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LIQUIDITY CAPACITY AND FINANCIAL PERFORMANCE OF COMMERCIAL BANKS IN KENYA

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ABSTRACT

This study determined the effect of liquidity capacity on the financial performance of commercial banks in Kenya. Specific the study determined the effect of Net Stable Funding, Liquidity Coverage, Liquidity Gap and Provisioning for Non-Performing Loans on the financial performance of banks in Kenya. Bank competition variable was used to determine the moderating effect on the relationship between liquidity capacity and the financial performance of commercial banks in Kenya. The study was anchored on the positivism philosophy. The study used an explanatory research design. The study applied panel data models (random effects) based on the outcome of Hausman specification tests to determine the effect of liquidity capacity on the financial performance of commercial banks in Kenya. To test the moderating effect of bank competition variable on the relationship between liquidity capacity and the financial performance of commercial banks in Kenya, Keppel and Zedeck (1989) two-step procedure was used. The regression results revealed that Net Stable Funding and Liquidity Coverage have a significant positive effect on financial performance of commercial banks in Kenya. Provisioning for Non-Performing Loans Liquidity Gap and Provisioning for Non-Performing Loans had a significant negative effect on financial performance of commercial banks in Kenya. The study established that bank competition had a significant moderating effect on the relationship between liquidity capacity and the financial performance of commercial banks in Kenya. Based on these findings, the study recommends that commercial banks in Kenya need to have a good appreciation in terms of having full visibility of all cash flows on the positions of exposures across their operations. Further, they need to have a good insight in terms of the assumptions that drive the cash flows both from a liquidity point of view and from the valuation perspective to best address the terms of requirement from the regulatory standpoint. Additionally, they should empress the stress testing element into the overall equation of their operational activities as prescribed in the Basel III accords. Finally, the study recommends that all commercial banks in Kenya should incorporate liquidity costs, benefits, and risks in the performance measurement, pricing, and approval process for all significant business activities to ensure that the performance of commercial banks in Kenya is enhanced. This research was unable to identify all the possible variables with explanation power on commercial banks' financial performance in Kenya. Hence, this formed a basis for further research.

Keyword: *Net Stable Funding, Liquidity Coverage, Liquidity Gap, Provisioning for Non-Performing Loans, financial performance*

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INTRODUCTION

The performance of the banking system is essential to guarantee economic growth and stability (Halling & Hading, 2006). Banks carry out beneficial economic activities (Diamond & Rajan, 2001). On the asset side of the statement of financial position, banks guarantee the smooth flow of funds by lending to deficit units while providing liquidity to surplus units on the liability side. Further banks facilitate trade and enhance business transactions through the provision of elaborate payment and settlement systems (Jenkinson, 2008). Through these functions, banks are exposed to a large number of risks, which include credit risk, foreign exchange risk, market risk interest rate risk, and liquidity risk (Landskroner & Paroush, 2011).

It is important that banks take account of liquidity problems and they should do it in the most formal possible way, not as an afterthought (Lion & Dragos 2006). Consequently, this has compelled banks to introduce highly advanced systems for handling liquidity problems when they arise (Siaw, 2013). This makes the commercial banking industry the likely place to turn for direction on how to communicate most effectively on liquidity issues to the market (Eccles, Herz, Keegan, and Phillips, 2013). The Basel Committee on Banking Supervision endorsed the Basel I Accords, the Basel II Accords and most recently the Basel III, to address this matter (Sensarma and Jayadev, 2009).

Over the past quarter-century, the globe has undergone some financial crises (Fu, Lin, & Molyneux, 2014). At the heart of these crunches are often issues entangled with liquidity (Berger, and Carolina, 2009). A depiction of the "liquidity phase" of the financial crisis that began in 2007, numerous banks irrespective of their decent capital level still had trouble because of poor liquidity management. The predicament emphasised the gravity of liquidity to a proper functioning of the commercial banking sector (Basel Committee on Banking Supervision, 2013). Prudential controls in the form of liquidity or capital requirements were designed to facilitate the resilience to shocks of financial systems by requiring banks to maintain reasonable levels of capital and liquidity under a broad range of market conditions (Olarewaju, & Adeye, 2015).

Statement of the Problem

Despite the overall good picture depicted by the Kenyan banking sector, critical analysis indicates that there are a couple of banks struggling to reach profitability (Ongore & Kusa, 2013). More than half of the listed commercial banks in Kenya struggle to reach their targeted financial performance as core earnings per share (EPS) declined (Waweru, 2017). National Bank of Kenya (NBK), Standard Chartered, Housing Finance Group, CFC Stanbic, NIC and Barclays Bank of Kenya are 6 of the 11 listed commercial banks whose core earnings were negative, according to the Cytonn Investments' Banking Sector Report for year the years2010-2015. According to the Bank Supervision Annual Reports, the banking sector expenses have been rising at consistent rate of 2.3 percent to KShs. 354.9 billion in December 2016 from KShs. 270.9 billion in December 2019.

Despite research on liquidity capacity and financial performance of commercial banks, evidence on the resulting effect is mixed at best. For instance, Oloo (2011), Lamberg and Valming (2010), Konadu (2011), Tabari, Ahmadi, & Emami (2013) and Olarewaju, & Adeye (2015), have suggested that liquidity capacity is positively related to the financial performance of commercial banks. Conversely, Karasulu (2001), Staikouras and Wood (2003) Said and Tumin, (2011), Arif and Nauman (2012), and Crowe (2009) indicate that liquidity capacity has a negative effect on the financial performance of commercial banks.

The liquidity capacity in commercial banks in Kenya has also received research attention. Wambu (2013), Musembi, Ali, and Kingi, (2016), Ogilo and Mugenyah, (2015) Ouma, (2015) and Maaka (2013) used different sample sizes and similar measures of liquidity to study effects of liquidity risk on the financial performance of commercial banks in Kenya but they have produced a mixed result. Further, unlike other studies in this area, (Giannotti et al., 2011; Angora & Roulet, 2011; Giordana & Schumacher, 2012, Muriithi & Waweru, 2017), the studies on liquidity capacity in commercial banks in Kenya have not considered NSFR

and LCR, which are the two liquidity measures proposed in the Basel III framework, while incorporating other contemporary ratios. It is against this backdrop that this study was conceived.

Objectives of the Study

The main objective of the study was to determine the effect of liquidity capacity on the performance of commercial banks in Kenya. The specific objectives of the study were to:

- Determine the effect of Net Stable Funding on the financial performance of commercial banks in Kenya.
- Establish the effect of the Liquidity Coverage on the financial performance of commercial banks in Kenya.
- Establish the effect of the Liquidity Gap on the financial performance of commercial banks in Kenya.
- Determine the effect of Provisioning for Non-Performing Loans on the financial performance of commercial banks in Kenya.
- Determine the moderating effect of bank competition on the relationship between liquidity capacity and the financial performance of commercial banks in Kenya.

The study sought to test the following null hypotheses;

- H_{01}**.** Net Stable Funding has no significant effect on the financial performance of commercial banks in Kenya.
- H_{02}. Liquidity Coverage has no significant effect on the financial performance of commercial banks in Kenya.
- H_{03}. Liquidity Gap has no significant effect on the financial performance of commercial banks in Kenya.
- H_{04}. Provisioning for Non-Performing Loans has no significant effect on the financial performance of commercial banks in Kenya.
- H_{05}. Bank competition has no significant moderating effect on the relationship between liquidity capacity and the financial performance of commercial banks in Kenya.

LITERATURE REVIEW

Theoretical Review

The Anticipated Income Theory

The anticipated income theory was developed by Prochanow (1944) on the basis of the practice of extending term loans by the US commercial banks. The theory holds that liquidity can be guaranteed if the anticipated loan payments are made on the future income of the borrower. This theory accords loan repayment should rely on income rather than rely on collateral. The theory also stipulates that a financial institution liability can be affected by the maturity pattern of loans and investment portfolios (Jenkinson, 2008). The theory perceived that certain types of loans have more liquidity than others.

Based on this theory, commercial bank management adopted ladder effect in the investment portfolio. Banks should ensure a certain amount of securities is maturing annually and at times when the funds are needed for lending or withdrawal (Olarewaju, & Adeye, 2015). However, there was no clue about the future income of the borrower. This warrants the significance of this theory to the study because of the stipulation of the theory that financial institution liability can be affected by the maturity pattern of loans and investment portfolios (Giannotti *et al.*, 2011). Since these commercial banks depend heavily on this loaned funds if sufficient care is not taken care of liquidity of these institutions may get depleted. This can engender liquidity problems hence affecting the financial performance of these institutions.

Liquidity Preference Theory

According to the Liquidity preference theory, investors prefer to keep their money liquid as cash, and they demand interest to be given in return for sacrificing their liquidity. This concept was first developed by (Keynes, 1936). According to Keynes, people demand liquidity is determined by three motives. First is the precautionary motive, this is the desire to keep extra cash in case an unforeseen situation that requires some cash outlay. According to Keynes, people keep commodities as well as some savings accounts, and stocks with a precautionary motive in order to take care of unexpected events. The second motive is speculative; according to Financial (Glossary, 2011), the speculative motive is a desire to hold money in order to be poised to exploit any attractive investment opportunity requiring a cash expenditure that might arise.

The Shiftability Theory of Liquidity

The shift-ability theory of bank liquidity was propounded by (Moulton, 1925). The Central contention of this theory holds that the bank's liquidity relies upon its capacity to shift its assets to someone else without any loss, be it capital or material when a necessity for liquidity arises (Mahmoodi, 2011). This theory asserts that if the banks hold a substantial number of assets that can be shifted on to the other banks for cash without loss in case of necessity, hence, no obligation to depend on maturities. According to this reasoning, an asset to be absolutely shiftable must be spontaneously transferable without capital loss when the need for liquidity arises (Adeyemi, 2015). This is particularly relevant to short-term markets investments, such as treasury bills and bills of exchange, which can be immediately sold whenever it is necessary to raise funds for banks.

Moulton, one of the originators of the theory, asserted, "Liquidity is tantamount to shiftability". The shiftability theory redirected the attention of bankers and the banking authorities from loans to investments as a source of bank liquidity (Anesa, 2012). Consequently, the theory attempted to expand the list of assets demand appropriate for bank ownership, and, therefore, diverted the attention of the banking authorities and banks from loans to investments as a source of bank liquidity that is; the central source of liquidity is the banks' secondary resources. This theory informs this study in that it attempts to explain what causes liquidity problems. This justifies the relevance of this theory to the study in that the demand for liquidity capacity influences the performance of banks in Kenya.

Conceptual Framework

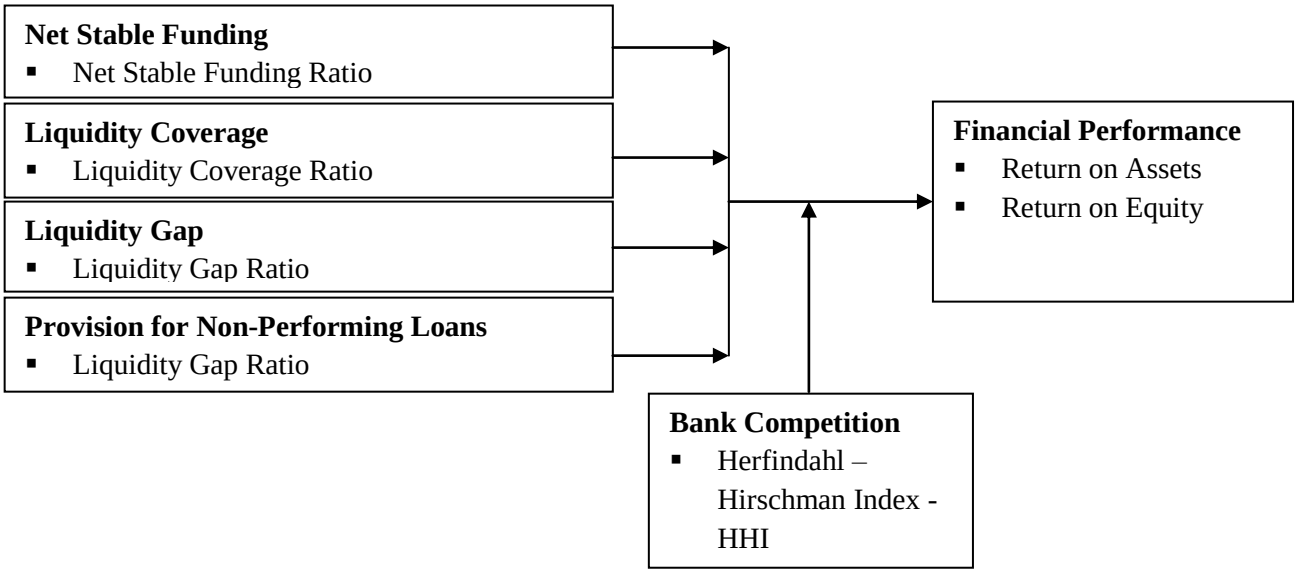

Figure 1: Conceptual Framework

METHODOLOGY

Research Design: TThis study utilized explanatory research design. An explanatory research design was suitable because the researcher strived to explain how the phenomenon works by distinguishing the underlying determinants that produce the change in which case there was no manipulation of the independent variable (Mugenda & Mugenda, 2003).

Empirical Model: The general empirical model used in the study was defined as follows:

$Y_{it} = \alpha + \chi'_{it}\beta + e_{it}$…….. (a)

$\varepsilon_{it} = V_i + U_{it}$ ……..(b)

where Y_{it} is the dependent variable denoting financial performance of bank i at time t, i denote the observation(bank),i = 1, ...,42 while t is the time period t =2016, ... ,2018; X_{it} denote a vector of independent variables β are coefficients to be estimated, α is a constant term, and e_{it} is a composite error term. Where V_i denote heterogeneity effects and U_{it} denote idiosyncratic disturbances.

Direct Effect Model: Equation 1 was expanded to obtain equations 2 and 3 which were used for estimation.

$ROA_{it} = \alpha+\beta_1 NSF_{it}+\beta_2 LC_{it} + \beta_3 LG_{it} + \beta_4 PPL_{it} + e_{it}$ ……2

$ROE_{it} = \alpha+\beta_1 NSF_{it}+\beta_2 LC_{it} + \beta_3 LG_{it} + \beta_4 PPL_{it} + e_{it}$ ……...…….3

Where;

ROA_{it} - Return on Asset of bank i at time t

ROA_{it} - Return on Equity of bank i at time t

NSF - Net Stable Funding

LC - Liquidity Coverage

LG - Liquidity Gap

PPL - Provisioning for Non-Performing Loans

e- Error term

Moderating Effect Model: To test the moderating effect of bank competition on the relationship between liquidity capacity and the financial performance of commercial banks in Kenya, Keppel and Zedeck (1989) two-step procedure was used. In the first step, model 2, and 3, which includes bank competition as an explanatory variable is estimated as the base model to determine the effect of the explanatory variables on the response variables. The explanatory variable does not have to be statistically significant predictors of the dependent variable to test for an interaction term (Baron & Kenny, 1986). In the second step, model 4, and 5, which captures the interaction terms (the product of the independent variables and moderator) were computed. To this end, the research employed the moderation approach recommended by Friedrich (1990) and used by Makori (2017). Hence, to determine the moderating effect of competition on the relationship between liquidity capacity and financial performance of banks in Kenya the equation was formulated as follows.

$ROA_{it} = \alpha+\beta_1 NSF_{it}+\beta_2 LC_{it} +\beta_3 LG_{it} +\beta_4 PPL_{it} +\beta_5 COMP_{it} + \beta_6[(NSF_{it})*(COMP_{it})] +\beta_7 [(LC_{it})*(COMP_{it})]+ \beta_8 [(LG_{it})*(COMP_{it})] + \beta_9 [(PPL_{it})*(COMP_{it})]+ \beta_{10}[(COMP_{it})*(COMP_{it})]+e_{it}$……..4

$ROE_{it} = = \alpha+\beta_1 NSF_{it}+\beta_2 LC_{it} +\beta_3 LG_{it} +\beta_4 PPL_{it} +\beta_5 COMP_{it} + \beta_6[(NSF_{it})*(COMP_{it})] +\beta_7 [(LC_{it})*(COMP_{it})]+ \beta_8 [(LG_{it})*(COMP_{it})] + \beta_9 [(PPL_{it})*(COMP_{it})]+ \beta_{10}[(COMP_{it})*(COMP_{it})]+e_{it}$……...5

Where;

COMP - Bank Competition

Target Population: The target population for this study was all the 38 commercial banks in Kenya. As at December 2022, according to the Central Bank of Kenya Supervision Report (2018), the banking sector consisted of 38 commercial banks.

Sampling Design: The study adopted a census approach because of the small number of commercial banks in Kenya. According to (Mugenda & Mugenda, 2003), a census approach enhances the validity of the collected

data by including certain information-rich cases for study. The total numbers of commercial banks in Kenya that were used in the study were 38.

Data Collection Instruments: A data collection schedule was used to extract and compile the required financial data for analysis from the annual reports. This data collection instrument is available at appendix II at the end of this document. Panel data was mined from 38 commercial banks over a period of 7 years between 2016 and 2022.The extraction of data for all the variables in the study was based on the annual published financial reports of the commercial banks.

Data Analysis and Presentation: The data was analysed using descriptive and inferential statistics, Descriptive statistics used included the mean, median, and standard deviation. Inferential statistics used included panel regression. Panel regression was appropriate because it allows controlling for panel unit effect and time effect when estimating regression coefficients (Schumacher, 2016). The data analysis was aided by STATA software. But first the researcher carried out data cleaning and coding of the collected data to create inferences through a series of controls involving editing to eliminate repetitions and inconsistencies. Excel worksheets were used to compute each commercial bank's relevant ratios for the period under consideration based on the data extracted from the financial statements. The data was then arranged in STATA format before importing data to STATA software from excel worksheets. STATA was used because it can work with unbalanced panel data (Ogol, 2011). The study further employed Feasible Generalized Least Square (FGLS) after accounting for some violations of classical linear assumptions

RESULTS AND DISCUSSION

Descriptive Statistics

Table 1 presented the descriptive statistics for the data used in the analysis.

Table 1: Descriptive Statistics

Variable	Mean	Maximum	Minimum	Std. Dev.
Return on Assets	2.675180	7.700000	-6.13000	2.626798
Return on Equity	15.94108	49.40000	-76.7000	18.63120
Net Stable Funding	1.797374	4.276249	-1.03884	1.396796
Liquidity Coverage	0.340882	0.848534	0.094773	0.180637
Liquidity Gap	1.67785	1.03496	-2.72383	0.358822
Provisioning for Non-Performing	0.341638	0.928389	0.00677	0.219731
Bank Competition	3.402500	14.52000	0.25000	3.839621

Source: Study Data (2023)

Table 1 presents the mean value of return on assets of 2.675180 with a standard deviation of 2.626798. The maximum and minimum values were 7.700000 and -6.13000 respectively. The positive return on assets indicates that the commercial banks were on average profitable although some commercial banks were operating at a loss as reflected in the negative minimum observed value of return on assets. The mean value of return on equity of 15.94108 is an indication that banks are competing among themselves for better financial performance however their standard deviations of 18.63120 percent is evident that their financial performance is divergent from each other. The maximum and minimum values were 49.40000 and -76.7000 respectively. The negative minimum value observation for return on equity signifies that some commercial banks were operating at a loss.

The results in Table 1 further indicated that, the mean Liquidity Coverage and Net Stable Funding were, 0.340882 and 1.797374 respectively. Therefore, on average the commercial banks in Kenya created more money from their deposits and sufficiently met liquidity requirements. The average Liquidity Coverage of Kenyan banks was 0.340882 with standard deviation of 0.180637. The maximum and minimum values were 1.03496 and 2.72383 respectively. This indicates high liquidity which could be attributed to the fact that

commercial banks require higher liquidity levels to satisfy the customer cash needs which are commonly on random demand. Available amount of stable funding is much higher than the required amount of stable funding for the commercial banks during the period of the study. Available amount of Stable Funding comprises of the bank's capital, preferred stock and liabilities with maturities greater than or equal to one year while required amount of stable funding is calculated as the weighted sum of the value of assets held and funded by the entity including off-balance sheet exposures.

From the results output displayed in Table 1, the mean value of Provisioning for Non-Performing Loans was 0.341638 % with a standard deviation of 0.219731. The maximum and minimum values were 0.928389 and 0.00677 respectively. This mean the variability in Provisioning for Non-Performing Loans was high though also Provisioning for Non-Performing Loans on average was higher. This means that as much as some of the banks enjoy good financial performance, they are the same time facing a high level of non-performing loans. This is further shown by the negative minimum value observation of the Liquidity Gap.

Table 4.1 indicates that bank competition had a mean of 3.402500 with a standard deviation of 3.839621. The maximum and minimum values were 14.52000 and 0.25000 respectively. This mean the variability in Market Share was high meaning market share played an important role in the commercial bank performance in that the higher the market share the higher the commercial bank financial performance.

Hypothesis Testing

The study's general objective was to determine the effect of liquidity capacity on the financial performance of commercial banks in Kenya. Independent variables of the study were Net Stable Funding, Liquidity Coverage, Liquidity Gap and Provisioning for Non-Performing Loans independent variables while the dependent variable was financial performance measured by ROA and ROE. The subsequent sections presented the discussions and the results of the regression models used to test the hypotheses. The discussion provided the interpretation of the empirical results by comparing them to the theoretical background; and findings of previous studies on liquidity capacity and financial performance of commercial banks in Kenya. The focus was on the major findings of the study and it was structured according to the specific objectives of the study. The rule for testing the hypothesis was the P-Value method such that the null hypothesis was rejected if the P-Value was less than 0.05 (5 percent) significance level or failed to reject the null hypothesis if P-Value was greater than 0.05 (5 percent) significance level.

Liquidity Capacity and Financial Performance (ROA) of Commercial Banks in Kenya

The direct effect of liquidity capacity on Financial Performance (ROA) of Commercial Banks in Kenya regression results are presented in Table 2.

Table 2: Regression Results (Dependent Variable: ROA)

Variable	Coefficient	Std. Error	Z	P>z
Net Stable Funding	0.040741	0.269615	0.151108	0.0088
Liquidity Coverage	0.465974	0.888386	1.650154	0.0102
Liquidity Gap	-0.385513	0.466581	-0.826252	0.0410
Provisioning for Non-Performing Loans	-0.362869	0.805316	-2.934088	0.0040
Bank Competition	-2.362869	0.00342	0.142667	0.0040

Source: Study Data (2023)

Net Stable Funding and Financial Performance of Commercial Banks in Kenya

Table 2 presents the results of the regression model. Net Stable Funding was found to have a significant positive effect on Financial Performance of commercial banks in Kenya at 5 percent significance level. The results implied that an increase in the Net Stable Funding would lead to a corresponding increase in the financial performance of commercial banks in Kenya. Net Stable Funding had a regression coefficient of

0.040741 which implied that a unit increase in Net Stable Funding would result into an increase of 0.040741 in the financial performance of commercial banks. This coefficient was found to be statistically significant since the p-value for Net Stable Funding was 0.0088 which was lower that the adopted significance level of 0.05. Therefore, the study rejected the null hypothesis that Net Stable Funding does not have a significant effect on the financial performance of commercial banks in Kenya and concluded that Net Stable Funding had a significant effect on the financial performance of commercial banks in Kenya.

These findings support those of Muriithi and Waweru (2017) who found that the impact of Net Stable Funding on bank performance is positively related to the performance of commercial banks in Kenya. The finding also concurred with Musembi, Ali, and Kingi (2016) who conducted a study whose purpose was to determine the effect of liquidity risk determinants on the financial performance of commercial banks listed at the Nairobi Securities Exchange. The outcome of their study revealed that there was a notable positive relationship between Net Stable Funding and the financial performance of banks in Kenya.

Similarly, the results were in agreement with Olarewaju and Adeyemi (2015) who studied the relationship linking liquidity and performance of the Nigerian banks. The study concluded that there was a notable positive significant relationship between Net Stable Funding and financial performance of banks in Nigeria. However the results contradicted Mwangi (2014) who concluded that commercial bank's available amount of stable funding which is a construct of Net Stable Funding Ratio had a negative correlation with the financial performance of commercial banks.

Liquidity Coverage and Financial Performance of Commercial Banks in Kenya

The empirical results indicate that the regression coefficient of Liquidity Coverage was found to be 0.465974. This value shows that holding other variables in the model constant, an increase in Liquidity Coverage by one unit causes the performance of commercial banks in Kenya to increase by 0.465974. The study further established that Liquidity Coverage had a statistically significant positive effect on Financial Performance of commercial banks in Kenya since the P-Value of 0.0102 is lower than the adopted significance level of 5 percent. Based on this finding, the study therefore, rejected that null hypothesis that Liquidity Coverage does not have significant effect on Financial Performance of commercial banks in Kenya and concluded that Liquidity Coverage has a significant effect on Financial Performance of commercial banks in Kenya.

This result was compatible with the findings of Arif, Nauman, and Anees (2012). Their study also established that Liquidity Coverage had a significant positive influence on Financial Performance of commercial banks. These findings differed with those of Ouma (2015) whose results confirmed that Liquidity Coverage had a significant negative impact on the bank's financial performance measures. Further, these results disagreed with the findings of Konadu (2011), who found no significant relationship between commercial banks' financial performance and Liquidity Coverage existed.

Liquidity Gap on the Financial Performance of Commercial Banks in Kenya

The study further sought to establish the effect of the Liquidity Gap on commercial banks' financial performance in Kenya. Liquidity Gap was found to have a significant negative effect on financial performance of commercial banks in Kenya. The findings also indicate that a unit increase in Liquidity Gap could lead to a decrease in financial performance of commercial banks in Kenya by 38.5513 percent. Further, this coefficient was statistically significant as shown by the P-Value of 0.0410 which is less than the adopted significance level of 5 percent. Based on these findings, the study rejected the null hypothesis that Liquidity Gap does not have a significant effect on Financial Performance of commercial banks in Kenya and concluded that Liquidity Gap had a significant effect on Financial Performance of commercial banks in Kenya.

These findings support those of Agbada and Osuji (2013), who studied the effects of effective liquidity management on Nigeria's banking performance. The results pointed out that there exists a notable link connecting a negative Liquidity Gap and banking performance. Likewise, the study was in agreement with

Lartey, Antwi, and Boadi (2013), who sought to determine the relationship between liquidity risk and the financial performance of commercial banks listed on the Ghana Stock Exchange. The results indicated that Liquidity Gap had a significant negative effect on commercial financial performance. Maaka's (2013) results were concurrent with the current study in that the outcomes of the study signify that Kenyan commercial banks' performance is negatively affected by the increased Liquidity Gap. Vodová (2011) also found out that as the bank Liquidity Gap increased, it negatively affected the performance of banks. However, Bordeleau and Graham (2010), on their study on the impact of liquidity on commercial bank profitability in Canada, observed that Liquidity Gap had no significant effect on the financial performance of commercial banks in Canada.

Provisioning for Non-Performing Loans and Financial Performance of Banks

With regard to provisioning for non-performing, the regression result indicated that the coefficient for Provisioning for Non-Performing Loans was found to be -0.362869 and statistically significant at 5 percent level, with a p-value of 0.0040. The finding implies that holding other independent variables in the regression constant, a unit increase in Provisioning for Non-Performing Loans would lead to a decrease in Financial Performance (measured by ROA) of commercial banks in Keya by 36.2869 percent. Based on these findings, the study rejected that the null hypothesis that Provisioning for Non-Performing Loans has no significant effect on Financial Performance of commercial banks in Kenya and concluded that Provisioning for Non-Performing Loans has a significant negative effect on Financial Performance (measured by ROA) of commercial banks in Kenya.

These findings presented were consistent with the Liquidity Preference Theory that was first postulated by (Keynes, 1936). According to the Liquidity preference theory, investors prefer to keep their money liquid as cash, and they demand interest to be given in return for sacrificing their liquidity. Muturi (2016) concluded Non-performing loans provisioning was observed to influence the liquidity capacity negatively, hence negatively impacting the financial performance (ROA) of commercial banks. Further, the findings of this present thesis were in agreement with the empirical results obtained by Odunga (2016) who found out that there was a significant negative effect on commercial banks performance (ROA) that was occasioned by the increase in the Provisioning for Non-Performing Loans.

Bank Competition and Financial Performance of Commercial Banks in Kenya

Concerning Bank Competition, the regression results indicated that the coefficient for Bank Competition was -2.362869, and it was statistically significant at 5 percent level, with a p-value of 0.0040. This finding implies that holding other independent variables in the regression model constant, a unit increase in Bank Competition, would lead to decline in Financial Performance (as measured by ROA) of commercial banks by 2.362869 units. Based on this finding, the null hypothesis that Bank Competition does not have significant effect on Financial Performance (measured by ROA) of Commercial Banks in Kenya was rejected and the study concluded that Bank Competition had a significant negative effect on Financial Performance (measured by ROA) of Commercial Banks in Kenya.

These findings support those of Gudmundsson, Ngoka and Odongo (2013) who established that Bank Competition has a significant negative effect on financial performance of commercial banks in Kenya. Additionally, Abishua (2010) determined that Bank Competition has a significant negative effect on financial performance of commercial banks in Kenya. However, the results contradicted Musau, Muathe and Mwangi (2018) who concluded that Bank Competition had a significant positive effect on Financial Performance of commercial banks in Kenya.

Liquidity Capacity and Financial Performance (ROE) of Commercial Banks in Kenya

Using return on equity (ROE) as the dependent variable, the study examined a set of hypotheses on the effect liquidity capacity on financial performance of commercial banks in Kenya. As indicated in the results return

on equity was regressed on Net Stable Funding, Liquidity Coverage, Liquidity Gap, and Provisioning for Non-Performing Loans;

Table 3: Regression Results (Dependent Variable: ROE)

Variable	Coefficient	Std. Error	Z	P>z
Net Stable Funding	0.935311	0.617368	2.433157	0.0163
Liquidity Coverage	0.647250	0.104649	0.935620	0.0351
Liquidity Gap	-0.549088	0.775230	-0.940099	0.0349
Provisioning for Non-Performing Loans	-0.06426	0.368702	-2.208339	0.0289
Bank Competition	-0.88451	0.677673	0.006524	0.0156

Source: Study Data (2023)

Net Stable Funding and Financial Performance of Commercial Banks in Kenya.

Concerning Net Stable Funding, the regression result indicated that the coefficient for Net Stable Funding was 0.935311, and it was statistically significant at 5 percent level, with a p-value of 0.0163. This result implied that a unit increase in Net Stable Funding would result into an increase of 0.935311 in the financial performance (ROE) of commercial banks in Kenya. Consequently, the study rejected the null hypothesis that Net Stable Funding does not have a significant effect on the financial performance of commercial banks in Kenya and concluded that Net Stable Funding has a significant positive effect on Financial Performance of commercial banks in Kenya.

The results moreover corroborate the empirical evidence obtained by Olarewaju and Adeyemi (2015). They found that there was a notable positive relationship between Net Stable Funding and financial performance (ROE) of commercial banks in Nigeria. The finding, however, contradicts the results by, Mwangi (2014) who concluded that Net Stable Funding had a significant negative correlation with the financial performance (ROE) of commercial banks in Kenya. Further, the current results support those of Muriithi and Waweru (2017) who found that the impact of Net Stable Funding on bank performance is positively related to the performance (ROE) of commercial banks in Kenya.

Liquidity Coverage and Financial Performance of Commercial Banks in Kenya

Table 3 presented the results of the regression with regards to Liquidity Coverage and the financial performance (ROE) of commercial banks in Kenya. The regression coefficient of Liquidity Coverage was found to be 0.647250 with an associated p-value of 0.0351, which is less than the 0.05 significance level. This implied that Liquidity Coverage had a significant positive effect on the financial performance (ROE) of commercial banks in Kenya. Therefore, the study rejected the null hypothesis that Liquidity Coverage does not have a significant effect on the financial performance of commercial banks in Kenya. This value shows that holding other variables in the model constant, an increase in Liquidity Coverage by one unit causes the performance of commercial banks in Kenya to increase by 0.647250.

These conclusions differed with those of Ouma (2015), whose results affirmed that Liquidity Coverage had a significant negative impact on the bank's financial measures of performance. The current thesis results were harmonious with the findings of Arif, Nauman, and Anees (2012), whose result confirmed that Liquidity Coverage had a significant positive effect on commercial banks' financial performance (ROE). Further, these results disagreed with the findings of Konadu (2011), who found no significant relationship between commercial banks' financial performance and Liquidity Coverage existed.

Liquidity Gap on the Financial Performance of Commercial Banks in Kenya

The results revealed that Liquidity Gap had a statistically significant negative effect on the financial performance (ROE) of commercial banks in Kenya as shown by a P-Value of 0.0349 at 0.05 significance level. Further the regression coefficient for Liquidity Gap was -0.549088 which implied that a unit increase in

Liquidity Gap leads to a decrease in financial performance (as indicated by ROE) of commercial banks in Kenya by 54.9088. Based on these findings, the study rejected the null hypothesis that Liquidity Gap does not have significant effect on Financial Performance (ROE) of commercial banks in Kenya and concluded that Liquidity Gap had a significant negative effect on Financial Performance (as measured by ROE) of commercial banks in Kenya.

However, these results contradicted Bordeleau and Graham (2010), who observed that Liquidity Gap had no significant effect on the financial performance (measured by ROE) of commercial banks in Canada. Nevertheless Maaka's (2013) results were concurrent with the current study signifying that Kenyan commercial banks' performance is negatively affected by the increased Liquidity Gap. Likewise, Lartey, Antwi, and Boadi (2013), results were in agreement with the current study whose results indicated that Liquidity Gap had a significant negative effect on commercial banks' financial performance (ROE). Agbada and Osuji (2013), whose results pointed out that there exists a significant link connecting a negative Liquidity Gap and bank financial performance (ROE) results supported the current study's results.

Provisioning for Non-Performing Loans and Financial Performance of Banks

Pertaining Provisioning for Non-Performing Loans, the regression result indicated that the Provisioning for Non-Performing Loans has a p-value of 0.0289, which is less than 0.05 level of significance. This led to the rejection of the null hypothesis that Provisioning for Non-Performing Loans does not have significant effect on Financial Performance (indicated by ROE) of commercial banks in Kenya. The study concluded that Provisioning for Non-Performing Loans had a significant negative effect on Financial Performance (indicated by ROE) of commercial banks in Kenya. The coefficient for Provisioning for Non-Performing Loans was found to be -0.06426 implying that a unit increase in Provisioning for Non-Performing Loans would lead to a decrease of 0.06426 in Financial Performance (measured by ROE) of commercial banks in Kenya

This result was inconsistent with the findings of Kamau and Were (2013) who found out that

Provisioning for Non-Performing loans had a negative effect on liquidity capacity and financial performance of commercial banks. Muturi (2016) concluded Non-performing loans provisioning was observed to influence the liquidity capacity negatively, hence negatively impacting the financial performance (ROE) of commercial banks. Further Odunga (2016) empirical results were in agreement with the current study; he found out that there was a significant negative effect of Provisioning for Non-Performing Loans on commercial banks financial performance (ROE).

Bank Competition and Financial Performance of Commercial Banks in Kenya

Regarding bank competition, the regression result in Table 4 designated that the coefficient for Bank Competition was -0.88451, and it was statistically significant at 5 percent level, with a p-value of 0.0156. This finding implies that holding other independent variables in the regression model constant, a unit increase in Bank Competition, would lead to decline in Financial Performance (as measured by ROE) of commercial banks by 0.88451 units. Based on this finding, the null hypothesis that Bank Competition does not have significant effect on Financial Performance (measured by ROE) of Commercial Banks in Kenya was rejected and the study concluded that Bank Competition had a significant negative effect on Financial Performance (measured by ROE) of Commercial Banks in Kenya.

This result concurred with Berger, Klapper, and Ariss (2017) who found out that bank competition had a significant effect on the financial performance and financial stability of commercial banks. Cetorelli (2004) did a study on Real effects of bank competition on commercial banks. He concluded that bank competition had a significant effect on the financial performance of commercial banks. Delis (2012) found out that Bank competition had a significant effect on the financial performance. Contrary to the current results Carlson and Mitchener (2005) found out that bank competition had no significant effect on the financial performance of commercial banks.

Test for Moderating Effect

The fifth objective of this study sought to determine the moderating effect of bank competition on the relationship between liquidity capacity and the financial performance of commercial banks in Kenya. The corresponding hypothesis (H05) stated that bank competition had no significant moderating effect on the relationship between liquidity capacity and the financial performance of commercial banks in Kenya. The purpose of section 4.5 was to present and discuss the regression results on the moderating effect of Bank Competition on the relationship between Liquidity Capacity and Financial Performance (indicated by ROA and ROE) of commercial banks in Kenya. Keppel and Zedeck (1989) two-step procedure was used. Table 4 and 5 presented the regression results.

Table 4: Moderation Effect Regression Results with ROA

Dependent Variable: ROA				
Variable	Coefficient	Std. Error	Z	P>|Z|
Net Stable Funding	0.840543	0.267187	3.145901	0.0021
Liquidity Coverage	0.646775	1.128994	2.344365	0.0206
Liquidity Gap	-0.836056	0.629575	-1.327969	0.1865
Provisioning for Non-Performing Loans	-0.429435	0.970776	-3.532673	0.0006
Bank Competition	0.549754	0.360896	4.294189	0.0000
Net Stable Funding* Bank Competition	0.377226	0.093636	4.028653	0.0001
Liquidity Coverage* Bank Competition	0.397283	0.234889	1.691365	0.0932
Liquidity Gap* Bank Competition	-0.157168	0.090034	-1.745653	0.0833
Provisioning for Non-Performing Loans* Bank Competition	-0.410905	0.274637	-1.496174	0.0371
Intercept	0.822408	1.250815	0.657498	0.5120
F-statistic	5.045093	Durbin-Watson stat		1.766297
Prob (F-statistic)	0.000008			

Source: Study Data (2023)

The regression results showed that Net Stable Funding coefficient was positive and statistically significant (β=0.840543and P-value = 0.0021< 0.05). The regression results also reveal that the coefficient of Liquidity Coverage was positive and statistically significant (β=0.646775 and P-value = 0.0206<0.05). The results further reveal that Liquidity Gap coefficient was negative and not statistically significant (β=-0.836056 and P-value =0.1865>0.05) while Provisioning for Non-Performing Loans coefficient was negative and statistically significant (β=-0.429435 and P-value=0.0006<0.05). The results in addition indicate that the coefficient of Bank competition was positive and statistically significant (β=0.549754 and P-value = 0.0000<0.05).

The regression results presented in Table 4 indicated that the coefficient of the interaction between Net Stable Funding and Bank Competition, was positive and statistically significant (β=0.377226 and P-value = 0.0001<0.05). The result suggests that Bank competition intensifies the effect of Net Stable Funding on Financial Performance (measured by ROA). The regression results in Table 4.10 also showed that the coefficient of the interaction between Liquidity Coverage and Bank Competition is positive and not statistically significant (β=0.397283 and P-value = 0.0932>0.05).

The regression results in Table 4 further indicated that the coefficient of the interaction between Liquidity Gap and Bank Competition was not statistically significant at 5 percent (β=-0.157168; P-Value=0.0833>0.05). The results implied that the effect Liquidity Gap on Financial Performance (measured by ROA) of commercial banks is weakened by Bank Competition. Finally the regression results presented in Table 4 indicated that the coefficient of the interaction between Provisioning for Non-Performing Loans and Bank Competition, was negative and statistically significant (β=-0.410905 and P-value = 0.0371<0.05). The result suggests that bank competition intensifies the effect of Provisioning for Non-Performing Loans on Financial Performance (measured by ROA)

Table 5: Summary Results for Moderating Effect (Dependent Variable: ROA)

Variable	Model 3.2 (Before Moderation)		Model 3.12 (After Moderation)		Significance of Change	
	B	P-Value	B	P-Value	B	P-Value
Net Stable Funding	0.040741	0.0320	0.840543	0.0021	0.799802	0.0021<0.05
Liquidity Coverage	0.465974	0.0088	0.646775	0.0206	0.180801	0.0206<0.05
Liquidity Gap	-0.385513	0.0102	-0.836056	0.1865	-0.450543	0.1865>0.05
Provisioning for Non-Performing Loans	-0.362869	0.0410	-0.429435	0.0006	-0.066566	0.0006<0.05
Bank Competition	-2.362869	0.0040	0.549754	0.0000	3.912623	0.0000<0.05

Source: Study Data (2023)

The regression results in Table 5 showed that Net Stable Funding was significant before moderation (β=0.040741, P=0.0088<0.05) and significant after moderation either (β=0.840543, P=0.0021<0.05) which indicates a significant change of 0.799802. Liquidity Coverage coefficient was significant before moderation (β=0.465974, P=0.0102<0.05) and also significant after moderation at (β=0.646775, P=0.0206<0.05) which indicates a significant change of 0.180801. At the same time, that of Liquidity Gap was significant before moderation (β=-0.385513, P=0.0410<0.05) and not significant after moderation (β= -0.836056, P=0.1865>0.05) which indicates a significant change of -0.450543. The results also indicate that the coefficient of Provisioning for Non-performing Loans is significant before moderation (β=-0.362869, P=0.0040<0.05) it was also significant after moderation (β= -0.429435, P=0.0006<0.05) which indicates a significant change of -0.066566. Mackinnon et al. (2007) affirms that when the interaction coefficients in model 3.4 are not significant and the moderator coefficient in model 3.2 is significant, then there is no moderating effect. However, if the interactive coefficients in Model 3.4 are significant then there is a moderating effect. Based on this criterion, the study concluded that bank competition had a significant moderating effect on the relationship between liquidity capacity and financial performance (ROA) of commercial banks in Kenya.

However, the study result differed from Yahaya, et al (2015) study which revealed that competition had no moderating effect on liquidity and financial performance of commercial banks. But, the current study supports Fu, Lin, and Molyneux's (2014) who indicated that higher concentration encourages financial performance and that lower pricing power also induces liquidity capacity problems exposure. The finding also concurs with the study by Assefa, Hermes and Meesters (2013) which revealed that bank competition had a significant moderating effect on commercial banks' performance in India. The finding further agreed with Uddin and Suzuki (2014) whose regression result shows evidence of a significant moderating relationship between competition and bank performance.

Table 6: Moderation Effect Regression Results with ROE

Dependent Variable: ROE Variable	Coefficient	Std. Error	Z	P>|Z|
Net Stable Funding	0.218527	0.198575	2.373595	0.0191
Liquidity Coverage	0.93446	0.766853	1.426709	0.0261
Liquidity Gap	-1.99550	0.463063	-2.012698	0.0462
Provisioning for Non-Performing Loans	-0.80819	0.365591	-2.367817	0.0124
Bank Competition	0.910392	0.989744	2.645842	0.0092
Net Stable Funding* Bank Competition	0.307982	0.775990	2.974241	0.0035
Liquidity Coverage* Bank Competition	0.905587	2.035776	1.427263	0.1559
Liquidity Gap* Bank Competition	-1.855392	0.781043	-2.375530	0.0190
Provisioning for Non-Performing Loans* Bank Competition	-1.893159	2.368964	-0.799151	0.0257
Intercept	4.890308	10.43476	0.468656	0.6401
Durbin-Watson stat	1.606544			
F-statistic	3.147185			
Prob(F-statistic)	0.001835			

Source: Study Data (2023)

The regression outcome confirmed that Net Stable Funding coefficient was positive and statistically significant (β=0.218527and P-value = 0.0191< 0.05) and the coefficient of Liquidity Coverage was also positive and significant (β=0.93446 and P-value = 0.0261<0.05). The results further reveal that Liquidity Gap coefficient was negative and statistically significant (β=-1.99550 and P-value =0.0462<0.05). Moreover Provisioning for Non-Performing Loans coefficient was negative and statistically significant (β=-0.80819 and P-value=0.0124<0.05). The results finally reveal that the coefficient of Bank competition was positive and statistically significant (β=0.910392 and P-value = 0.0092<0.05).

The regression results indicated that the coefficient of the interaction between Net Stable Funding and Bank Competition was positive and statistically significant (β=0.307982 and P-value = 0.0035<0.05). The result suggests that bank competition intensifies the effect of Net Stable Funding on Financial Performance (measured by ROE). The regression results in Table 4.12 further showed that the coefficient of the interaction between Liquidity Coverage and Bank competition is positive and statistically significant (β=0.905587and P-value = 0.0156>0.0932). The result implied that bank competition intensified the effect of Liquidity Coverage on Financial Performance (measured by ROE).

The regression results additionally indicated that the coefficient of the interaction between Liquidity Gap and Bank competition was negative and statistically significant (=-1.855392and P-value = 0.0190<0.05). The result implied that Bank Competition enhanced the effect of Liquidity Gap on Financial Performance (indicated by ROE). Lastly, the regression results indicated that the coefficient of the interaction between Provisioning for Non-Performing Loans and Bank competition was negative and statistically significant (β=-1.893159 and P-value = 0.0257<0.05). The result suggests that Bank Competition intensifies the effect of Provisioning for Non-Performing Loans on Financial Performance (measured by ROE).

Table 7: Summary Results for Moderating Effect (Dependent Variable: ROE)

Variable	Model 3.2 (Before Moderation)		Model 3.12 (After Moderation)		Significance of Change	
	B	P-Value	B	P-Value	B	P-Value
Net Stable Funding	0.935311	0.0163	0.218527	0.0191	-0.716784	0.0191<0.05
Liquidity Coverage	0.647250	0.0351	0.93446	0.0261	0.28721	0.0261<0.05
Liquidity Gap	-0.549088	0.0349	-1.99550	0.0462	1.446412	0.0462<0.05
Provisioning for Non-Performing Loans	-0.06426	0.0289	-0.80819	0.0124	-0.74393	0.0124<0.05
Bank Competition	0.88451	0.0156	0.910392	0.0092	0.025882	0.0092<0.05

Source: Study Data (2023)

The regression outcomes showed that Net Stable Funding was significant before moderation (β= 0.935311, P=0.0163<0.05) and significant after moderation (β= -0.218527, P=0.0191<0.05) which presents significant change of -0.716784. Liquidity Coverage was significant before moderation (β=0.647250, P=0.0351<0.05) and also significant after moderation at (β=0.93446, P=0.0261<0.05) which presents significant change of 0.28721. Furthermore, coefficient of Liquidity Gap was significant before moderation (β=-0.549088, P=0.0289<0.05) and significant after moderation (β= -1.99550, P=0.0462<0.05) which presents significant change of 1.446412. The results also indicate that the coefficient of Provisioning for Non-Performing Loans is significant before moderation (β=-0.06426, P=0.0289<0.05) and was also significant after moderation (β= -0.80819, P=0.0124<0.05) which presents significant change of -0.74393. Therefore, taking into consideration of the moderation rule by Mackinnon et al. (2007) which recommends that if the interactive coefficients in Model 3.5 are significant then there is a moderating effect, the study concluded that bank competition had a significant moderation effect on the relationship between liquidity capacity and financial performance (ROA) of commercial banks in Kenya.

The current study results concur with Angel (2016), Strahan and Tehranian (2011), Goodhart (2014) Cooper and Ross (2008) who revealed that bank competition had a significant moderating effect on commercial banks's performance. Further, these results were compatible with the findings of Arif, Nauman, and Anees (2012) who found a significant moderating effect on the relationship between bank competition and commercial banks' financial performance. These findings differed with those of Ouma (2015), whose results confirmed that competition had no moderating effect on liquidity and financial performance of commercial banks. Further, these results disagreed with the findings of Konadu (2011) who found no moderating effect on liquidity and financial performance of commercial banks. The results of the current study were consistent with the findings by Assefa, Hermes, and Meesters (2013) which revealed that bank competition had a significant moderating effect on commercial banks' performance in India

SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

Summary of findings

The study sought to investigate the effect of liquidity capacity and commercial banks' financial performance in Kenya. The study was guided by the five specific objectives: To determine the effect of Net Stable Funding on Financial Performance of commercial banks in Kenya; to examine the effect of Liquidity Coverage on Financial Performance of commercial banks in Kenya; to establish the effect of Liquidity Gap on Financial Performance of commercial banks in Kenya; to determine the effect of Provisioning for Non-Performing Loans on Financial Performance of commercial banks in Kenya; and to establish the moderating effect of Competition on the relationship between Liquidity Capacity and Financial Performance of commercial banks in Kenya.

The study established that Net Stable Funding had a statistically significant positive effect on commercial banks' financial performance in Kenya. The results implied that an increase in the Net Stable Funding would lead to a corresponding increase in the financial performance of commercial banks in Kenya. Therefore, the study rejected the null hypothesis that Net Stable Funding does not have a significant effect on the financial performance of commercial banks in Kenya.

With respect to the Liquidity Coverage the study established that it had a statistically significant positive effect on financial performance of commercial banks in Kenya. This implies that an increase in Liquidity Coverage causes a significant increase in financial performance of commercial banks in Kenya. Therefore, the study rejected the null hypothesis that Liquidity Coverage does not have a significant effect on the financial performance of commercial banks in Kenya.

With respect to Liquidity Gap the study established that it had a statistically significant negative effect on financial performance of commercial banks in Kenya. This implies that an increase in Liquidity Gap could lead to a decrease of financial performance of commercial banks in Kenya. The study, therefore, rejected the null hypothesis that Liquidity Gap does not have a significant effect on the financial performance of commercial banks in Kenya.

In terms of Provisioning for Non-Performing Loans the study established that it had a significant negative effect on financial performance of commercial banks in Kenya. The findings imply an increase in Provisioning for Non-Performing Loans would lead to a decrease in Financial Performance of commercial Banks. The study, therefore, rejected the null hypothesis that Provisioning for Non-Performing Loans does not have a significant effect on the financial performance of commercial banks in Kenya.

The study established that Bank Competition had a moderating effect on the relationship between Liquidity Capacity and Financial Performance of commercial banks in Kenya. The regression results showed that Net Stable Funding was significant before moderation and significant after moderation. Liquidity Coverage coefficient was significant before moderation and also significant after moderation. At the same time, that of Liquidity Gap was significant before moderation and not significant after moderation. The results also indicated that the coefficient of Provisioning for Non-performing Loans was significant before moderation and it was also significant after moderation.

Conclusion of the study

The study concluded that Net Stable Funding has a significant positive effect on Financial Performance of commercial banks in Kenya. This implies that Net Stable Funding is a key determinant of the financial performance of commercial banks in Kenya. The positive effect implies that when Net Stable Funding goes up the financial performance of commercial banks in Kenya improves. Net stable finding is a significant component of the Basel III reforms. It promotes the resilience over a long-term time horizon by requiring banks to fund their activities with more stable sources of finding on an ongoing basis. This enables banks to maintain a stable funding profile in relation to the composition of their assets and off-balance sheet activities.

The study concludes that Liquidity Coverage has a significant positive effect on Financial Performance of commercial banks in Kenya. This implies that Liquidity Coverage is a crucial determinant of commercial banks' financial performance in Kenya. The positive effect implies that when Liquidity Coverage goes up, the financial performance of commercial banks in Kenya improves. Liquidity coverage therefore promotes short term resilience of banks to potential liquidity capacity disruptions by ensuring that they have sufficient high quality liquid assets to survive an acute stress scenario lasting for 30 days.

The study concludes that Liquidity Gap has a significant negative effect on Financial Performance of commercial banks in Kenya. This implies that Liquidity Gap is a key determinant of financial performance of commercial banks in Kenya. The negative effect implies that when Liquidity Gap goes up, the financial performance of commercial banks in Kenya declines. Liquidity Gap is described as the difference between a

bank's assets and liabilities. Aside from the foregoing maturity mismatch, liquidity problems arise owing to recessionary economic conditions, leading to less resource generation. This will increase the demand of depositors creating liquidity problems. This could cause the failure of a given bank or perhaps the whole banking industry attributable to contagion effect.

The study concludes that Provisioning for Non-Performing Loans has a significant negative effect on Financial Performance of commercial banks in Kenya. This implies that Provisioning for Non-Performing Loans is a key determinant of commercial banks' financial performance in Kenya. The negative effect implies that when Provisioning for Non-Performing Loans goes up, the financial performance of commercial banks in Kenya declines. Banks with a high stock of NPLs earn less and therefore have less money to lend. When a loss occurs emanating from a defaulted loan, the bank uses the amount set aside to cover the loss instead of using the cash flows.

The study concludes that Bank Competition has a significant moderating effect on the relationship between Liquidity Capacity and Financial Performance of commercial banks in Kenya. This implies that bank competition is a significant determinant of the relationship between Liquidity Capacity and Financial Performance of commercial banks in Kenya. In the long run, bank competition rectifies the adverse feature of intermediation inefficiency that exhibits in the form of extraordinary bank financial performance driven by high-interest rates and wide interest rate spreads. Fundamentally, therefore, the competitive aspect between commercial banks determines the level of banking sector stability, allocation of capital, entrepreneurial activities, and access to finance.

Policy Recommendations

This study established that Net Stable Funding had a statistically significant positive effect on the financial performance of commercial banks in Kenya. As a result, the study recommended that commercial banks in Kenya need to have a good appreciation in terms of having full visibility of all cash flows on the positions of exposures across their operations. Further, they need to have a good insight in terms of the assumptions that drive the cash flows both from a liquidity point of view and from the valuation perspective to best address the terms of requirement from the regulatory standpoint hence to help monitor the fluctuations in the Net Stable Funding in the commercial banks in Kenya.

This study also established that Liquidity Coverage had a statistically significant positive effect on the financial performance of commercial banks in Kenya. Therefore the study recommends that the commercial banks should invest on strategic planning in order to come up with business models that suit their operations hence to safeguard their liquidity capacity to ensure that the performance of commercial banks in Kenya is enhanced.

This study further determined that Liquidity Gap had a statistically significant negative effect on financial performance of commercial banks in Kenya. Thus, the study recommends that all commercial banks in Kenya should incorporate liquidity costs, benefits, and risks in the performance measurement, pricing, and approval process for all significant business activities. Hence, actively managing their Liquidity Gap positions and risks to meet payment and settlement obligations on a timely basis under both normal and stressed conditions, consequently contributing positively to the financial performance of commercial banks in Kenya.

This study, moreover determined that Provisioning for Non-Performing Loans had a statistically significant negative effect on the on financial performance of commercial banks in Kenya. The study further revealed that most commercial banks in Kenya have designed a Stress test and Contingency Funding Plans (CFPs) under a supposition that a liquidity capacity problems related to Provisioning for Non-Performing Loans would be relatively short-lived. Furthermore, there is a weak connection between stress-test results and the shaping of commercial banks' CFPs. Therefore the study recommends the use of market-wide set-ups covering an extensive time limits in stress tests, additionally the study recommends an explicit linkage of stress-test results

to CFPs to enhance liquidity capacity hence improving the financial performance of commercial banks in Kenya is improved.

Finally, the study established that Bank Competition has a statistically significant moderating effect on the relationship between Liquidity Capacity and Financial Performance of commercial in Kenya. The study recommends that as a measure, the government can spur consolidation among small sized and medium sized banks through a minimum market share policy. In Kenya the market share of commercial banks is measured using the Composite Market Share Index (CMSI). The government can set a minimum CMSI index to trigger consolidation among small sized and medium sized banks. A legal requirement of CMSI would create a mutual interest among small sized and some medium sized commercial banks to merge. The market share policy would not trigger consolidation motives among large sized banks since they already satisfy the requirement. The resulting large commercial banks would be large enough to matter in all forms of competition and therefore, reduction of exceptional financial performance in commercial banks in Kenya

Areas for Further Research

Liquidity capacity is determined by market and funding liquidity, supervisory and regulatory factors, and macroeconomic factors. Since there are exorbitant funding costs for obtaining liquidity, liquidity capacity is regarded as one of the major factors for commercial banks' financial performance. The current study only looked into funding liquidity variables. Therefore, in this light, future research should consider other necessary market liquidity variables, macroeconomic variables, supervisory and regulatory variables to establish their effect on financial performance of commercial banks in Kenya

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