan, 2020). In a practical sense, liquidity and performance are good measures of the health and success of any business, including microfinance organizations (Shrestha, 2018). A bank's solvency and financial performance are both hit hard by liquidity issues. Because there is an opportunity cost to maintaining liquid assets, which might lead to greater returns, inadequate liquidity is a key factor in bank failures, particularly during crises (Pradhan & Gautam, 2019). Finding the sweet spot between profitability and liquidity is essential for any company that wants to maximize shareholder value. But it's critical to strike a balance between easy money and a good return for the bank (Khati, 2020).

Theory of liquidity shiftability, theory of liquidity preference, and theory of tradeoffs will all serve as frameworks for this investigation. According to Satyamoorthi, Mapharing, and Dzimiri (2020), banks should engage in securities and credit instruments having a secondary market as per the shiftability theory of liquidity. This manner, these funds may be readily changed to cash in the event that the need to address deteriorating liquidity arises. Rather than idly meeting loan demand, banks should actively pursue balance sheet policies, as per liquidity preference theory (Onyekwelu, Chukwuani & Onyeka, 2018). The trade-off hypothesis states that a company's liquidity management should enable it to optimize operating profitability while also satisfying short-term debt and conserving liquidity, even if these two aims are fundamentally contradictory (Malik, Awais & Khursheed, 2016).

Unregulated digital credit providers have mushroomed in Kenya, offering far smaller aggregate loans than traditional banking institutions including commercial banks, microfinance institutions, and microfinance companies that do not accept deposits (Maina & Mungai, 2021). However, they have had a detrimental impact on society via practices like as predatory debt collection, high interest rates on loans, and concerns over the use of personal data. In light of the fact that no laws have previously addressed digital credit firms, the CBK felt obliged to seek an amendment to the CBK Act. After receiving the president's assent on December 7, 2021, the CBK (Amendment) Act

took effect on December 23, 2021. Within three months of the Amendment's effective date, CBK must establish rules. Within six months of the regulations' publication, any anyone engaging in digital credit business that is not already controlled by another written legislation must apply for a license.

Among the countries in Sub-Saharan Africa, Kenya's microfinance industry is among the most advanced. It is believed to service more than six million homes. When it comes to expanding access to banking services in Kenya, this industry has been crucial throughout the years. The non-deposit taking microfinance institutions have countrywide coverage as members of the AMFI-K. They serve important economic sectors in both rural and urban communities, including agriculture, industry, education, health, water and sanitation, and more. Above all else, these companies go above and above by providing value-added services, such as financial literacy training programs, to their clients in addition to lending. Following its operationalization, the business remained unregulated, despite efforts by non-deposit taking players to be included in the regulatory scope under Section 3 of the Microfinance Act, 2008. Everything changed in August 2021 when regulations were put in place by the National Treasury to prohibit and regulate microfinance firms that refused to take deposits (CBK, 2021).

1.1.1 Liquidity

According to Onyekwelu, Chukwuani, and Onyeka (2018), "corporate liquidity" may be described as a company's capacity to satisfy its immediate financial commitments. The danger that a company can run out of cash before it can pay its short-term bills is known as liquidity (Pradhan and Gautam, 2019). Shrestha (2018) states that one way to assess a company's liquidity is to consider its cash and short-term investments. A greater level of liquidity is associated with assets that can be turned into cash more quickly. Financial institutions' capacity to punctually satisfy both current and future financial obligations is correlated with their liquidity and the efficacy of their liquidity management. According to Sathyamoorthi, Mapharing, and Dzimiri (2020), public trust in banks declines as liquidity levels rise, which threatens the very existence of these institutions.
Financial institutions, whose principal responsibility is the custody of deposits, have an exceptionally high liquidity need (Onyekwelu, Chukwuani & Onyeka, 2018). When making investment plans, it is crucial to take liquidity into account because of the substantial impact it has

on an entity's asset base and performance. In order to satisfy its commitments and improve its survival position, a corporation has to manage its liquidity (Li et al., 2020). When it comes to client convenience and pleasure, liquidity is a key aspect in determining the revenue level of the organization. Keeping liquidity at a healthy level is the most crucial item. When a bank is in deep financial trouble, one of the first signs is usually a lack of liquidity (Khati, 2020).

Liquidity coverage ratios (LCRs), loans-to-assets ratios, liquid assets-to-total-assets ratios, and loans-deposit ratios are some of the ways that banks' liquidity may be measured. If the bank's loan-to-deposit ratio is high, it means it doesn't have enough money to deal with unexpected events. Instead, inefficiency is shown by a low ratio. Since loans are less liquid than total assets, a high ratio of the two indicates a high level of risk. It does, however, suggest that the bank's interest income will be somewhat large, leading to substantial profits (Zaharum et al., 2022). The ratio of a bank's liquid assets to its total assets shows how well the bank can meet both anticipated and unforeseen cash needs. According to the LCR, in the event of a severe liquidity crisis, banks must have sufficient high-quality liquid assets to cover their liquidity demands for a period of thirty days. Accordingly, the LCR limits the amount of short-term liquidity risk that a bank may have (Pradhan & Gautam, 2019). The LCR ratio will be used to measure liquidity in this research.

1.1.2 Financial Performance

According to Bekhet, Alhyari, and Yusoff (2020), a company's financial performance may be described as the extent to which its primary revenue can be converted into physical assets. The success or failure of a business is directly proportional to the care and investment its leaders put into its assets throughout time, say Mahardini et al. (2022). The capacity to manage and control a company's resources is directly related to its financial performance (Fatihudin, 2018). Financial reports are usually prepared at the end of each company's fiscal year and describe the assets, liabilities, capital, income, and operating expenses of the business. These reports detail how well the business did financially. According to Muslih and Marbun (2022), a company is considered to have performed well if it is able to effectively use its resources to accomplish its goals as planned, while also considering the impact on its customers.

One of the most important aspects of every firm is its financial performance, which describes its competitiveness, its potential, the economic interests of its management, and the trustworthiness of its current and prospective contracts (Kim, Duvernay & Thanh, 2021). When people or teams

within an organization carry out their duties and responsibilities in a lawful manner, the results they produce are a reflection of the firm's performance. A company's financial performance may be used to gauge its health and to forecast its growth potential, according to Bekhet, Alhyari, and Yusoff (2020). Businesses can't make it through today's cutthroat business climate without strong financial results (Bhunia, Mukhuti & Roy, 2011).

The degree to which a business is able to transform its main source of income into tangible assets is one measure of its financial success (Bekhet, Alhyari, and Yusoff, 2020). The success or failure of a business is directly proportional to the care and investment its leaders put into its assets throughout time, say Mahardini et al. (2022). The capacity to manage and control a company's resources is directly related to its financial performance (Fatihudin, 2018). Financial reports are usually prepared at the end of each company's fiscal year and describe the assets, liabilities, capital, income, and operating expenses of the business. These reports detail how well the business did financially. According to Muslih and Marbun (2022), a company is considered to have performed well if it is able to effectively use its resources to accomplish its goals as planned, while also considering the impact on its customers.

1.1.3 Liquidity and Financial Performance

An important part of corporate finance is the relationship between financial performance and liquidity. Companies should keep their present asset levels relatively low in order to achieve high levels of profitability, as this will allow them to strike a balance between liquidity and profitability, according to the tradeoff hypothesis (Malik, Awais & Khursheed, 2016). retaining liquid assets may boost profitability, according to the shiftability hypothesis. However, there is a tipping point beyond which organizations' profitability is negatively impacted by retaining more liquid assets. A more diverse and balanced asset-liability mix may help firms improve their financial performance, satisfy their financial duties, remain liquid, and increase profits (Li et al., 2020).

Based on his research on the relationship between profitability and liquidity management at Nepalese commercial banks, Shrestha (2018) concluded that liquidity does not much impact profitability. Based on their research, Zaharum et al. (2022) concluded that commercial banks in Malaysia that properly manage their liquidity tend to perform better. Among the correlations between commercial banks' liquidity and performance that Khati (2020) discovered, one was positive but not statistically significant. The authors Malik, Awais, and Khursheed found a

correlation between liquidity metrics and the efficiency of financial institutions (2016). More specifically, the research examined the financial performance of private banks in Pakistan in connection to liquidity.

1.1.4 Non-Deposit-Taking Financial Institutions in Kenya

Savings and credit facilities are made available to the majority of Kenyans by financial organizations in Kenya that do not accept deposits. This is due to the fact that the majority of Kenyans do not have banking accounts. Their money is mostly placed on merry-go-rounds and chamas located in the surrounding area. The majority of the inactive accounts in the banking sector are held by individuals who have accounts but their funds are either very little or nonexistent. They have a more difficult time obtaining financial facilities, which makes it more difficult for them to improve their life or create development initiatives for themselves. Microfinance organizations are financial firms that provide modest loans to those who do not have access to banking services. These individuals are excluded from the traditional banking system. Small loans are also made available to those with low incomes, job possibilities are created, and capacity development is provided to borrowers via the provision of a variety of skills, including the use of loans, entrepreneurial skills, and management skills. An very significant influence has been made by NDTMs in the rural regions over the course of the last several decades. All things considered, they have been a significant factor in the amazing growth that has taken place in rural regions, where they are the only known form of organized credit. The underprivileged have been able to get access to financial resources and send their children to school thanks to microfinance, which has resulted in the breaking of the vicious cycle of poverty. According to Ogilo, Omwoyo, and Onsumu (2018), some local value chains can only be built via the use of microfinance. This is because organizations who have received funding from donors have been able to engage agronomists and play a significant role in market linkages.

Alternatively, a non-deposit-taking microfinance institution (NDTM) is a kind of financial institution that offers small loans to its clients. Although the National Treasury Administration's Cabinet Secretary has not yet laid out the regulations, it is subject to the principles stated in Section 3(2b) of the Microfinance Act. In order to serve their consumers, especially the rural poor, NDTM enterprises utilize technology that is mostly integrated with touch. Their goal is to make a big difference and help them change their lives. In order to lend or extend credit, NDTMs do not ask

for deposits from the public at large but instead receive loan guarantee funds from its clients. Reason being, the people they help out are already in a tough financial situation, therefore they don't have any assets like shares, logbooks, or title papers to back up their loans. Particularly micro and small enterprises are the focus of these microfinance organizations. In Kenya, NDTMs serve both rural and urban areas, and their coverage extends throughout the whole country. Their services are vital to many essential parts of the economy, including farming, manufacturing, schools, hospitals, and water and sanitation systems (Maina & Mungai, 2021). Their involvement in AMFI-K makes this feasible.

Individuals and businesses are empowered and their standard of living is meant to be improved through the provision of non-financial services, such as client financial education and business management services, as well as credit, according to the non-deposit taking microfinance business model. This sector of the microfinance sector provides vital services that shape the sector as a whole. In addition to improving people's lives, they also provide opportunities and money. Compliance with Consumer Protection laws and principles necessitates that non-traditional financial institutions (NDTMs) adhere to certain lending processes and procedures and, like conventional financial institutions, engage in human contact. Group lending is the primary mode of distribution for non-traditional financial institutions (NDTMs), which is another attribute that sets them apart from other types of financial organizations. Clients from the same marketplace or localities get together to create organizations and choose representatives for such groups. These customers are required to go through training, during which they are given the opportunity to acquire financial knowledge and become familiar with the regulations governing lending. Immediately after the completion of the training, they are evaluated by the institutional credit officers in conjunction with the officials of their respective groups. after this, credit is distributed in a step-by-step manner using a co-guarantee method (CBK, 2021).

1.2 Research Problem

Anandasayanan found in his 2020 study that financially stable organizations can only endure as long as there are financially successful and liquid financial institutions. While addressing the issue of liquidity is critical for every business, microfinance institutions face it on a much grander scale. For financial institutions to remain stable and profitable, good liquidity management is crucial, since poor management is the leading cause of poor financial performance (Sathyamoorthi,

Mapharing, & Dzimiri, 2020). Financial institutions must have effective liquidity management systems in place. Companies' chances of success are diminished when organizations, especially microfinance institutions, do not have enough cash on hand to pay their bills. This is because microfinance institutions can facilitate the flow of funds by means of interest and loans when a firm is in a strong financial position and can thus meet its obligations (Onyekwelu, Chukwuani, & Onyeka, 2018).

Some of the growing issues and important areas of concern in Kenya that need regulation of NDTM companies include safeguarding sensitive information, preventing money laundering, and tracking terrorist financing. These regulations will address a wide range of important concerns, including consumer protection, credit information sharing, transaction security, financial crime prevention, tax and accounting procedures, institution transformation, lending protection from excessive debt, and consumer protection from abusive practices. The number of online lenders operating unchecked in Kenya has grown recently. Their aggregate lending is much smaller than that of deposit-accepting commercial banks, microfinance institutions, and microfinance businesses. On the other hand, they've caused harm to society by things like predatory lending practices, excessive interest rates, and the abuse of personal data, all of which have made people quite worried. The outcome was that the CBK sought a change to the CBK Act to control and oversee digital credit companies, who are currently unregulated by any other statute (Bochaberi & Job, 2021). Primary causes of bank failures in Kenya, according to Maina and Mungai (2021), include ineffective credit management, poor governance, and noncompliance with prudential regulations on management, capital sufficiency, and liquidity. In spite of the fact that Kenyan banks have implemented prudential liquidity restrictions, the overall performance of the financial industry has been deteriorating.

Various studies have been undertaken on the interrelationship between liquidity and performance. In Nigeria, Onyekwelu, Chukwuani and Onyeka (2018) examined whether liquidity affects microfinance banks performance and documented a positive and significant interrelationship while Bagh et al. (2017) examined whether liquidity affects microfinance banks profitability and found a negative and significant interconnection. The study conducted by Kariuki, Muturi, and Njeru (2021) in Kenya explored the impact of liquidity on the performance of insurance businesses, revealing a statistically significant and favorable correlation. On the other hand, Ratemo and

Ndede (2021) investigated whether liquidity risk affects the performance of microfinance banks and discovered a negative and significant interconnection. Nevertheless, studies on this topic often yield neutral results, even though it is often believed that liquidity boosts microfinance institutions' profits. Plus, none of the several regional and international studies were conducted in Kenya, so we can't use their findings to our advantage here. Therefore, this study aims to fill these knowledge gaps by examining how liquidity affects the bottom lines of Kenya's non-deposit financial institutions.

1.3 Research Objective

To determine the effect of liquidity on financial performance of non-deposit is taking financial institutions in Kenya

1.4 Value of the Study

The study's results could help management at NDT banks improve their liquidity management procedures by providing them with the tools they need to respond effectively to customer demands. Microfinance bank managers in Kenya may be able to apply this study's suggestions and conclusions to improve their companies' bottom lines.

Authorities such as the CBK, the National Treasury, and other government institutions that are assigned with the responsibility of formulating policies pertaining to the banking industry are examples of policymaking bodies. The results and recommendations of the research may be used by policymaking bodies in order to formulate strategic strategy in order to strengthen prudential rules on liquidity management and to increase the performance of the banking sector.

Furthermore, the paper will provide the groundwork for further research, and scholars in the future might use the study as a starting point for their own unique research projects. Supplementing the current theoretical literature on the study hypotheses, this investigation will provide further information. In addition, the study's findings will bolster the academic literature on liquidity and financial success based on actual data.

CHAPTER TWO: LITERATURE REVIEW

2.1 Introduction

In this chapter, the theoretical foundations that guided the research are presented, and a summary of the numerous papers that were subjected to empirical examination is also presented. The conceptual model is also presented in this chapter, along with a description of the gaps that have been identified as a result of the research.

2.2 Theoretical Review

The liquidity shiftability theory, the liquidity preference theory and the tradeoff theory have been adopted as the key theories for this study.

2.2.1 Liquidity Shiftability Theory

In 1915, Moulton proposed a notion that would become known as the Shiftability hypothesis. The liabilities section of a bank's balance sheet is the primary emphasis of this theory. This idea proposes that this may be used as a bank's obligations are a source of extra liquidity. Theoretically, cash on hand should not be an asset that banks hold on their balance sheets (Bagh et al., 2017). This is because banks are able to purchase all of the monetary resources that they require. A financial institution may best protect itself from the potential loss of big deposits by maintaining a liquidity reserve of credit instruments with an established secondary market, so goes the thinking. In addition to commercial paper and prime banker's acceptances, this liquidity reserve also included treasury bills, which turned out to be the most essential component of the aforementioned reserve. Every single one of these instruments was able to pass the marketability and capital certainty criteria under normal circumstances (Chinweoda et al., 2020). This was due to the fact that their periods to maturity were very short.

This theory states that banks may guarantee liquidity by holding highly marketable securities and by ensuring that their assets are shiftable, marketable, or transferable (Sathyamoorthi, Mapharing, & Dzimiri, 2020). This theory was developed by Sathyamoorthi, Mapharing, and Dzimir (2020). There have been a number of writers who have provided their critical commentary on this hypothesis. The common view is that during a moment of difficulty, it may be difficult for a bank to secure the needed liquidity. This is because, in most cases, creditworthiness would be absent,

and the market's confidence may have been seriously damaged. Liabilities, which include deposits, market funds, and other creditors, are a substantial source of liquidity for a sound bank (Bagh et al., 2017). Similar to the major error that led to the demise of the commercial loan theory of credit, another major defect in the theory was uncovered. This shortcoming was that, without a market, secondary reserve assets are less useful as a liquidity source during times of widespread crisis (Khati, 2020).

Microfinance institutions might utilize this strategy to their advantage by gaining access to data and options that could help them weather liquidity crises. If a bank's assets can be easily sold or transferred to other investors or lenders, then the bank can keep its liquidity high, according to this theory. According to Chinweoda et al.'s research from 2020, shiftability refers to a strategy that entails depository institutions keeping a proportional mix of liquid assets and illiquid loans. An extra reserve is created by the liquid securities in case there are any unanticipated liquidity issues in the future. When seen from this angle, the term "secondary reserve" refers to any security that is retained for the purpose of conversion in the event of a liquidity crisis, while cash assets constitute the primary reserves (Bagh et al.'s 2017 definition). The notion of shiftability contends that a bank's liquidity is assured when the bank has assets that may be transferred to other banks prior to maturity in the event that it is required to do so. The "shiftability" of assets in this sense means that they are transferred to the central bank instead of other banks. Lastly, the central bank is the country's last resort lender.

2.2.2 Liquidity Preference Theory

In 1936, Keynes came up with the idea of the liquidity preference hypothesis. In order for investment banks to trade with one another or their clients, this theory explains their liquidity, interest rates, and credit status. Interest rates, according to Keynes, should be seen as a matter of trade. Interest rates are subject to market forces such as supply and demand for money, since they are considered a return on investment for the exchange of liquidity. People appreciate money for two reasons, according to Keynes's liquidity preference theory: first, for immediate purchases and second, as a means to accumulate wealth for the future. For this reason, they would forego the opportunity to earn interest on funds that they may use immediately or even set aside as a cushion. According to the results of the research conducted by Chinweoda et al. in 2020, individuals are prepared to sacrifice some of their savings for the listed goals if interest rates were to rise.

By financing somewhat illiquid assets with comparatively liquid liabilities, the theory contends that banks are able to generate liquidity on their balance sheets. With this notion in mind, investors often demand high interest rates when dealing with assets that have maturities that are over a lengthy period of time. According to Onyango and Gatumo (2022), interest is the repayment that is made for the provision of liquidity for a certain amount of time. Keynes introduces the liquidity preference theory there as a theory of interest that emphasises liquidity preferences. The gap that he saw in the conventional savings theory that piqued his attention is what this theory aims to fill. According to the 2019 research by Pradhan and Gautam, known as the liquidity preference hypothesis, individuals place a high value on money for both making immediate purchases and storing wealth for the future.

The speculative motivation, the cautious motive, and the transaction drive are the three reasons that Keynes (1936) highlighted as being vital for liquid cash. Banks' operational cash needs for conducting economic transactions are collectively known as the need for money for transaction purposes. This demand is typically determined by the quantity of the income, the amount of time that passes between the sources of revenue, and the spending habits of the borrowers. On the other hand, the speculative motivation is when banks retain cash on hand in order to take advantage of fluctuations in the values of bonds and securities (Li et al., 2020). The precautionary motive is a postulate that states that when banks wish to preserve some liquid money to meet any unanticipated crises, eventualities, and mishaps. As a result, this theory will be helpful in understanding how banks retain money to fulfill the liquidity demands of their members in contrast to the three reasons of hold. The liquidity preference approach in the banking industry proposes that banks adopt active balance sheet strategies rather than simply accommodating the demand for credit.

2.2.3 Trade-off Theory

A corporation should strive to have an optimal degree of liquidity, according to the trade-off theory, in order to achieve a balance between the costs associated with retaining liquid assets and the advantages that result from holding such assets. The tax disadvantage and the poor profits that such assets bring to the company are both included in the cost of retaining liquid assets—according to Guise (2020). Liquid assets, on the other hand, have several benefits. First, they enable the firm to have enough liquid assets for its transactions thereby saving the firm on transaction costs that it could have incurred to liquidate long-term assets. Secondly, liquid assets enable the firm to have

low cost investment funds when other sources of funds prove to be expensive or are not available. According to Shrestha (2018), there is an ideal degree of liquidity for a company that strikes a balance between the advantages and hazards of having liquid assets.

Potentially showing more favorable effects throughout the phases of crisis, the link between profitability and liquidity might be significantly recurrent. This is due to the fact that banks see a rise in profitability together with an improvement in their liquidity situation. A bank's ideal liquidity level will change during the economic cycle, according to the tradeoff theory, with an increase expected in response to rising predicted costs of distress. According to Malik, Awais, and Khursheed (2016), the short-term correlation between liquidity and profitability could be positive or negative, depending upon the gap between the bank's actual and intended liquidity. The ideal liquidity of the bank is a determining factor here. According to Anandasayanan (2020), the theory suggests that every business must choose between two competing goals: liquidity and profitability.

It follows that a bank can't aim for both high profits and stable liquidity at the same time, as Shrestha (2018) points out. This suggests that financial institutions should aim for an optimal liquidity level, as suggested by Guise (2020), to find a middle ground between the benefits of holding cash—like lowering transaction costs—and the drawbacks, like a tax disadvantage and a liquidity premium. this theory describes how liquidity may influence the firm's performance by providing an explanation for how ownership of highly liquid current assets could effect the firm's performance. One of the most crucial parts of this study is the trade-off theory, which explains how corporations with a lot of cash on hand might have low returns on their liquid assets but less risk overall because they can pay their short-term obligations without getting into debt.

2.3 Determinants of Financial Performance

2.3.1 Liquidity

One of the most important factors in a credit institution's financial performance is its liquidity, say Augustin and Darmawan (2019). Liquidity is a measure of a bank's ability to pay back its creditors when it's really needed, and it's specifically a measure of the amount of money the bank has on hand that can cover its short-term financial obligations (Muslih & Marbun, 2022). Mobilizing low-interest short-term deposits, together with long-term investments or loans made at growing interest rates, is a common way for organizations to create assets and liabilities. As a result, there is a need for effective management by these institutions. The profitability of the business is negatively

impacted by issues related to liquidity, which in turn leads to difficulties with solvency. According to Onyekwelu, Chukwuani, and Onyeka (2018), liquidity is one of the primary measures of financial stability. This is with the understanding that a lack of liquidity in a single institution might result in systemic issues across the banking sub-sector due to the interconnectedness of the institutions.

2.3.2 Bank Size

The size of a bank is a reflection of the institutional strengths and the capabilities of the bank to deal with issues related with asymmetry of information, which may result in a reduction in the amount of non-performing loans. According to Harelimana (2017), this might be an indication that the variety of options is expanding, which in turn reduces the risk that the institution is exposed to. In addition to being able to obtain financing at lower rates, larger institutions are able to reap the advantages of economies of scale, which results in such organizations having lower expenses. It is expected that the firm's capacity to create and fulfill its different commitments will expand as the organization grows in size. According to Muslih and Marbun (2022), the terms "company size indicators" may be translated into a variety of other metrics, including the value of assets and the quantity of capital for the company. As the corporation becomes larger, it will be required to provide more information about the company's status, including financial and other details. As the business grows, this need will become more pressing. The study done by Agustin and Darmawan (2019) found that the size of the organization significantly affected its financial success.

2.3.3 Capital Adequacy

A bank is considered to have sufficient capital if its present capital can cover the cost of increasing its assets. A specific amount of capital is required by institutions (Harelimana, 2017) so that they can withstand the credit, financial, market, and operational risks they face, absorb any losses that may occur, and launch expansion into risky but potentially lucrative initiatives. Maintaining an acceptable amount of capital is a crucial component, and meeting the statutory minimum capital requirement is the most important issue to consider when determining whether or not a company has sufficient capital (Guisse, 2020). Banks that have a lower capital adequacy are deemed to be at a high risk, which makes it harder for them to receive money at a reduced cost and raises the cost of capital, which in turn has an impact on their overall success. As a result of this advantage,

well-capitalized institutions have reduced predicted bankruptcy costs, which translates into greater performance, according to a research that was conducted by Harelimana (2017).

2.3.4 Non Performing Loans

According to Agustin and Darmawan (2019), non-performing loans are the outcome of situations in which debtors are unable to return their loans and the interest they have accrued on those loans within the allotted time frame. This has a negative impact on the financial situation of the creditor. The most significant impact that poor loans have on financial institutions is the fact that they restrict the expansion of the banks' financial resources. As a result, if a financial institution does not successfully implement an effective system for managing credit risk, it will be confronted with a great deal of difficulties. According to Mensah et al. (2013), high default rates cause a decline in the degree of trust held by both depositors and foreign investors. These individuals may take an unusual stance against the banks, which might lead to a negative signal and liquidity issues. NPLs rate is a measure of non-performing loans, which is an aggregation of substandard, dubious, and loss categories that offer a high degree of difficulty for recovery. This rate is used to determine the amount of non-performing loans. In addition to being referred to as high risk, the ratio is produced by linking the component to the overall loan portfolio (Muslih & Marbun, 2022).

2.4 Empirical Review

The study conducted by Onyango and Gatumo (2022) reveals that investment banks in Kenya have challenges related to liquidity. The research used an explanatory research methodology and utilized secondary data obtained from sixteen investment banks that were operational during the years 2011 and 2019. The findings derived from the regression analysis indicate that investment banks operating in Kenya exhibit a limited level of apprehension towards liquidity risk, and this worry has a little, adverse impact on their financial performance. The authors of the report suggest that investment banks should consider diversifying their funding sources by shifting away from conservative stock financing and towards debt financing. Investment banks should also improve their processes for handling client funds, according to the survey.

Anandasayanan (2020) states that a comprehensive study was carried out in Sri Lanka to determine how liquidity management affected bank profitability. Starting in 1998 and continuing up until 2017, information was collected from 26 different Sri Lankan banks. Regression, correlation, and descriptive statistics were the tools of choice for the statisticians working on this project. The

correlation analysis shows that interest, capitalization ratio, and ROA are positively related. However, it was noted that the capital adequacy ratio and return on asset had a negative association. Our results show that liquidity and profitability are highly related according to the regression analysis.

Li et al. (2020) looked at non-financial publicly traded companies in Ghana and how liquidity relates to their sustainability. A comprehensive battery of statistical tests was run, including evaluations for heteroscedasticity, co-integration, causality, serial correlation, cross-sectional dependency, and unit root. The secondary data gathering process, which included fifteen different sources covering the years 2008–2017, was followed by these tests. Input variables are stable and co-integrated, there is no serial correlation or heteroscedasticity, and there is no cross-sectional dependence, according to the findings. The findings from a random effects generalized least squares regression analysis indicate that liquidity has a substantial negative impact on return on equity (ROE), while exhibiting a little positive influence.

The study undertaken by Sathyamoorthi, Mapharing, and Dzimiri investigated the influence of liquidity management on the financial performance of commercial banks operating in Botswana during the calendar year 2020. Between the years 2011 and 2019, a group of researchers systematically collected secondary data from a total of nine distinct commercial banks. Ratios of liquid assets to total assets and total assets to loans both indicate a favorable correlation with performance in the regression analysis. Statistical study revealed a negative association between performance assessments and the ratios of liquid assets to deposits and loans to deposits. The correlation between ROA and the proportion of total assets held in cash and equivalents was weak but favorable. Similarly, the percentage of deposits held in cash was shown to have a small but positive link with ROE. In contrast, there was a slight but negative link between ROA and the percentage of deposits kept in cash.

To determine how liquidity management affected the bottom lines of Nigerian banks from 2010 to 2018, Wuave, Yua, and Yua (2020) went through their financial data. The data used in this research was sourced from five distinct publicly listed banks in Nigeria. The study determined whether to use a random effect or fixed effect model by estimating the model using panel regression analysis and the Hausman test. Based on ROA, ROE, and net interest margin, the study concluded that the liquidity ratio significantly impacts banks' financial performance for the better.

Kenyan microfinance enterprises' bottom lines were studied by Njue (2020). All of the data, primary and secondary, was collected using questionnaires. The data was collected from 26 MFIs as secondary sources for the five-year period of 2012–2016. The methods of regression analysis and Pearson correlation were selected for our study. After looking at the numbers, it was clear that liquidity management strategies greatly affected the bottom lines of M&F banks. There was a small but noticeable detrimental effect on financial performance from the disparity in asset quality and maturity. The financial performance of several MFIs was positively and significantly affected by capital adequacy.

Pradhan and Gautam (2019) looked at how private Indian banks' liquidity management correlated with their profitability. Ten different private sector banks had their data collected between 2013 and 2017. Return on assets was shown to be strongly impacted negatively by the cash deposit ratio and the interest deposit ratio, according to regression analysis. For ROA, this turned out to be true. However, research has shown that banks' profitability and liquidity are unrelated when it comes to return on equity.

Researchers Ogilo, Omwoyo, and Onsumu (2018) looked at the correlation between commercial banks in Kenya going bankrupt and liquidity risk. Secondary data was sourced from real-time bank websites from 2013 to 2016. Logit panel regression was used for data analysis. Regression analysis revealed a positive and statistically significant relationship between the two variables, suggesting that more liquid banks were more prone to go bankrupt. One interesting finding from the study of failed Kenyan commercial banks was the lack of association between bank size and capital sufficiency.

In 2017, Muriithi and Waweru conducted research on how liquidity risk was affecting the profitability of commercial banks in Kenya. A total of 43 commercial banks in Kenya had their data gathered from 2005 to 2014. Some of the panel data methods utilized to run the study were generalized technique of moments and random effects estimation. Net short-term interest rate (NSFR) has a negative correlation with both long- and short-term bank profitability, according to the data. On the other hand, commercial banks in Kenya are unaffected by the loan-to-value ratio (LCR) over the long run. The overall effect of liquidity risk was to reduce the efficiency of the financial system.

In their research, Musiega, Olwney, and Mutna (2017) sought to investigate the influence of liquidity risk on the operational efficiency of commercial banks in Kenya. Based on secondary sources, the research included a comprehensive sample of forty-four commercial banks that are currently operational within the Kenyan market. It is noteworthy to mention that two of the aforementioned banks were placed under receivership, while one was subjected to statutory administration. For thirty different commercial banks, panel data was collected via both the institutions' own websites and the Central Bank of Kenya's. A whole ten years' worth of data was gathered, beginning in 2006. Data analysis methods such as descriptive statistics, correlation analysis, fixed and random effects models, and others were chosen. The study observed a robust positive relationship between performance and liquidity risk, as indicated by the ratio of readily convertible assets to total assets.

2.5 Conceptual Framework

This study comprises of the independent variable (financial performance), the control variables (size, capital adequacy and NPL) and the dependent variable (financial performance). Figure 2.1 shows the conceptual framework.

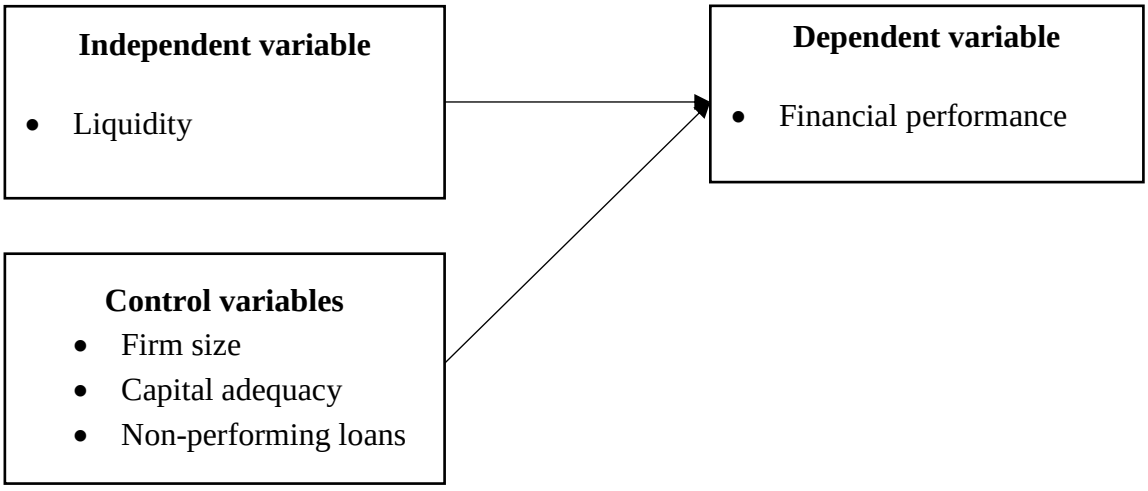

Figure 2.1: Conceptual Framework

Source: Authors (2023)

2.6 Summary of Literature Review

The results of this study indicate that many empirical studies concerning liquidity and financial performance have been reviewed. In contrast, the included studies employed a wide range of alternative variable measurements and were carried out in different contexts. For example, Li et al. (2020) looked at the liquidity and sustainability of non-financial publicly listed Ghanaian enterprises, while Anandasayanan (2020) studied the profitability and liquidity management practices of Sri Lankan banks. Private sector banks in India were studied for their profitability and liquidity management strategies in a 2019 research by Pradhan and Gautam. Both Onyango and Gatumo (2022) and Njue (2020) investigated Kenyan financial institutions, with the former focusing on investment banks and the latter on microfinance organizations (MFIs). Kenya was the site of both of these investigations. More specifically, Ogilo, Omwoyo, and Onsumu (2018) investigated how liquidity risk was associated with the failure of commercial banks in Kenya, while Musiega, Olwney, and Mutna (2017) looked at how liquidity risk affected output. Adding insult to injury, much of the previous research has similarly focused on wealthy nations when

seeking proof. So, researchers in Kenya may still look at the link between the liquidity of NDTM institutions and how well they do financially.

CHAPTER THREE: RESEARCH METHODOLOGY

3.1 Introduction

This chapter gives a synopsis of the methodology utilized to carry out the research. This chapter delves deep into the study's methodology, demographic, research design, data collecting procedures, and analytic tools.

3.2 Research Design

In this particular study, a descriptive research approach will be used. Kothari (2012) states that descriptive research is an approach to study design that aims to provide an account of the characteristics and facts of the phenomenon or population under consideration. To report on the numerous traits that make someone competent, and to study factors without trying to modify them, a descriptive research technique will be used. Also, descriptive research, whether qualitative, quantitative, or a hybrid of the two, provides comprehensive details on the examined setting or event. Sekaran and Bougie (2013) state that the descriptive strategy allowed for the discovery of correlations between different variables. It was possible to ascertain the independence of the variables, measure the strength of the relationship, and so on because of this.

Accurately profiling events, people, or situations is the goal of descriptive research (Saunders, Lewis, and Thornhill, 2016). To achieve this goal, prior to commencing the research endeavor, the researcher must possess a thorough comprehension of the phenomenon about which data will be collected. The descriptive research design was selected because it is more specific and accurate than other research designs. This research design includes the description of events and situations in a manner that is well organized, and it also presents the features of a population in their whole (Yin, 2003).

3.3 Population of the Study

Population is a term that describes an entire collection of entities, things, or events that have a common characteristic that can be seen collectively (Kothari, 2012). The definition of a population given by Ruzzier (2006) is a clearly defined group of goods or people that share characteristics. A population is defined as the set of people about whose data is being collected in a research study. As a result of the fact that the majority of researchers are unable to include all members of the public in their studies, they are forced to restrict the number of participants to just a sample of 31

people from the community. According to Saunders, Lewis, and Thornhill (2016), the word "population" encompasses the whole set of instances or components from which a sample is taken.

The sample for this study included all 32 non-banking financial institutions in Kenya as of December 31, 2022 (Appendix I). Consequently, a census of the 32 non-traditional financial institutions in Kenya was carried out as part of the research. It is feasible to conduct a census for a tiny population, and it is required when the elements are extremely distinct from one another. There was a high level of confidence in identifying the number of non-traditional financial institutions, and the tiny population made it reasonable to use the census for this study.

3.4 Data Collection

During the course of this inquiry, secondary data was gathered on a yearly basis. The data collection sheet given by the Association of Mutual Funds in India - Karnataka (AMFI-K) was used for the acquisition of secondary data. To get information pertaining to liquidity coverage ratio, total assets, capital adequacy, age, and financial performance (ROA), we conducted an analysis of the financial statements of individual banks, the CBK, and AMFI-K. The data was retained for a duration of five years, commencing in 2018 and concluding in 2022.

3.5 Data Analysis

Using SPSS's descriptive and inferential statistical procedures in tandem will simplify data analysis. Data will be analyzed descriptively, with metrics like standard deviation, mean, maximum, and lowest values included. Using inferential statistics, this study aims to find out whether liquidity and financial performance are related. By using correlation and regression analysis, in their respective roles, this aim may be more easily achieved.

3.5.1 Diagnostic Tests

The validity of the model was determined by conducting a battery of diagnostic tests. Among these were tests for things like multi-collinearity, homogeneity, autocorrelation, and normality. What we mean by "normal" is that the dependent variable's residual will follow a normal distribution, with the mean in the middle. The Shapiro-Wilk and Kolmogorov-Smirnov tests, among others, will be used for this purpose. In circumstances where a non-normally distributed variable was present, the logarithmic adjustment approach was used to facilitate corrections. One way to measure the degree to which two time series are similar across different periods is by looking at

their autocorrelation. This examination's results were evaluated using the Durbin-Watson statistic. Based on Khan (2008), the model will use resilient standard errors in the event that the assumption is not met.

Multicollinearity is a phenomena that arises when a strong or near-perfect linear relationship exists among many independent variables. A combination of VIF and tolerance levels will be used. After identifying and eliminating variables with multicollinearity, a new measurement will be introduced to replace the old one. Determining whether the residual dispersion in a regression study is reliant on the independent variables is done using the concept of heteroscedasticity. To check whether the data were equal variance, researchers used robust standard errors; otherwise, they used the Levene test (Burns & Burns, 2008).

3.5.2 Analytical Model

The following equation described the regression:

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

Where:

Y = Financial performance (ROA)

β_0 - Intercept (constant)

β_1 - β_5 = Beta coefficients

X_1 = Liquidity measured using the liquidity coverage ratio

X_2 = Firm size measured using the natural log of assets.

X_3 = Capital adequacy measured using the capital adequacy ratio

X_4 = Non-performing loans measured through the NPLR.

ε = Error term

3.6 Test of Significance

In order to determine whether or not the explanatory factors and the response variable were statistically significant, the t-test and the F-test were applied, respectively. At a significance level of 5%, the statistical significance tests were carried out respectively.

CHAPTER FOUR: DATA ANALYSIS, RESULTS AND DISCUSSION

4.1 Introduction

This chapter provides the results and interpretations that were deduced from the first assessed data. Consequently, the chapter encompasses an examination of the investigation's findings, along with a comprehensive analysis of the variables under consideration, the outputs of correlation and regression analyses, and ultimately, the study's conclusions.

4.2 Descriptive Statistics

This study set out to enumerate all thirty-two of Kenya's NDTs. Thirty NDT banks were able to participate, yielding a response rate of 93.75 percent. Mean, standard deviation, minimum, and maximum values were part of the descriptive statistics used to describe the research data. You can see the study's results in Table 4.1.

Table 4.1: Descriptive Statistics

	N	Minimum	Maximum	Mean	Std. Deviation
	Statistic	Statistic	Statistic	Statistic	Statistic
ROA	150	.00	.30	.1067	.07574
Liquidity	150	.02	7.20	.5489	1.21853
Non-performing loans	150	.00	15.00	1.0310	2.71447
Capital Adequacy	150	-5.67	.61	-.0207	.75177
Bank Size	150	7.20	8.73	8.0507	.41386
Valid N (listwise)	150				

Source: Authors (2023)

The data shown in Table 4.1 demonstrates that the ROA had a mean value of 0.1067 (S.D = 0.07574), with the smallest value being 0.00 and the highest value being 0.30. The fact that the minimal value is 0.000 suggests that some of the microfinance institutions have been experiencing losses in certain years is shown by this fact. The average value of liquidity was 0.5489, with a S.D of 1.21853. The lowest and greatest values of liquidity were respectively 0.02 and 7.20. The fact that the lowest low value was 0.02 suggests that some of the banks had low liquidity in certain years is shown by the finding. The study revealed that the mean bank size was 8.0507 (S.D = 041386). The minimum observed value was 7.20, while the maximum observed value was 8.73.

The capital adequacy values ranged from -5.67 to 0.61, with an average value of -0.0207 (S.D = 0.75177). The study found that the mean value of NPL was 1.0310, with a S.D of 2.7447. The minimum value observed was 0.000, while the maximum value recorded was 15.00.

4.3 Diagnostic Tests

To ensure the regression model's assumptions were not violated and to provide models suitable for scrutiny, diagnostic tests were conducted. This allowed the study to proceed. In light of this, pre-approximation and post-approximation evaluations were performed on the regression model before it was processed. In the context of addressing such scenarios, the preliminary assessments conducted included the examination of multicollinearity and the assessment of unit roots. Conversely, the post-estimation analysis included assessments for normality, heteroskedasticity, and autocorrelation. The research used these analyses to mitigate the potential for incorrect outcomes arising from the regression tests.

4.3.1 Normality Test

Various approaches may be used to assess the normality of data. Statistical analysis often makes use of the following techniques: the Shapiro-Wilk test, the Kolmogorov-Smirnov test, histogram analysis, P-P plots, box plots, Q-Q plots, and the computation of mean and standard deviation. Many tests for normality are in use, including the Shapiro-Wilk and the Kolmogorov-Smirnov tests. Although it may be used to higher sample sizes, the Shapiro-Wilk test is thought to work better with smaller samples ($n < 50$). However, when the sample size is more than fifty, the Kolmogorov-Smirnov test is often used. Consequently, the research used the Kolmogorov-Smirnov test as the quantitative approach for assessing normalcy.

Table 4.2: Normality test

	Skewness Statistic	Std. Error	Kurtosis Statistic	Std. Error
Return on Assets	.723	.297	-.173	.586
Liquidity	5.234	.297	27.330	.586
Non-Performing Loans	4.647	.297	21.678	.586
Capital Adequacy	-6.846	.297	51.548	.586
Bank Size	-.397	.297	-.849	.586

From the table 4.2 the skewness value for ROA was 0.723 and the kurtosis value was -.173. Both of the values fell within the normal range for a normal distribution. The skewness value for liquidity was 5.234 and the kurtosis value was 27.330. Both of skewness value and the kurtosis values were in the acceptable range for a normal distribution. The skewness value for NPL was 4.647 and the kurtosis value was 21.678. The skweness and kurtosis for capital adequacy and bank size were -6.846, 51.548 and -0.397, -0.849 respectively.

4.3.2 Multicollinearity Test

Multicollinearity is a problem in regression models where there is a lot of correlation between the independent variables. We checked for multicollinearity using the tolerance indices and VIF. It is evident that multicollinearity has occurred and the assumption has been violated when the VIF exceeds 10 and the tolerance score falls below 0.2. Results from the VIF show that there are no multicollinearity problems since the values are less than 10.

Table 4.3: Multicollinearity Test

Kolmogorov-Smirnov		**P-value**
Return on Assets	.890	1.112
Liquidity	.911	1.011
Non-Performing Loans	.897	1.024
Capital Adequacy	.925	1.196
Bank Size	.958	1.156

Table 4.4 displays the results, which reveal that all of the study variables followed a normal distribution with p-values larger than 0.05.

4.3.3 Homoscedasticity

Homoscedasticity was tested via histogram. The test results were presented on figure 4.1.

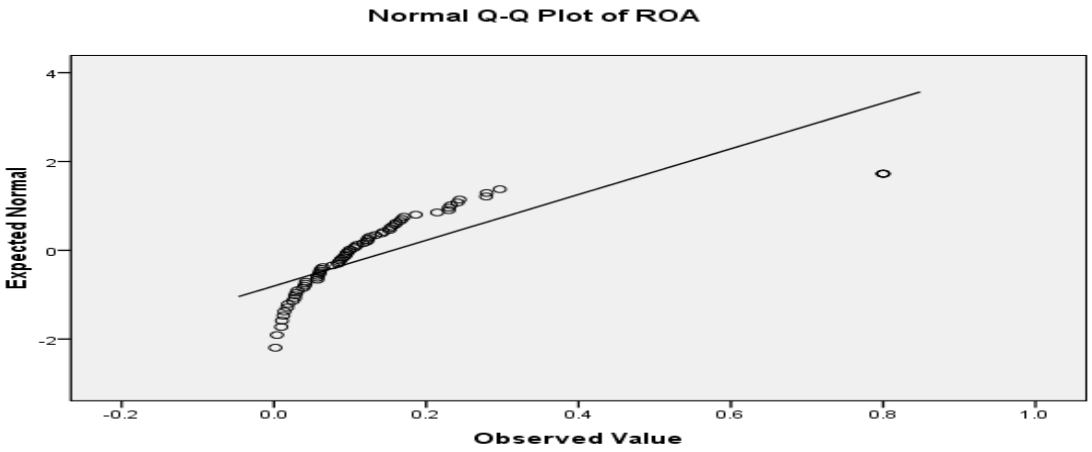

Figure 4.1: Homoscedasticity

From figure 4.1 it was evident that a relationship did exist between the regression standardized residual and frequency of the dependent variable ROA. Thus homoscedasticity assumption was not violated by the data set. When the Durbin Watson statistic is between 0 and 4, it indicates positive autocorrelation; conversely, when it is between 2 and less than 4, it indicates negative autocorrelation. In the absence of autocorrelation, values around 2 or equal to 2 indicate the data. When testing for multicollinearity, the degree of correlation between variables is examined. A VIF was used to test for multicollinearity in the research. High correlation is indicated by a VIF value more than 5, moderate correlation is 1<VIF<5, and no correlation is seen when VIF=1.

Table 4.4: Autocorrelation

Autocorrelation	
Durbin-Watson Statistic	1.679

A value of 1.679 was determined for the Durbin-Watson Statistic by consulting the autocorrelation table. A rough approximation puts the value at 2. It followed that the variables under consideration did not exhibit any signs of autocorrelation.

4.4 Correlation Analysis

Using the Pearson correlation, we may learn more about the connection between the variables. The correlation matrix is an important indication seeing how the variables are linearly related to one another. You may use the matrix to evaluate the significance of the model's variables as well. To do this, we need to identify the variable that best explains the correlation between liquidity and financial results. Table 4.5 displays a correlation matrix for the variables.

The results of the correlation study, which are shown in table 4.5, demonstrate that there exists a robust and favorable relationship between the liquidity of microfinance banks and their financial success (r=0.523, p <5%). Consequently, this suggested that there is a correlation between increasing levels of liquidity and improved levels of financial performance among NDT financial institutions in Kenya.

Table 4.5: Correlation Matrix

		ROA	Liquidity	Capital adequacy	NPL	Bank size
ROA	Pearson Correlation	1				
Liquidity	Pearson Correlation	.384*	1			
	Sig. (2-tailed)	.016				
Capital adequacy	Pearson Correlation	.463**	.197	1		
	Sig. (2-tailed)	.000	.000			
NPL	Pearson Correlation	-.224**	-.204**	-.006	1	
	Sig. (2-tailed)	.000	.004	.000		
Bank Size	Pearson Correlation	.591**	.283**	0.211**	-.316**	1
	Sig. (2-tailed)	.000	.000	.003	.000	
*. Correlation is significant at the 0.05 level (2-tailed).						
**. Correlation is significant at the 0.01 level (2-tailed).						

Source: Authors (2023)

Both liquidity and capital sufficiency were positively correlated with ROA (r=0.384 and r=0.463, respectively). The two corresponding variables are shown in Table 4.5. Also, there was a positive and statistically significant correlation between bank size and ROA (r=0.591) in the results.

According to the findings, NPL showed a negative association (r=-0.224) with ROA accordingly. This was the average correlation.

4.4 Regression Analysis

For the purpose of determining the nature of the connection that exists between liquidity, bank size, capital adequacy, NPL, and financial performance (ROA), regression analysis was used. The following is a list of the results.

4.4.1 Model Summary

Table 4.6: Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.623[a]	.452	.351	.02256

a. Predictors: (Constant), NPL, Bank size, Liquidity, Capital adequacy

Source: Authors (2023)

Financial performance (ROA) was shown to be 45.2% explicable by nonperforming loans (NPL), bank size, liquidity, and capital adequacy, as shown in Table 4.6 with a R squared value of 0.452. The remaining 54.8% was explained by variables beyond the scope of the research and the error term.

4.4.2 Analysis of Variance (ANOVA)

Table 4.7: ANOVA

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	.189	4	.047	44.806	.000[b]
	Residual	.174	148	.001		
	Total	.363	149			

a. Dependent Variable: ROA

b. Predictors: (Constant), NPL, Bank size, Liquidity, Capital adequacy

Source: Authors (2023)

A P-value of 0.000 < 0.05 indicates that the ANOVA findings in table 4.7 above are statistically significant, with an F-statistic of 44.806. That the regression model worked and was statistically significant proves that it was appropriate for the research.

4.4.3 Coefficients

Table 4.8: Coefficients

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	-.036	.014		-2.532	.012
	Liquidity	.031	.007	.268	4.310	.000
	Bank size	.006	.002	.137	2.416	.017
	Capital adequacy	.090	.023	.249	3.837	.000
	NPL	-.104	.013	-.525	-7.704	.000

a. Dependent Variable: ROA

Source: Authors (2023)

There was a favorable impact of liquidity on financial performance (ROA) (B=0.031) and a significant effect (P-value=0.000<0.05) on ROA, as shown in Table 4.8. The findings reveal that ROA was positively correlated with bank size (B = 0.006) and significantly correlated with capital adequacy (P-value = 0.000< 0.05), respectively. The ROA of nNPLs in Kenyan financial institutions was negatively impacted (B= -0.104) and significantly (P-value = 0.00 < 0.05). Using the data, the following regression model was created.

$$Y = -0.036 + 0.031X_1 + 0.006X_2 + 0.090X_3 - 0.104X_4$$

4.5 Interpretation of the Findings

Findings indicated that liquidity has a positive (B=0.031) and significant impact on ROA, or financial success. The ROA of Kenyan banks increases positively and substantially by 0.031 units for every one unit rise in liquidity of NDT financial institutions. Accordingly, it seems that liquidity significantly and positively affects banks' bottom lines. According to Zaharum et al.

(2022), banks' performance is positively affected by liquidity. Research by Khati (2020) found a weak but favorable relationship between banks' liquidity and their performance. Microfinance institutions' performance was shown to be significantly related to bank liquidity metrics (Malik, Awais, and Khursheed, 2016). In contrast, Shrestha (2018) found that liquidity was not significantly related to profitability.

Furthermore, the results showed that ROA was significantly and positively correlated with bank size (B = 0.006). This finding suggests that the ROA of Kenyan microfinance institutions is significantly enhanced by 0.006 units for every unit rise in the asset size of NDT banks. This proves that NDT financial institutions' financial performance is significantly and positively affected by the bank's size. According to Muslih and Marbun (2022), as the size of the business increases, the company will be obliged to provide more information about its condition, whether it be financial conditions or other circumstances. This recommendation is supported by the fact that the company will be needed to disclose more information. According to Agustin and Darmawan's (2019) study, a company's financial performance was negatively and significantly affected by its size.

It is clear from the numbers that ROA and capital sufficiency are positively and statistically related (B = 0.090). These figures show that NDT financial institutions in Kenya benefit greatly from capital sufficiency in terms of their financial success. Specifically, for every unit increase in capital adequacy, financial performance rises by 0.090 units. Guisse (2020) asserts that banks and other financial organizations with inadequate capital are considered to be very vulnerable. The cost of capital rises and these institutions have a harder time obtaining cheaper funding, which affects their performance in the long run. Harelimana (2017) found that institutions with sufficient capital have better financial stability and are less likely to incur bankruptcy-related expenses, which translates to better overall performance.

According to the results, NDT financial institutions' ROA was significantly and negatively affected by the quantity of non-performing loans. Based on these numbers, we can say that for every one unit rise in the amount of non-performing loans, the financial performance of Kenyan banks dropped by 0.104 units. According to the findings, NDT financial institutions' bottom lines take a serious hit when their loan portfolios exceed a certain threshold for performance. Depositors and international investors lose faith when default rates are high (Mensah et al., 2013). As a

consequence, these individuals may take an unusual stance against non-performing loans (NDT) financial institutions, which might lead to a negative signal and liquidity issues.

CHAPTER FIVE: SUMMARY, CONCLUSION AND RECOMMENDATIONS

5.1 Introduction

A brief synopsis of the study's findings, along with some interpretations and recommendations, are presented in this chapter. This section also includes a summary of the study's shortcomings as well as suggestions for future investigations.

5.2 Summary

Finding out how liquidity affects the bottom lines of Kenya's commercial banks was the driving force for this research. In particular, the theories of liquidity shiftability, tradeoff, and liquidity preference will form the basis of this investigation. The thirty-two non-traditional financial institutions that were part of this descriptive analysis were all active in Kenya as of December 31, 2022. In order to collect data for the study, the thirty NDT were subsequently interviewed extensively. The research, which spanned 2018–2022, relied only on secondary data acquired yearly using a data collecting sheet. The SPSS application was used to do the data analysis. In addition to the more conventional measures such as standard deviation, mean, maximum, and minimum values, this study also used inferential statistics using methods such as regression analysis and correlation.

Results from descriptive statistics show that ROA had a mean of 0.00179 and a S.D of 0.046329, according to the dataset. At its lowest point, ROA was -0.303 and at its highest point, it was 0.070. Some financial institutions may have suffered losses in particular years if a negative value of -0.303 is present. There was a S.D of 0.397015 and a mean liquidity value of 0.49018. The values of liquidity varied between -0.254 and 3.622. Some of the banks included in the research may have experienced negative liquidity throughout the study years, as indicated by the occurrence of a minimum negative value of -0.254. The survey found that the average bank size was 8.525, the average capital adequacy was 0.19829, and the average nNPL were 0.22806.

After conducting a correlation analysis, it was shown that the liquidity of a bank exhibited a weak however positive connection with return on assets (ROA). Similarly, ROA was positively and weakly correlated with bank size. Additional evidence suggests a favorable and robust correlation

between capital sufficiency and ROA. In addition, the data shows that the ratio of non-performing loans to operational assets has a significant negative relationship with ROI.

A regression analysis reveals that financial performance, particularly ROA, is enhanced by liquidity. Furthermore, the research found a favorable and statistically significant relationship between ROA and bank size. ROA was favorably and statistically connected with the capital adequacy of the bank. The ROA of Kenyan banks has been hit hard by nonperforming loans (NPLs).

5.3 Conclusions

The findings indicate that liquidity significantly impacts the financial system's operational dynamics for the better. Microfinance organizations' financial performance is positively and significantly affected by liquidity, according to research based on the aforementioned fact. The second discovery showed that the larger the bank, the more favorably and strongly associated the return on extra assets with the bank's size. Findings from this study support the idea that non-traditional financial firms' bottom lines benefit from having bigger banks as customers.

In addition, the research found a positive and statistically significant relationship between return on assets and capital adequacy. Microfinance organizations are more likely to be financially successful if they have access to enough capital, the research found. The study's authors concluded that microfinance institutions' ROA was significantly and negatively impacted by non-performing loans. Findings show that financial institutions dealing with NDTs see a negative and statistically significant relationship between the volume of nonperforming loans and their profitability.

5.4 Recommendations

According to the study's conclusions, NDT financial institutions' bottom lines benefit greatly from increased liquidity. Microfinance bank management should provide enough liquidity, according to this study's results. This is due to the fact that a company's ability to pay its bills is partly dictated by its liquidity, and that its involvement in the ease and happiness of its consumers is most strongly correlated with its ability to preserve its liquidity.

This study found that NDT financial institutions' financial performance is significantly and favorably affected by the size of the bank. This finding supports the premise that non-banking financial institution management in Kenya should prioritise increasing asset investment. Reason

being, bigger banks can take use of economies of scale, which means they can obtain smaller quantities of money for less money overall. Hence, smaller banks can afford to have cheaper expenses.

Further, this study's results show that non-traditional financial institutions' financial performance is significantly and favorably affected by their degree of capital adequacy. Based on these findings, the study recommends that microfinance bank management provide enough capital and capital buffers. This is due to the fact that with sufficient capital, banks can weather the storms of credit, finance, markets, and operations, and even recoup some of their losses. What's more, with sufficient capital, banks may launch growth initiatives that are both risky and lucrative.

As a conclusion, this study found that non-performing loan amounts significantly affect the bottom lines of NDT banks. In order to ensure that Kenyan banks can profit from the interest revenue generated by loan repayments, this research suggests that bank management should take steps to reduce the number of NPLs and improve loan loss provisioning.

5.5 Limitations of the Study

It is possible that the conclusions of this research cannot be applied to other nations throughout the globe since the operations of non-traditional financial institutions vary from country to country and various currencies are utilized in each country. Kenya was the site of this research. Furthermore, there is a wide range in the rates of economic development across countries. In addition, the study established the interrelationships between the variables by means of the regression model. Nevertheless, to keep the regression model from departing from its assumptions, it could be required to alter or exclude variables from the dataset. Additional resources used in the research included secondary data and accounting ratios. As an inherent quality, these procedures are historically oriented and fail to account for the qualitative viewpoints of bank executives.

5.6 Suggestions for Further Research

Despite its limitations, this research used the regression model to analyze the data. To circumvent this issue, the authors of this research recommend undertaking another one similar to it. Researchers may choose to use non-parametric tools, such as chi-square or general mores, to perform the study instead of parametric approaches. Due to an over-reliance on secondary sources, the qualitative perspectives and opinions of agricultural firm executives about liquidity's impact

on financial performance were ignored. Primary data, such as that gathered from interviews and surveys, is crucial for conducting similar studies and accurately assessing the interrelationships of the variables. Not only that, the research model summary indicated that NPLs, bank size, liquidity, and capital adequacy accounted for 45.2% of the variance in return on assets (ROA).

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APPENDICES

APPENDIX I: DATA COLLECTION FORM

YEAR	Net Income	Liquidity Ratio	Return on Assets	Capital Adequacy	NPL	Total Assets
2018						
2019						
2020						
2021						
2022						

APPENDIX II: LIST OF NON DEPOSIT TAKING FINANCIAL IN KENYA

1. AFRACA – African Rural and Agricultural Credit Association
2. BIMAS Kenya Limited. Website
3. Century Microfinance Bank Limited
4. Choice Microfinance Bank Limited
5. Daraja Microfinance Bank Limited
6. ECLOF Kenya. Website
7. FinCredit Limited. Website
8. Hand to Hand Eastern Africa
9. Jijenge Credit Limited
10. Jitegemea Credit Scheme
11. Juhudi Kilimo Company Limited
12. KEY Microfinance Bank Limited
13. Longitude Finance
14. Maisha Microfinance Bank Limited
15. MESPT – Micro Enterprises Support Program Trust
16. Momentum Credit Limited
17. Musoni Microfinance. Website
18. Mwananchi Credit Limited
19. MyCredit Limited
20. Neema HEEP
21. Ngao Credit Limited
22. OIKO Credit. Website
23. Platinum Credit Limited
24. Premier Credit Limited
25. SEEP – Social Economic Empowerment Program
26. SMEP Microfinance Bank Limited
27. Sumac Microfinance Bank Limited
28. Swiss Contact. Website
29. U&I Microfinance Bank Limited
30. Ushindi Bora. Website
31. Uwezo Microfinance Bank Ltd
32. Yehu Microfinance Limited