The Effect of Bank Specific Factors on Financial Performance of Commercial Banks in Kenya

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Abstract

The main goal of every banking institution is to operate profitably in order to maintain stability and sustainable growth. External and internal economic environments are viewed as critical drivers for bank performance. The main purpose of this study was to determine the effects of bank specific factors on the financial performance of commercial banks in Kenya for a period of 5 years, starting from the year 2011 to 2015. The dependent variable under investigation was return on assets (ROA). The independent variables were capital adequacy, asset quality, management efficiency, earnings ability and liquidity. The specific objectives of this research were to determine the effects of capital adequacy on the financial performance of commercial banks in Kenya, evaluate the effects of asset quality on the financial performance of commercial banks in Kenya, determine the impact of management efficiency on the financial performance of commercial banks in Kenya, determine the impact of earnings ability on the financial performance of commercial banks in Kenya and evaluate the effects of liquidity on the financial performance of commercial banks in Kenya. The choice of this five-year period was based on the explosive growth of the banking sector in the country and the availability of complete data for that period. The study concentrated on the bank specific factors that affect the banks' financial performance. In this research, the scope was all the 11 banks listed in the Nairobi securities exchange.

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This study adopted an explanatory approach by using panel data research design to fulfill the objectives. The researcher collected data on published financial statements for five years from 2011 to 2015 that was analyzed to show the effect of bank specific factors on financial performance of commercial banks over that period under study. The findings were presented in tables and narratives. They show that there has been a significant decrease in capital adequacy during the five-year period. There was also a finding that asset quality affects profitability and the financial performance of banks. The study concludes that Asset quality of the bank have the highest influence on ROA of banks. The study recommends that efficient and effective management should be adopted by bank managers to ensure that banks do not become insolvent.

Keywords: Bank performance; Specific factors.

1. Introduction

1.1 Background of the Study

Banks play very important role in the economic development of nations as they largely wield control over the supply of money in circulation and are the main stimuli of economic progress [20]. Bank performance may be defined as the reflection of the way in which the resources of a bank are used in a form, which enables it to achieve its objectives. Furthermore, the term bank performance means the adoption of a set of indicators, which are indicative of the bank's status, and the extent of its ability to achieve the desired objectives [20]. Some of the reasons why we evaluate the performance of banks are to determine their operational results and their overall financial condition, measure their asset quality, management quality, efficiency, and achievement of their objectives as well as ascertain their earning quality, liquidity, capital adequacy and level of bank services.

1.2 Statement of the problem

Understanding the bank specific factors and their influence in bank profitability and performance is crucial to the management of commercial banks, stakeholders and other interest groups such as the central bank and the government. Research studies conducted to assess the internal aspects that determine the profitability and financial performance of commercial banks have revealed several internal bank specific factors, external and industry specific factors. The bank specific factors are particular to a given institution, thus the internal factors that determine profitability in one bank are different from other banking institution in Kenya.

A review in literature indicates that several research studies done on local and international arena concentrated on specific factors. Reference [26] studied the determinants of bank's profitability in developing economies, with a particular interest in Nigeria showed that bank specific factors such as efficient management of expenses and increased interest income affects profitability. Additionally, the same research indicated that macro environment factors such as favorable economic conditions also result in increased profitability of commercial banks. This study ignored the industry specific factors. A study by authors in [31], concentrated on factors influencing banking sector performance in Kenya. The researcher found out that board, management decisions influence the performance of commercial banks in Kenya, and that macro-economic factors have minimal impact on the banks performance. However, the research omitted the impact of industry specific factors on the

performance of banks in the country. Available literature has not exclusively concentrated on identifying the bank specific factors that influence bank's profitability in developing countries and with particular focus on Kenya. It is clear that in Kenya, there is limited literature on the bank specific factors and ways in which they determine bank profitability. This study sought to fill this gap.

2. Literature review

2.1 Theoretical review

An organized research of bank financial performance began in the late 1980's with the application of the Market Power (MP) and Efficiency Structure (ES) theories [3].

2.1.1 Market Power Theory

Market theory is the extent to which a firm can influence the price of an item by exercising control over its demand, supply, or both. Under the economic concept of perfect competition, all firms in a market are assumed to have zero market power. Thus, each firm has to accept the current market price without being able to exercise any control over it. The MP theory states that increased external market forces results into better financial operations and profitability. In addition, the hypothesis asserts that only organizations with large market share and well differentiated portfolio of products can win their competitors and earn monopolistic profit.

2.1.2 Efficiency Structure Theory

Conversely, the ES theory proposes that enhanced managerial scale efficiency leads to higher concentration and then to higher profitability. This is a clear indication of desirable financial performance of firms especially the commercial banks. Authors in [25] asserted that the balanced portfolio theory added a different dimension into the study of bank performance. The theory suggests that the portfolio composition of a commercial bank, its profit and the return to shareholders is the result of the decisions made by the management and the overall bank's policy decisions. Therefore, the theories contribute to the conclusion that banks financial performance is influenced by both internal and external factors. According to this study, bank specific factors fall under the internal factors.

The overall financial performance of commercial banks in Kenya has been improving during the last ten years. However, not all commercial banks have been experiencing the improvement. Some banks have been experiencing losses [4] along the study period of ten years.

2.2 Empirical Literature

A study done by authors in [19] focused on the effects of variables from the CAMEL model on bank performance in China. The study concentrated on the CAMEL variables that included capital adequacy, asset quality, management, earnings ability, and liquidity. The researcher's sample size consisted of 13 Chinese banks all listed in the Shanghai Stock Exchange between 2008 and 2011. Liu implemented the fixed effects multiple

linear regression model in his research to measure the relationship between internal factors from CAMEL model and bank performance. The findings of this study indicated that return on assets is directly affected by shareholders risk-weighted capital adequacy ratio, costs to income ratio, net interest rate margins, and loans to deposits ration. Additionally, the findings indicated that the return on equity could be affected by costs to income ratio, operating expenses to assets ratio and loans to deposits ratio.

Authors in [4] reviewed the financial performance of Mellat Bank using the CAMEL model. Mellat bank is a private bank in Iran that has existed since 1980 as a merger of ten pre-revolution private banks. Each of the CAMEL model dimensions were examined using trend analysis method and both mean and standard deviation statistics. In the process, the researchers determined all the model criteria and identified an ascending trend in the period under investigation. The researchers further investigated the relationship between the model variables and the financial performance of Mellat bank and examined the relationship using two linear and multiple regression as well as OLS method. The findings of the study show that there exist a positive significant relationship between the indices of liquidity, quality of management and earnings ability with financial performance. However, the findings indicated no relationship was identified between capital adequacy and assets quality with bank financial performance. The results also indicated the existence of a positive relationship between financial performance of commercial banks and the management quality section. This relationship showed that the bank experienced better financial performance in the management quality section.

Authors in [17] also conducted a study that compared the financial performance of different ownership structured commercial banks in Nepal based on their financial characteristics. The study identified the determinants of performance exposed by financial rations that were based on CAMEL model. Jha and Hui analyzed 18 banks for the period of 2005 to 2010. The researcher utilized the econometric model, multivariate regression analysis, by formulating two regression models utilized in estimating the impact of capital adequacy ratio, non-performing loan ratio, interest expenses to total loan, net interest margin ratio and credit to deposit ratio on the financial profitability namely return on assets and return on equity of these commercial banks. The outcome of the research study indicated that public sector banks are significantly less efficient than their counterpart. However, domestic private banks are equally efficient as compared to foreign-owned and joint venture banks. Additionally, the research results revealed that return on assets was significantly influenced by capital adequacy ratio, interest expenses to total loan and net interest margin, while capital adequacy ratio substantial effect on return on equity.

Authors in [16] carried out a research study on the impact of bank-specific variables and selected macroeconomic variables on the South African banking sector between 1994 and 2011. The researcher considered capital adequacy, asset quality, management, earnings ability and liquidity under the CAMEL model of bank performance evaluation in the study. The Ifeacho & Ngalawa's study employed data in annual frequency from South Africa's four largest banks, namely ABSA, First National Bank, Nedbank, and Standard Bank. The four banks account for over 70% of the South Africa's banking assets. The researcher investigated the banks using the return on assets (ROA) and return on equity (ROE) as measures of the bank performance. According to the findings, all bank-specific variables are statistically noteworthy determinants of bank performance. The study indicated that asset quality, management quality, and liquidity have a positive effect on

both measures of bank performance, consistent with the theoretical expectations. Additional findings indicated that capital adequacy exhibited a significant negative relationship with ROA, while its relationship with ROE is significant and positive as expected. Ifeacho & Ngalawa further found that only interest rates in the ROA model, the unemployment rate in ROA model and rate of inflation in ROE model were statistically significant. The rest of the macroeconomic variables were insignificant.

A study done by authors in [3] examined the impact of bank specific, industry-specific and macroeconomic factors on bank profitability using an empirical framework that incorporated the traditional Structure-Conduct-Performance (SCP) hypothesis. The research involved Greek banks that were conducted 1985-2001. The researchers used several independent variables, namely capital, credit risk, productivity, expense management, ownership, inflation and business cycles. The empirical results indicated that capital is significant in explaining bank profitability. The findings also indicated that capital increased the exposure to credit risk and lowers profits for commercial banks. Similarly, authors in [18] conducted a research on the impact of bank-specific characteristics, macroeconomic conditions and financial market structure of UK owned commercial banks' profits. The researchers measured the effects on profitability using the return on average assets (ROAA) and net interest margins (NIM). The research covered the period 1995-2002 where an unbalanced panel data set of 224 observations was provided for the econometric analysis. The findings of the research indicated that capital strength as shown by the equity to assets ratio is a significant determinant of profitability of the UK commercial banks. Additionally, cost-to-income ratio and bank size also affected profitability negatively. Moreover, other macroeconomic factors such as GDP growth and inflation have a positive effect on bank performance.

Authors in [37] conducted a research whose main objective was to assess the contribution of bank-specific, macroeconomic, and financial structure factors to the profitability of banks in Macao. The researchers utilized bank level data for the period of 1993-2007. Additionally, the researchers adopted the panel data regression to establish the important factors in achieving high profitability by using internal variables, namely capital ratio, asset composition, asset quality, expense management, source of funds, and market share. The research also included external variables, such as the GDP growth rate, real interest rate and inflation. ROA was the main ratio used as a measure of profitability for the commercial banks. The findings of the research indicated that capital strength of a bank has a positive impact on profitability. Conversely, asset quality measured by the loan-loss provisions negatively affects the performance of the commercial banks. Commercial banks with large retail deposit-taking network do not attain a level of profitability higher than the banks with a smaller network. Considering the macroeconomic variables, the findings indicated that only the rate of inflation had a significant effect on the commercial bank's performance.

Further research study conducted by authors in [11] entailed the investigation of bank-specific characteristics, macroeconomic variables and industry-specific factors that have an impact on the profitability of 453 commercial banks in Switzerland. The research was conducted over the period of 1999 and 2006. This research represented the first econometric study that investigated the importance of factors affecting banking profitability for the banks in Switzerland. The study also incorporated the influence of additional factors such as growth of bank loans relative to the growth rate of the market, effective tax rate, and bank age. The findings indicated that better capitalized commercial banks appeared to be more profitable. Additionally, the commercial banks whose

loan volumes grew faster than the market portrayed a positive impact on the institution's profitability. The findings also indicated that bank age does not have any significant effect on profitability. However, a bank's location directly affected bank's profitability. The same findings indicated that bank ownership had an impact on profitability. Locally owned banks were more profitable as compared to the foreign banks.

Authors in [35] examined the determinants of financial performance under profitability during the period 1990-2005 in Philippines banks. The results of the study showed a direct relationship between financial performance and bank-specific factors. Similarly, the empirical results suggested that the bank specific factors such as capital adequacy, asset quality and management efficiency affects profitability and by extension the financial performance of the banks.

Authors in [27] conducted a research on the factor that determines financial performance of commercial banks in Kenya. The study took place during the period 2001 to 2010. The researchers utilized the linear multiple regression model and Generalized Least Square on panel data. The researchers used independent variables such as capital adequacy, asset quality, Management Efficiency, Liquidity Management, GDP growth rate and inflation. The dependent variables used to measure the performance included the return on investments (ROA), return on equity (ROE), and Net Interest Margin NIM. The findings indicated that the considered bank-specific factors had a significant impact on the performance of commercial banks in the country. However, the factors did not have an effect on the liquidity variable. Additionally, the effect of macroeconomic variables was inconclusive at 5% significance level.

In a different study, authors in [12] study the main explanatory factors that were likely to have an impact on banks performance in Tunisia. The researchers empirically assessed various internal factors such as size, operational efficiency, capital ratio, ownership and credit quality. The research also included other external factors that included both the industry-specific variables and the macroeconomic variables. Industry-specific variables included concentration and size of the banks while the macroeconomic variables were represented by GDP growth and inflation. The researchers collected data from 10 conventional commercial banks during the period 1998 to 2011. The Generalized method of moments (GMM) was employed for the dynamic panel data estimation approach. The empirical findings indicated that bank capitalization in addition to the best managerial efficiency have a positive and significant impact on the bank profitability and performance. Additionally, the findings indicated that private owned banks appeared to be more profitable than the state owned commercial banks. Other industry-specific factors such as bank size and concentration also significantly affected the performance of the banks under investigation. The findings on macroeconomic indicators concluded that not all the factors under the study had any significant impact on bank performance.

The main objective of the research done by authors in [15] in Ghana was to determine the factors that affected the financial performance of the Naara rural banks in the upper east region of the country. The researcher used the annual financial statements that covered an 11-year long period between 2000 and 2010. Multiple regression analysis was used as the main statistical tool to analyze the data collected from the bank under the study. The research sought to establish empirical relationship that existed between Naara rural banks financial performance on one hand and its credit portfolio, liquidity, non-performing loan and total assets on the other hand. The

findings of the research indicated that liquidity and size were positively and related considerably to the performance of the bank. Additionally, the impact of the bank's portfolio was positive even though the effects on the performance of the financial institutions were found to be statistically insignificant. The non-performing loans were found to affect the performance of the banks negatively.

Authors in [38] conducted a research to observe the effects of bank-specific factors such as liquidity risk, bank size, capital adequacy, operating cost, credit risk and macroeconomic determinants such as GDP growth rate and interest rate on the profitability of commercial banks in Sri Lanka. The researchers utilized quarterly data relating to the bank-specific and macroeconomic indicators. The research took place between 2001 and 2011. Multiple panel regression was used to analyze the data and determine the relationship between the dependent and the independent variables. Additionally, the researchers used the ROA and the ROE as profitability indicators of the banks under the study. The empirical results indicated that the larger the commercial banks the more the profits recorded. This is because of the economies of scale as compared to the banks with a higher regulatory capital ratio. Additional findings from the panel regression indicated that the liquidity and operating cost efficiency for banks were inversely proportional to the commercial banks profitability in the country. The interest rate investigated indicated a significant effect on the profitability of the banks and a negative relationship between the return on assets (ROA) of the banks.

Capital and liquidity as bank specific factors that researchers have identified to have a direct impact on the financial performance and profitability of commercial banks in both developed and developing countries. According to authors in [34], there is a positive relationship between greater equity and financial performance among EU commercial banks. Additional research done by authors in [2] indicated that there was a positive effect of the equity level of a bank on the financial performance and profitability of that organization. There exists a positive relationship between capita and banks earnings. Capital adequacy for commercial banks is determined by various variables namely the log of total assets (LTA), loan loss provisions to total loans, loans to assets, tax to operating profit before tax, non interest income to total assets, and overhead expenses to total assets. Capitalization is principal measure for capital adequacy and is a measure of shareholders equity to total assets. On the other hand, liquidity of banks is considered to have an impact on the financial performance f the institutions. Various researchers found out that insufficient liquidity of commercial banks is a major reason for failure in the business. According to authors in [21], there exists a negative relationship between the level of liquidity and the financial performance of banks.

2.3 Bank specific factors

Authors in [29] conducted a study in Kenya's banking sector to investigate the effects on bank-specific factors on financial performance of commercial banks. The study employed an explanatory approach by using panel data research design. Annual financial statements of 38 Kenyan banks from 2002 to 2008 were obtained from the Central Bank of Kenya and banking survey 2009 for the analysis purpose. The researchers analyzed the data using multiple linear regression method. The results of the analysis showed that all the bank specific factors had statistically significant impact on profitability and financial performance.

2.3.1 Capital adequacy

Capital is one of the bank specific factors that have an impact on the level of banks profitability and financial performance. Capital can be defined as the amount of own fund available to support the bank's operations. Adequate capital minimizes the chances of distress in banks [10]. Capital adequacy is the level of own capital possessed by a bank and that is required to sustain the banks amid risks such as credit, market and operational risks. Adequate capital enables banks to absorb potential losses and protect the banks' debtors. Authors in [9] asserted that the adequacy of capital is measured based on the capital adequacy ratio (CAR) that shows the internal strength of the bank to withstand losses during financial crisis. This directly affects the profitability and financial performance in banks in the country.

2.3.2 Asset quality

This is another bank-specific factor that affects profitability and the financial performance of banks. These assets include the current and fixed assets, credit portfolio and other investments. Loans are a major asset in Kenya's commercial banks that generates a large portion of a banks income. However, the loans also expose the banks to latent losses derived from delinquent loans [9]. It is advisable for banks to keep their amount of nonperforming loans to low levels by commercial banks because such loans affect the profitability of the banks and eventual financial performance [33].

2.3.3 Management efficiency

This is one of the key bank-specific factors that determine the financial performance and the profitability of commercial banks in Kenya. The management efficiency is represented by various financial rations such as total asset growth, earning growth rate and so on. Management quality can also be measured by the efficiency in managing banks operating expenses. The ability of the management of commercial banks to deploy its resources efficiently, income maximization, reducing operating costs can be determined using financial rations. The quality of management exhibited by the finance departments of commercial banks determines the levels of operating expenses and in turn affects profitability and financial performance [3].

3. Research methodology

3.1 Target Population

The target population was all the 11 commercial banks listed in the Nairobi securities exchange (NSE) in Kenya as at the end of 2015.

3.2 Sample Design

The sample comprised all commercial banks listed in the Nairobi Securities Exchange as at the end of 2015. Therefore all the eleven banks listed constituted the sample.

3.3 Data Collection

The study used secondary data constituting the income statements and balance sheet sourced from the banks audited annual reports and financial statements for the ten year period, between 2011 to 2015, available from the CBK and CMA websites.

The period was chosen because it offers recent time series observations and it constitutes a period of major developments in the Kenyan Banking system. Data for each of the bank specific factors will be collected namely; capital adequacy, asset quality, management efficiency, earnings ability and liquidity. Data on ROA to measure performance for the commercial banks was also collected over the study period.

3.4 Data Analysis

The data collected was analyzed using SPSS software version 20. To test for the effect of bank specific variables on the bank performance a multiple linear regression model was employed The ROA was measured as indicated below:

$$ROA = PBT/Total\ assets \ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots..\ 1$$

Hence we estimate the following regression model.

$$ROA = \alpha + \beta_1\ C_{it} + \beta_2\ AQ_{it} + \beta_3\ Mgt_{it} + \beta_4\ Ea_{it} + \beta_5\ Liq_{it} + \varepsilon_i \ldots\ldots\ldots\ldots..\ 2$$

Where:

ROA = performance of bank I at time t

α =　 constant

$\beta_1, \beta_2, \beta_3, \beta_4, \beta_5$ = regression coefficients

C_{it} =　 Total capital / Total risk weighted assets of bank i at time t　(Capital adequacy)

AQ_{it} =　 (NPI-Provision)/Gross advances of bank i at time t　　　　　(Asset quality)

Mg_{it} =　 Total operating revenue/total profit of bank i at time t　　　　(Mgt efficiency)

Ea_{it} =　　Net profits /Total assets of bank i at time t　　　　(Earnings ability)

Liq_{it} =　　Net liquid assets/Total deposits of bank i at time t　　　　(Liquidity)

ε_i =　 Error term

Coefficients $\beta_1, \beta_2, \beta_3$ and β_4 and β_5 were used to measure the sensitivity of the dependent variable *(*ROA$_{it}$) to

unit changes in the five explanatory variables. F-statistic and t -statistic were used to carry out tests of significance for the overall fit of the model (R^2) and the independent variables respectively. Pearson and spearman correlation coefficients will be used to test for multi collinearity.

4. Research findings and presentations

4.1 Regression analysis

Table 4.1 gives the regression model summary results. It presents the R value which is the measure of association between the dependent and the independent variables, the R Square which is the coefficient of determination measuring the extent at which the independent variables influence the dependent variable as well as the Adjusted R Square which measures the reliability of the regression results.

Table 4.1: Model summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.774[a]	.749	.709	.04384

a. Predictors: (Constant), x1, x2, x3,x4,x5

Source: Research data (2016)

The findings show that *R* which is the multiple correlation coefficients that shows quality of the prediction of the dependent variable by the independent variable is 0.774.

This is a good indication since it points to a strong correlation. The *R-Square* which is the coefficient of determination shows that the five independent variables in the model explain 74.9% of performance of commercial banks. Subsequently from the Adjusted R-Squared it is evident that after adjusting the model for inefficiencies the independent variables can explain 70.9% of performance of commercial banks.

Regression coefficients

In order to answer the proposed model for the relationship between performance and the independent variables, the regression coefficients were calculated and presented in table 4.2.

These with their significance values (also given in the table) measures the effect of each independent variable on performance (dependent variable) and the effect that would occur to performance in an attempt to changing (increasing/decreasing) these variables.

Table 4.2: Coefficients (a)

Model		Standardized Coefficients	T	Sig.
		Beta		
1	(Constant)	0.425		
	Capital adequacy	.354	3.454	0.000
	Asset quality	.461	2.554	0.004
	Management efficiency	.454	2.299	0.003
	Earnings ability	.349	2.413	0.002
	Liquidity	.343	2.464	0.002

a. Dependent Variable: ROA

As per the SPSS generated output as presented in table above the coefficients were used to answer the following regression model which relates the predictor variables (independent variables) and the dependent variables.

$ROA = \alpha + \beta1\ Cit + \beta2\ AQit + \beta3\ Mgtit + \beta4\ Eait + \beta5\ Liqit + \varepsilon i$…………….. 2

Where:

ROA = performance of bank I at time t

α =   constant

$\beta1, \beta2, \beta3, \beta4, \beta5$ = regression coefficients

Cit   =   Total capital / Total risk weighted assets of bank i at time t   (Capital adequacy)

AQit =   (NPI-Provision)/Gross advances of bank i at time t   (Asset quality)

Mgit =   Total operating revenue/total profit of bank i at time t   (Mgt efficiency)

Eait   =   Net profits /Total assets of bank i at time t   (Earnings ability)

Liqit   =   Net liquid assets/Total deposits of bank i at time t   (Liquidity)

εi   =   Error term

Based on these coefficients, the regression model therefore becomes;

ROA = .425 + .354 Cit + .461AQit+ .454 Mgtit + .349 Eait + .343 Liqit……3

From the regression model 3, Constant = 0.425 shows that if all the independent variables (capital adequacy, asset quality, management efficiency, earnings' ability, liquidity) all rated as zero, ROA would rate 0.425. While holding the other factors constant a unit increase in capital adequacy of the bank led to 0.354 increase in ROA. A unit increase in asset quality while holding the other factors constant would lead to an increase in ROA of banks by a factor of 0.461, a unit change in management efficiency while holding the other factors constant would lead to an increase of 0.454 in ROA of the banks. A unit increase in earnings ability while holding the other factors constant would lead to an increase in ROA of banks by a factor of 0.349, a unit change in liquidity while holding the other factors constant would lead to an increase of 0.343 in ROA of the banks.

This implied that asset quality had the highest influence on ROA of banks (p - value .004). The analysis was undertaken at 5% significance level. The criteria for comparing whether the predictor variables were significant in the model was through comparing the obtained probability value and $\alpha = 0.05$. If the probability value was less than α, then the predictor variable was significant otherwise it wasn't. All the predictor variables were significant in the model as their probability values were less than $\alpha = 0.05$

5. Summary, Cconclusions and Rrecommendations

5.1 Summary of Findings

5.1.1 Effects of capital adequacy on the financial performance of commercial banks in Kenya

On the correlation of the study variable, the researcher conducted a Pearson moment correlation. The study found a strong positive correlation between the capital adequacy of commercial banks and ROA as shown by correlation coefficient of 0.733, this too was also found to be significant at 0.054 level. From the regression model obtained, a unit increase in capital adequacy while holding the other factors constant would lead to an increase in ROA of banks by a factor of 0.354.

These findings are in line with those of [6] who found that banks capital creates liquidity for the bank due to the fact that deposits are most fragile and prone to bank runs. The current findings contradict [10] who found a negative relationship between bank liquidity and performance. Capital is the amount of own funds available to support the bank's business and act as a buffer in case of adverse situation. Moreover, greater bank capital reduces the chance of distress [10].

According to authors in [9], the adequacy of capital is judged on the basis of capital adequacy ratio (CAR). Capital adequacy ratio shows the internal strength of the bank to withstand losses during crisis. Capital adequacy ratio is directly proportional to the resilience of the bank to crisis situations. It has also a direct effect on the profitability of banks by determining its expansion to risky but profitable ventures or areas [33].

5.1.2 Effects of asset quality on the financial performance of commercial banks in Kenya

On the correlation of the study variable, the researcher conducted a Pearson moment correlation the study also found weak positive correlation between ROA of commercial banks and asset quality as shown by correlation coefficient of 0.389, this too was also found to be significant at 0.028 level. From the regression model obtained, a unit increase in asset quality while holding the other factors constant would lead to an increase in ROA of banks by a factor of 0.461.

The findings are in line with [33] who found that asset quality affects profitability and the financial performance of banks. These assets include the current and fixed assets, credit portfolio and other investments. Loans are a major asset in Kenya's commercial banks that generates a large portion of a banks income. However, the loans also expose the banks to latent losses derived from delinquent loans. It is advisable for banks to keep their amount of nonperforming loans to low levels by commercial banks because such loans affect the profitability of the banks and eventual financial performance (9).

5.1.3 Impact of management efficiency on the financial performance of commercial banks in Kenya

On the correlation of the study variable, the researcher conducted a Pearson moment correlation the study found a weak positive correlation between management efficiency of commercial banks and capital adequacy as shown by correlation coefficient of 0.388 at 0.477 level of confidence which is less than 0.5. The study also found weak positive correlation between management efficiency of commercial banks and ROA as shown by correlation coefficient of 0.310 at 0.028 level of confidence. From the regression model obtained, a unit increase in management efficiency while holding the other factors constant would lead to an increase in ROA of banks by a factor of 0.454.

The findings are in line with author in [3] who identifies management efficiency as a factor that affects the financial performance and the profitability of commercial banks in Kenya. The management efficiency is represented by various financial rations such as total asset growth, earning growth rate and so on. Management quality can also be measured by the efficiency in managing banks operating expenses. The ability of the management of commercial banks to deploy its resources efficiently, income maximization, reducing operating costs can be determined using financial rations. The quality of management exhibited by the finance departments of commercial banks determines the levels of operating expenses and in turn affects profitability and financial performance.

5.1.4 Impact of earnings ability on the financial performance of commercial banks in Kenya

On the correlation of the study variable, the researcher conducted a Pearson moment correlation the study found a weak positive correlation between ROA of commercial banks and earnings ability as shown by correlation coefficient of 0.34 at 0.006 level of confidence.

5.1.5 Effects of liquidity on the financial performance of commercial banks in Kenya

On the correlation of the study variable, the researcher conducted a Pearson moment correlation the study found a weak positive correlation between ROA of commercial banks and liquidity as shown by correlation coefficient

of 0.351 at 0.001 level of confidence.

5.2 Conclusion

The study objective was meant to examine the effect of specific factors on financial performance of commercial banks in Kenya. The correlation analysis results indicated that a significant relationship indeed existed between the variables. The Pearson's product moment coefficient of correlation r = 0.774 is high and suggests that the relationship between the variables was positive and strong. The specific factors significantly affected the financial performance of the banks. Therefore the researcher concluded that the specific factors influence the performance of all commercial banks in Kenya.

From the regression model obtained, all the independent variables (capital adequacy, asset quality, management efficiency, earnings' ability, liquidity) all rated as zero, ROA would rate at 0.411. Therefore it can be concluded that only 41.1% of ROA variation in banks can be explained by capital adequacy, asset quality, management efficiency, earnings' ability and liquidity. Based on the findings it can be concluded that the Asset quality of the bank had the highest influence on ROA of banks.

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