EVALUATION OF THE IMPACT OF LIQUIDITY ON PROFITABILITY OF COMMERCIAL BANKS IN KENYA

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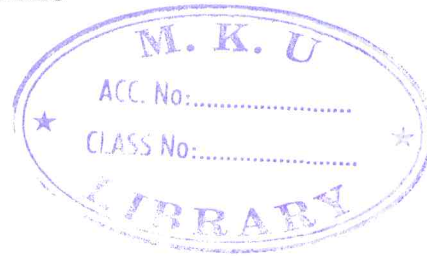

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A RESEARCH PROJECT SUBMITTED IN PARTIAL FULFILLMENT FOR THE DEGREE OF BACHELOR OF COMMERCE OF MOUNT KENYA UNIVERSITY

SEPTEMBER 2014

ABSTRACT

The study sought to establish the relationship between the profitability and the liquidity of commercial banks in Kenya. The recent crisis has underlined the importance of sound bank liquidity management. In response, regulators are devising new liquidity standards with the aim of making the financial system more stable and resilient. In this paper, the authoranalyzes the impact of liquid asset holdings on bank profitability for a sample of Commercial Banks in Kenya. The population used for this study comprised of the 44 banks in Kenya. A bank had to have been in operation during this time to qualify for the study. Secondary data used in this study were carried from audited financial statements of the banks at the end of the years of study, text books, journals, magazines and newspaper.The study used descriptive statistics and regression analysis to establish the relationship between the study variables.Our findings indicate that there was a positive relationship between liquiditymanagement and the existence of any banks.Results also suggest that profitability is improved for banks that hold some liquid assets, however, there is a point at which holding further liquid assets diminishes a banks' profitability, all else equal. Moreover, empirical evidence also suggests that this relationship varies depending on a bank's business model and the state of the economy. These results are particularly relevant as policymakers devise new standards establishing an appropriate level of liquidity for banks. While it is generally agreed upon that banks undervalued liquidity prior to the recent financial crisis, one must also consider the trade-off between resilience to liquidity shocks and the cost of holding lower-yielding liquid assets as the latter may impact banks' ability to generate revenues, increase capital and extend credit.