

## Abstract

Microfinance banks liquidity has been sustained by massive slowdowns in lending that accompanied moratoria on repayments, but should this be extended beyond the initial months, it would effectively push the liquidity crunch onto the low-income communities they are supposed to serve and put the sustainability of the MFBs themselves into question by exposing them to liquidity risks. This study aimed to establish capital adequacy, bank size and the liquidity risk of deposit taking microfinance banks in Kenya. Specifically, the study sought to assess whether capital adequacy influenced the liquidity risk of deposit taking microfinance banks in Kenya with bank size as the moderating variable. The study was guided by the trade-off theory and capital buffer theory. The study employed the longitudinal research design and targeted 13 microfinance banks. The study utilized panel data extracted from the financial reports of the banks for the period 2018 to 2023. The study summarised and analysed data using descriptive and inferential statistics. Descriptive statistics included mean and standard deviations while inferential statistics included correlation and regression analysis. The research hypotheses were tested using panel data regression analysis. Data was presented using statistical output tables and discussions there off. The study found that capital adequacy positively but insignificantly influenced liquidity risk ( $p = 0.851 > 0.05$ ,  $t = 0.19 < 1.96$ ,  $\beta = 0.2639$ ). Bank size moderated positively and insignificantly the association between capital adequacy and liquidity risk ( $p = 0.423 > 0.05$ ,  $\beta = 0.6680$ ). Bank size explained 5.54% variance in liquidity risk. The study concluded that capital adequacy do not influence the liquidity risk of deposit taking microfinance banks in Kenya, while the moderator variable bank size does not moderate the relationship between capital adequacy and liquidity risk. Recommendations to the bank regulators is to avoid a one-size-fits-all approach and instead develop capital regulations for banks with different characteristics as increasing capital requirements on all banks may not affect liquidity creation to the extent that regulators expect. Also, banks be allowed to participate in regulatory forbearance in times of liquidity distress to increase their stability through the extension of low provisioning on restructured loans . Further, bank managers should also combine bank funding diversification and liquidity creation in a mixed strategy to help regulate and balance capital adequacy.