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**Effects of Selected Financial Management Practices on Financial  
Performance of Commercial Banks in Kenya**

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## Effects of Selected Financial Management Practices on Financial Performance of Commercial Banks in Kenya

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### Abstract

**Purpose:** The main aim of the study was to determine effects of selected financial management practices on financial performance of commercial banks in Kenya. The research was guided by the following specific objectives; to determine the influence of liquidity management, capital structure management, credit risk management and working capital management on the financial performance of commercial banks in Kenya.

**Methodology:** The research employed a descriptive research design. Census method of sampling was employed, all the 43 commercial banks formed the study units. Both primary and secondary data were used. Secondary data was obtained from the audited annual financial reports of the commercial banks in Kenya while primary data was collected using questionnaire which was designed in form of Likert scale. Descriptive and inferential statistics were used, whereby correlation and regression were used to establish the strength of the relationship between the financial management practices and financial performance of the commercial banks. Data was presented in form of tables, mean and standard deviation. Correlation analysis was performed to examine the relationship between the financial management practices and financial performance of the commercial banks.

**Results:** The study concludes that liquidity management had positive significant effect on the financial performance of commercial banks in Kenya. Measuring liquidity risk is important to making sure that liquidity problems are identified in time. The study concludes that capital structure management practice has positive significant effect on the financial performance of commercial banks in Kenya. On credit risk management practice, the research found strong positive significant on the financial performance of commercial banks in Kenya. Most of financial institutions have risk eliminating strategy in place, proper risk management. Finally, the study concludes that working capital management practice has positive significant on the financial performance of commercial banks in Kenya.

**Unique contribution to theory, policy and practice:** The research recommends that banks management should make sure that they maintain substantial levels of liquidity, so as to maintain competitive performance. Commercial institution must have a feasible capital structure in place that addresses issues such, as flexibility where changes in the capital market should be well adapted to the capital structure.

**Key Words:** *Liquidity Management, Capital Structure Management, Credit Risk Management and Working Capital Management and Financial Performance*

## 1.0 INTRODUCTION

Financial management practices are an important element in the performance and management of the banking industry (Alnajjar, 2016). Therefore, it is vital that banks' management seek strategic ways of enhancing profitability in order to realize sustained growth and stability of the financial institutions. Today, all forms of businesses, banks included, are under constant pressure to develop, implement and rapidly revise their financial management strategies (Kirkpatrick, 2009). To do this, commercial banks need to develop and implement sound financial strategies that would help them manage their business risk and improve their financial performance (Devi, 2013). Financial management is a discipline that deals with the financial decision's corporations make, and the tools and analysis they use to make the decisions (Brigham & Houston, 2012). Regulations in the banking sector is an approach used by the government to control the behaviour of the banks. The bank regulations encourage transparency since they direct on the limitations, requirements and guidelines that need to be followed in the banking sector. Effective and successful bank regulations aim to accomplish two goals; to protect the depositors, creditors and investors private interests, investors and creditors; and to protect the interest by endorsing good reputation and integrity of financial markets. Llewellyn (2013) posits that banks are important players in the economy of any nation implying that banks need to be supervised and controlled to not only protect the clients and investors but also to attain stability in the banking sector. Financial management is one of the several functional areas of management but it is the center to the success of any business. Inefficient financial management practices, combined with the uncertainty of the business environment often leads business enterprises to serious problems (Chandra, 2011). According to Golda (2013), careless financial management practices are the leading cause of failure for banks in Sub-Saharan Africa. Hunjra, Butt and Rehman (2010) observes that if the financial decisions of a firm are wrong, profitability of the company will be adversely affected. Consequently, a business organization's performance could be damaged because of improper financial management practices. Business enterprises have often failed due to lack of knowledge of efficient financial management practices.

### 1.0 Financial Management Practices

According to Jain, Singh and Yadav (2014), financial management practices are defined as the practices performed by the accounting officer, the chief financial officer and other managers of a firm in the areas of budgeting, supply chain management, financial structure, asset management and control. The goal of financial management is enhancing a firm's value by ensuring that a firm's return on capital exceeds its cost of capital, without taking excessive financial risks (Arnold, 2014). At an individual's level, financial management involves tailoring one's expenses according to one's financial resources while from the organizational perspective the process of financial management is associated with financial planning and financial control (Gitman & Zutter, 2011). Modern financial management practices basically provide a conceptual and analytical framework for financial decision making and emphasize on effective use of organizational financial resources (Brigham & Houston, 2012). The most common financial management practices applied in the

banking industry include Liquidity Management (LM), Capital Structure Management (CSM), Credit Risk Management (CRM) and Accounting Information Systems (AIS) (Asuquo, 2016). Liquidity management refers to the ability to trade an asset, such as a stock or bond, at its current price. (Graham & Bordeleau, 2010). This involves managing the relationship between a firm's short-term assets and short-term liabilities. Working capital is a part of a firm's current assets. Working capital is defined as a company's total investment in current assets or assets that a company expects to be converted into cash within a year or less (Lartey, 2013). The investment in working capital involves carrying costs and shortage costs, so the firms have to find the tradeoff between them (Jain, Singh, & Yadav, 2015)

Capital Structure Management, according to Arnold (2014), means overseeing the capital structure of a financial institution. A company's capital structure refers to the mix of its various sources of funding. Most companies are funded by a mix of debt and equity. Capital structure is defined as the relative amount of debt and equity used to finance a firm. It is the relative amount of permanent short-term debt, long term debt, preferred stock and common equity used to finance a firm (Shubita & Alsawalhah, 2012). The capital deposited in banks is mostly unused for financial activities but act as a shield against risk-bearing active assets. The amount of equity resource that banks must save are specified by the regulatory authorities and their standards are strictly complied with (Jain, Singh, & Yadav, 2015). Foreign resources are basically composed of deposits and national/international loans. They account for a large part of the total resources of banks. Credit Risk Management relates to a bank's policies against the risk that a borrower will default on any type of debt/loan by failing to make required payments as agreed (Kargi, 2011). Accounting information system relates to the use of Information and Communication Technology (ICT) based platforms to transform economic data into financial information for conducting the firm's business operations, and providing information concerning the entity to a variety of interested users (Jain, Singh, & Yadav, 2015). Caouette, Altman, Narayanan, and Nimmo (2011), purported that the biggest advantage of computer-based accounting reporting systems is that they automate and streamline financial reporting. However, the recording and organizing of the financial information through the accounting reporting systems will not meet objectives unless the financial reports from systems are analyzed and used in making managerial decisions (Gitman & Zutter, 2011).

## **1.2 Organizational Financial Performance**

Organizational financial performance is a subjective measure of how well firms use their assets from their primary mode of business to generate revenue (Kirkpatrick, 2009). According to Yusuf, Onafalujo, Idowu, and Soyebó (2014), organizational financial performance is explained as the degree to which an organization's financial objectives are being or has been accomplished. It is the process of measuring the results of a firm's policies and operations in monetary terms. It is used to measure firm's overall financial health over a given period of time and can also be used to compare similar firms across the same industry or to compare industries or sectors in aggregation (Alnajjar, 2016). The financial performance of a commercial bank is of vital interest to different stakeholders. For instance, lenders are concerned with the bank's ability to repay borrowed funds as well as whether it is abiding by loan contracts (Agbaje, Busari & Adeboye, 2014). Bank's customers are concerned with the safety of their deposits as well as the going concern ability of the bank as an important source of loan funds (Casu, Girardone & Molyneux, 2016). Potential

investors are interested in determining the financial strength of the entity as an element in assessing its value in their investment decisions. The shareholders are interested in deriving a good return on their investment; the government is interested in the soundness and stability of the financial sector as well as whether the banks are meeting their tax obligations while the general public are interested with the corporate social responsibility of the banks (Roberts, 2015). In common practice, accounting ratios are employed in determination of an entity's financial performance. Among the common accounting ratios used to measure a firm's profitability are: return on assets (ROA) and return on equity (ROE). Return on assets is an indicator of how profitable a company is relative to its total assets. It gives an idea as to how efficient management is at using its assets to generate earnings and is calculated by dividing a company's annual earnings by its total assets and is shown as a percentage. Return on equity is an indicator of how profitable a company is relative to its shareholders' equity. It gives an idea as to how efficient management is at using its shareholders' invested amounts to generate earnings. It is calculated by dividing a company's annual net earnings by its shareholder's equity and it is also shown as a percentage (Chandra, 2011). For the purpose of this study, the return on assets ratio will be used to evaluate the financial performance of the commercial banks in the country. ROA is used in this study because it gives commercial banks an idea as to how efficient a financial institution management is at using its assets to generate earnings.

### **1.3 Financial Management Practices and Financial Performance**

The ultimate goal of financial management is to maximize the financial wealth of the business owner(s). This general goal can be viewed in terms of more specific objectives: profitability and liquidity. Profitability management is concerned with maintaining or increasing a business's earnings through attention to cost control, pricing policy, sales volume, inventory management and capital expenditures. Liquidity management ensures that the business's obligations (wages, bills, loan repayments, tax payments) are paid (Hunjra, Butt, & Rehman, 2010). Matz(2011) viewed growth as another objective of financial management in relation to liquidity, growth and profitability. He further noted that financial management also aims to maximize the share price in the securities market and enhancing long-term value of the firm. Brigham and Houston (2012), observes that financial management will be one of the key challenges for corporations in the next decade and only those institutions that have sound financial structures and stable income flows will be able to fulfil their organizational missions and respond to the current challenges in an increasingly complex and global environment. Indeed, financial management is not an end in itself; it aims to ensure organization's goals are reached by guaranteeing that the institution produces sufficient income to enable it to invest in its future. Unsustainable firm operations can be accommodated by either developing sustainable operations or by planning for a future lacking in resources currently required. In practice organizations mostly tend to aim towards sustainability by increasing efficiency in the way in which resources are utilized (Jainet al., 2014). Good financial management is essential for the expansion of business. Getting your finances in order means the business can work more efficiently and puts you in a better position when seeking funding for growth. Financial management plays an essential role in the planning and controlling of the firm's financial resources. Without proper financial management practices, the firm cannot be able to optimally utilize its financial resources in turn adversely affecting the firm's performance (Brigham & Houston, 2012). Good financial management practices are paramount: it is essential

that the management has current, accurate, and relevant financial data to ensure sound organizational decision-making (Gitman & Zutter, 2015). The study selected the four variables (liquidity management, capital structure management, credit risk management and working capital management) since they are the most key and major variables that do affect financial performance according to Asuquo, (2016).

#### **1.4 Statement of the Problem**

According to Kithinji (2017), the deteriorating performance of commercial banks in Kenya which has seen asset quality decline and decline in private sector lending has sent risks to the banking sub-sector. The rapid non-performing loans growth rates recorded in 2016 dissipated in second half of 2017 through 2018 (CBK,2019). However, the ratio of gross NPLs to gross loans has maintained a steady upward trend, signifying elevated credit risk in the banking industry. The banks' assets quality reflected by nonperforming loans deteriorated in 2018 compared to 2017. The gross non-performing loans (NPLs) rose by 19.69 percent to Ksh.316.7 billion in December 2018 from KSh 264.6 billion in 2017 (CBK,2019). Similarly, gross NPLs to gross loans rose from 12.3 percent by end 2017 to 12.7 percent by end 2018. From the performance trend, the practice and requirement of the financial management is vital to regain financial health. Empirical scrutiny of previous studies outcome on effects of financial management practices on financial performance has been empirically inconclusive. Previous studies have produced mixed outcomes regarding the effects of financial management practices on financial performance. Girmay (2016) carried out a study on relationship between financial management practices on profitability on selected private manufacturing companies in Mekelle City. The research found that profitability was inversely related with age of the company, capital budgeting and capital structure management practices. The companies should exercise to maintain suitable ratio between debt and total capital; use effective financial leverage and should review the debt level in order to use it for making finance decisions.

Abaniset (2015), conducted a study in Western Uganda aimed at determining the influence of financial management practices on financial performance of SME and found out a positive effect existed. Mensa, (2016) investigated the financial management practices adopted by SMEs in Ghana and also established a positive relationship existed. Saah, (2015) on the other hand conducted a study on how SMEs in Tamale region in Ghana conducted their financial management practices and established that accounting, reporting and investing had a positive impact on financial performance. Nthenge and Ringera (2017), aimed at establishing the effect of financial management practices on financial performance of small and medium enterprises in Kiambu town, Kenya. He study showed that the combined effect of financial management practices working capital management, investment decision, financial decision have a moderate positive relationship between financial management practices and financial performance. On the other hand, Odongo (2018), studied the effects of financial management practices on financial performance of large construction companies in Nairobi County, Kenya. The research revealed that financial reporting, working capital management, internal control and financial planning had a positive and significant effect on performance of construction companies in Kenya. Addo (2017), established the effect of financial management practices on the financial performance of top 100 small and medium enterprises in Kenya. The financial management practices had positive

Pearson Correlations implying that all the variables had a positive effect on the SMEs' performance. This means that an increase in these variables caused an increase in the organization's returns. There is limited empirical evidence on the influence of financial management practices on the financial performance of commercial banks in Kenya. Majority of the studies conducted have focused on single financial management variables and their effect on the banks' performance. However, these financial management aspects do not operate in isolation and therefore it is imperative to ascertain their effect on the banks' financial performance from a holistic perspective. It is against this backdrop that this study embarks to fill this existing research gap by investigating the influence of selected financial management practices on the financial performance of commercial banks in Kenya.

### **1.5 Research objectives**

- i. To determine the influence of liquidity management on the financial performance of commercial banks in Kenya.
- ii. To establish the influence of capital structure management on the financial performance of commercial banks in Kenya.
- iii. To find out the influence of credit risk management on the financial performance of commercial banks in Kenya.
- iv. To examine the influence of working capital management on the financial performance of commercial banks in Kenya.

## **2.0 LITERATURE REVIEW**

### **2.1 Theoretical Review**

#### **2.1.1 Shiftability Theory of Liquidity**

The Shiftability theory liquidity replaced the commercial loan theory and was supplemented by the doctrine of anticipated income. Formally developed by Harold Moulton in 1915 and later by Mitchell, (1923), the shiftability theory held that banks could most effectively protect themselves against massive deposit withdrawals by holding, as a form of liquidity reserve, credit instruments for which there existed a ready secondary market. Included in this liquidity reserve were commercial paper, prime bankers' acceptances and, most importantly as it turned out, Treasury bills. Under normal conditions all these instruments met the tests of marketability and, because of their short terms to maturity, capital certainty (Alnajjar, (2016). The theory explains that if all banks are looking to liquidate assets, they are doing so at a cost because it would be difficult to find buyers, meaning lower prices for the assets and ultimately by doing so would not leave the banking system as a whole in a more liquid condition (Alnajjar, 2016). One shortcoming of the Shiftability theory, similar to one that led the banking system away from the orthodox theory, was that in times of stress or crisis, the effectiveness of these assets for liquidity purposes goes away as there is no market for them (Casu, Girardone & Molyneux, 2006). The role of the central bank as lender of last resort gained new prominence, and ultimately liquidity was perceived to rest outside the banking system. Furthermore, the soundness of the banking system came to be identified more closely with the state of health of the rest of the economy, since business conditions had a direct influence on the cash flows, and thus the re-payment capabilities, of bank borrowers (Xiani, 2013). The shiftability theory is relevant to the study these since these realizations under a

modified form that included the idea of ultimate liquidity in bank loans resting with shiftability to the Federal Reserve Banks. Under this institutional scheme, the liquidity concerns of banks were partially returned to the loan portfolio, where maintenance of quality assets that could meet the test of intrinsic soundness was paramount (Khan & Ali, 2016).

### **2.1.2 Pecking Order Theory**

The Pecking Order Theory was developed by Myers and Majluf, (1984). According to this theory, the firms follow a financing hierarchy due to information costs (Myers & Majluf, 1984). Firms primarily face two potential costs when they approach the external markets to raise capital, information asymmetry costs and transaction costs. These additional costs make external capital more expensive and naturally lead firms to use internal over external funds. Information asymmetry arises due to the separation of ownership and management. Managers have more information about the value of the firm and would attempt to issue equity when its market value is higher (Baskin, 2017). Due to this information asymmetry between outside investors and managers, equity may be underpriced to account for this managerial incentive. This may make equity an expensive source of financing and lead firms to under-invest. Retained earnings are unaffected by such problems. Also, as debt requires fixed payments of interest, it is less sensitive to information asymmetries. Pecking Order Theory, states that capital structure is driven by firm's desire to finance new investments, first internally, then with low-risk debt, and finally if all fails, with equity. Therefore, the firms prefer internal financing to external financing (Myers & Majluf, 1984). This theory is applicable for large firms as well as small firms. Since small firms are opaque and have important adverse selection problems that are explained by credit rationing; they bear high information costs. Since the quality of small firms financial statements vary, small firms usually have higher levels of asymmetric information. Even though investors may prefer audited financial statements, small firms may want to avoid these costs (Donaldson, 2015). Therefore, when issuing new capital, those costs are very high, but for internal funds, costs can be considered as none. For debt, the costs are in an intermediate position between equity and internal funds. As a result, firms prefer first internal financing (retained earnings), then debt and they choose equity as a last resort. The pecking order theory is relevant in this study because it indicates that the profitability of a banks affects its financing decisions. If the firm issues debt, it is because it has an investment opportunity that exceeds its internally generated funds. Thus, changes in the capital structure often serve as a signal to outsiders with regard to the current situation of the firm, as well as the managerial expectations about future earnings (Frank, 2016). The basis of the pecking order theory of capital structure is the notion that managers have inside information. The pecking order theory suggest that firms have a particular preference order for capital used to finance their businesses owing to the information asymmetries between the firm and potential investors (Harold, 2015).

### **2.1.3 Capital Asset Pricing Model**

Treynor<sup>1</sup> (1961), Sharpe<sup>1</sup> (1964), Linter<sup>1</sup> (1965) and Mossin<sup>1</sup> (1966) introduced the CAPM each on their own, where they used the diversification work of Markowitz (1960) as their foundation. The theory argues that systematic and unsystematic risks are identified and acknowledged by capital asset pricing model (CAPM). Fletcher adds that rewards are only given to the systematic risk as unsystematic is diversifiable. Industry or firm specific risks are



unsystematic risks, strikes are also risks, natural disasters for example bad weather for farmers is a risk and this is why specific risk is not rewarded in CAPM as it is not part of the return of stock. Portfolio management can be used in diversifying a risk argument. Moffett, Stonehill and Eiteman (2015) argue that diversification cannot be done on systematic risks, as market portfolio is also related to it. The capital asset pricing model is relevant to the study since it ensures that as a risk is identified, exchange rates are derived and that investors view principles as important. The theory establishes a linear relationship between the required return on the commercial banks investment and risk. The model is based on the relationship between an asset's beta, the risk-free rate and the equity risk premium, or the expected return on the market minus the risk-free rate.

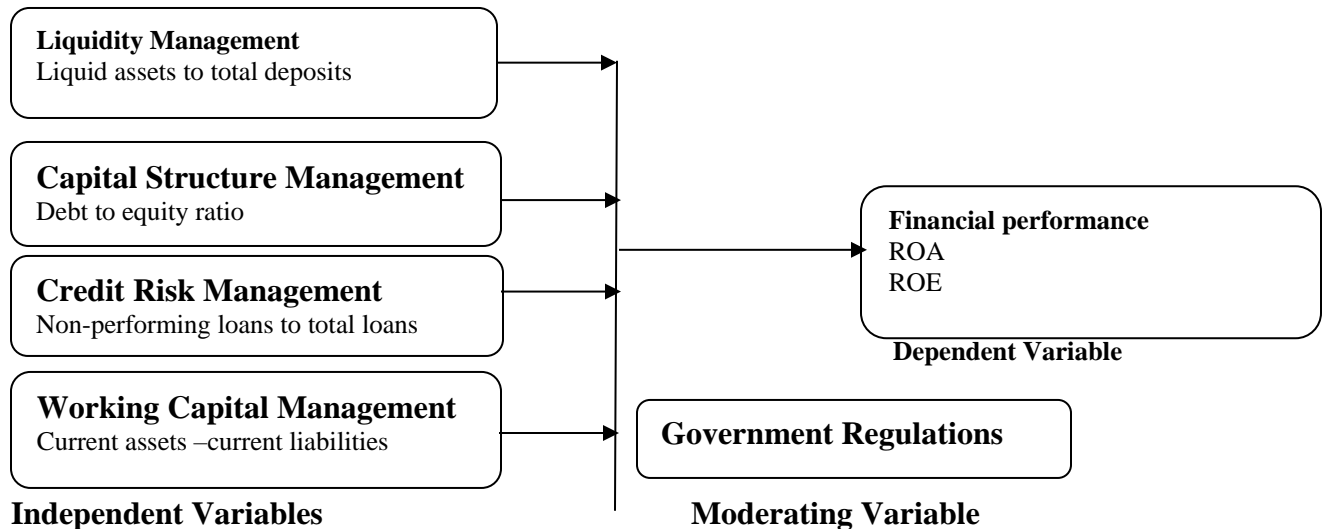
### **2.1.4 Cash Conversion Cycle Theory**

Gitman in (1974), introduced the cash conversion cycle theory. According to this theory amount of money that is needed for any kind of sales level can be computed by the use of constituents of working capital and that of the cash drift in an organization, both of which are part of the cash conversion cycle theory that was created by Gitman in 1974. The theory is a component of the operating cycle of which is calculated through summations of both the inventory time and accounts receivables and then taking accounts payables which is subtracted from the whole sum. Additionally, the theory focuses centers on several aspects on timelines and the inflow of cash such as those of raw materials acquisitions, additional efforts and the periods of time when they are acquired, and finally those of the finished goods of which the money they bring in is considered (Gupta & Huefner, 2012). It also takes into consideration the aspects of financing, particularly on the number of days when it is required for operations. The cycle combines some financial statements data specifically those from the income statement and balance sheet to create an appraisal with the dimension of time and can therefore measures the ongoing liquidity management. Although a business cycle for a specific company provides great assistance, it may differ from one industry to another and therefore, for improvement purposes it is highly important for any firm to be able to evaluate any opportunities it may be presented with as well as its cycle performance through the use of industry benchmarks. Therefore, comparing a particular company to the sector its main business is engaged is the most appropriate way (Hutchinson, 2009). The cash conversion cycle shows the time lag amidst expenditure for buying the raw materials and the assortment of sales of complete products and is applied as an all-inclusive measure degree of a working capital (Padachi, 2011). Businesses that are able to meet their financial obligations and those that have prospects over a long period of time and are also sustainable over time cannot do so when good liquidity management is lacking and thus running of the business's daily activities for its short-term assets and liabilities is very crucial for it to achieve success.

The theory is pertinent to this study because shortening the cycle is important for firms, because managers reduce the cycle to a reasonable minimum creating value for their shareholders and secondly, the increase in a banks sale can be identified if it has a longer cash conversion cycle and if it relaxes its policies especially on credits or high inventories it can be able to meet the competition. On the other hand, a higher cycle increases the time that cash is tied to non-interest-bearing account for example the account receivable that can damage the profitability of a business. Shortening the cash conversion cycle means cash is received quicker resulting to a higher net present value of the company's cash flows. The making use of the management of trade credit and

inventory uses the accounts payables, total number of days of the account's receivables and inventories (Sharma & Kumar, 2011).

## 2.2 Conceptual Framework



**Figure 1: Conceptual Framework**

## 2.3 Empirical Review of Literature

### 2.3.1 Liquidity Management and Financial Performance

Lartey, Antwi, and Boadi, (2015), carried out a study to establish the relationship between liquid assets and bank profitability for 90 banks in Europe, North America and Australia from 1972 to 1981, the study used econometric framework presented in an equation. The dependent variable, profitability, was regressed against a non-linear expression of relative liquid asset holdings, as well as a set of control variables. Liquid assets were generally included as a control variable in this study with very limited discussion around the estimated parameter. From the study a company with low liquidity and high profitability has to increase its borrowing leading to an increase of the financial costs. This would certainly lead to increasing interest rates, since the cheaper sources are quickly exhausted. Furthermore, having increased its debt, the company raises its credit risk, causing an increase in interest rates charged by their financiers. The study concluded that profitability and solvency are necessary condition for the healthy existence of the company and both are conditioned by the strategy adopted in the medium and long term.

Graham and Bordeleau (2010) reviewed the impact of liquidity on bank profitability for 55 US banks and 10 Canadian banks between the period of 1997 and 2009. The researchers analyzed the impact of liquid asset holdings on bank profitability for a sample of large US and Canadian banks. The study employed quantitative measures to assess the impact of liquidity on bank profitability. Results from the study suggested that a non-linear relationship exists between bank profitability and liquidity, whereby profitability is improved for banks that hold some liquid assets. However, there is a point beyond which holding further liquid assets diminishes a banks' profitability, all else equal. They concluded by noting that while it is generally agreed upon that banks undervalued

liquidity prior to the recent financial crisis (of 2008), banks must also consider the tradeoff 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.

### **2.3.2 Capital Structure Management and Financial Performance**

To study the effect of capital structure on profitability of the industrial companies listed on Amman Stock Exchange during a six-year period (2004-2009), Shubita and Alsawalhah (2012) found a significantly negative relation between debt and profitability. This suggests that profitable firms depend more on equity than debt. The study sample consisted of 39 randomly selected companies with correlations and multiple regression analysis as techniques of analysis. The findings contravene Myres and Majluf (1984) pecking order hypothesis that debt is preferred to equity. Similarly, to analyze the impact of capital structure on profitability of listed companies in India, Chisti et al. (2013) found that capital structure had a statistically significant impact on the profitability of firms. The study used secondary data of ten automobile companies for the 2007-2012 and used ratios analysis. GP margin, NP margin ROCE, return on investments were used as profit proxies while debt to equity, debt to assets and interest cover were used as capital structure proxies.

Yusuf, Onafalujo, Idowu and Soyebó (2014) to investigate the relationship between capital structure and profitability of firms quoted in the Nigeria Stock Exchange, sample data was collected from ten randomly selected firms among three industries from 2000 to 2011. The study used Return on Asset (ROA) and Return on Equity (ROE) as performance proxies while the debt-equity ratio (DER) and debt-asset ratio (DAR) were used as capital structure proxies. The relationship between the performance and capital structure proxies were analyzed using correlation coefficient and regression techniques. The study results showed that the effect of capital structure on ROA was not significant across all firms except for 7up and Nestle. The study findings also showed an insignificant relationship between ROE and DAR. However, there was a significant relationship in almost all firms between ROE and debt to equity ratio. They concluded that highly geared firms tend to have higher profitability.

### **2.3.3 Credit Risk Management and Financial Performance**

In a study of the impact of credit risk on profitability of the commercial banks in United Kingdom (UK), Saeed and Zahid (2016) aimed to analyze the impact of credit risk on profitability of five big UK commercial banks. For measuring profitability, two dependent variables ROA and ROE were considered whereas two variables for credit risks were: net charge off (or impairments), and non-performing loans. Multiple statistical analyses were conducted on bank data from 2007 to 2015 to cover the period of financial crisis. It was found that credit risk indicators had a positive association with profitability of the banks. This meant that even after the deep effects of credit crisis in 2008, the banks in the UK were taking credit risks, and getting benefits from interest rates, fee, and commissions etc.

Kargi (2011) studied the impact of credit risk on the profitability of Nigerian banks. Financial ratios as measures of bank performance and credit risk were the data collected from secondary sources mainly the annual reports and accounts of sampled banks from 2004-2008. Descriptive, correlation and regression techniques were used in the analysis. The findings revealed that credit

risk management has a significant impact on the profitability of Nigeria banks. Therefore, management need to be cautious in setting up a credit policy that might not negatively affects profitability and also they need to know how credit policy affects the operation of their banks to ensure judicious utilization of deposits.

### **2.3.4 Working Capital Management and Financial Performance**

Eljelly (2010), carried out a study in Saudi Arabia that involved 929 joint stock companies, which aimed to examine the association between financial performance and working capital management of the firms. Using current ratios, it was found that between an organization's share performance there was a substantial undesirable association, whereby the presence of cash alteration cycles for a firm shows a more pronounced relationship. However, the researcher discovered that the measure of liquidity is better elaborated through the use of the cash alteration cycle or the money opening at an industry level, then existing ratio that affects share performance. Gull, Rehman and Khan (2013), also carried out a study of the Karachi Stock exchange in Pakistan for a period between 2006 to 2012 involving small medium enterprises to investigate on their share performance under the influence of working capital management. The study used correlation and multiple regression analysis. The study found that working capital management had significant influence on share performance of firms. Further, the study established that cash conversion cycle influenced to a great extent the profitability of small and medium firms.

Oladipupo and Okafor (2013), conducted a study of the Nigeria Stock Exchange between the year 2002 to 2006, on share performance and working capital management. The study employed product moment Pearson correlation regression method in the analysis and examination of how a firm's share performance is impacted by its working capital management exercise, while also focusing on the extent of its effects on both factors. The financial data utilized by the company was sourced from 12 manufacturing establishments quoted on the stock exchange. The results of the study were that share performance was promoted by a shorter net trade cycle and debt ratio. Additionally, they found out that corporate profitability suffers a significant negative impact from the level of leverage.

## **3.0 RESEARCH METHODOLOGY**

This study will adopt a descriptive research design because it enabled the researcher to describe the characteristics of the variables of interest. The study targeted all the commercial banks in Kenya as provided for by the CBK database. The choice of the commercial banks in Kenya is based on the fact that their audited annual financial reports are readily accessible from the CBK's databases. Currently there are 43 operational commercial banks in Kenya (CBK, 2019). This study focused on all the 43 commercial banks as the study units. Both primary and secondary data was applied in the study. The study adopted both descriptive statistics and inferential statistics in analysing the collected data and results were presented by use of tables and figures. All the assumptions of the linear regression model were adhered in the study. The study used the following regression model:

$Y = \beta_0 + \beta_1 X_{1it} + \beta_2 X_{2it} + \beta_3 X_{3it} + \beta_4 X_{4it} + \epsilon$  where  $Y$  = Financial Performance,  $\beta_0$  = Constant,  $X_1$  = Liquidity Management,  $X_2$  = Capital Structure Management,  $X_3$  = Credit Risk Management,  $X_4$  = Working Capital Management,  $\beta_1 - \beta_4$  are the regression co-efficient or change introduced in  $Y$  by

each independent variable and  $\varepsilon$  is the random error term accounting for all other variables that influence financial performance but not captured in the model.

## 4.0 DATA ANALYSIS AND PRESENTATION

### 4.1 Descriptive Statistics

#### 4.1.1 Liquidity Management and Financial Performance

Participants were asked to indicate their level of agreement with the following statements relating to liquidity management as shown in Table 1.

**Table 1: Liquidity Management and Financial Performance**

Statements	N	Min	Max	Mean	Std. Dev
The institution has enough revenue to fund activities	78	3.00	5.00	4.26	0.71
Favorable dividend plans are in place to boost liquidity	78	2.00	5.00	4.03	0.77
Tax strategies are exercised to manage liquidity	78	2.00	5.00	4.13	0.71
The bank conducts other income generating activities to boost liquidity	78	2.00	5.00	3.94	0.78
The bank establishes formal liquidity thresholds to manage lending	78	3.00	5.00	4.05	0.68
The institution conducts internal accountabilities	78	2.00	5.00	4.00	0.66

Source: Research data, (2020)

Participants agreed that the financial institution which they worked for had enough revenue to fund activities ( $M= 4.26$   $SD=0.71$ ), implying that most of the banks were in a position to swiftly facilitate the implementation expansion programmes such as issuance of credit facilities. This conforms to the argument by Alemayehu & Ndung'u, (2012) that Liquidity management and bank performance are key factors that determine the development, sustainability, survival, growth and performance. Descriptive results show that Tax strategies embraced on banks are exercised to manage liquidity ( $M=4.13$   $SD=0.71$ ), in simple words, that Tax strategies allows organizations to attain strategic goals without incurring much cost. These findings are in support of the argument by Eljelly (2010), that Tax strategies should be designed to promote the short-term resilience of a bank's liquidity risk profile by ensuring that the bank has sufficient high-quality liquid assets. The bank establishes formal liquidity thresholds to manage lending ( $M=4.05$   $SD=0.68$ ) this therefore mandates financial institution to maintain an adequate capital want to survive. These results go hand in hand with research conclusion by Molefe & Muzindutsi (2015) realized a frail association between profitability and liquidity for the five leading South African banks. Results also shows that financial institutions had favorable dividend plans are in place to boost liquidity ( $M=4.03$   $SD=0.77$ ). These results confirms with the argument by Girmay, (2016) that in order to have concise liquidity analysis, bank management should not only conduct a continuous assessment on bank's liquidity position but also on funding necessities that are can evolve under various conditions, including the negative conditions. The institution conducts internal accountabilities

(M= 4.00 SD=0.66) in other words internal audits and accountability in identification of cash flow risk, pending liquidity issue. These findings concur with study observations by Lamberg & Valming, (2013) Measuring liquidity risk is important to making sure that liquidity problems are identified in time. The financial conducted other income generating activities to boost liquidity (M=3.94 SD=0.78) this implies that most the banks had long term income generating ventures which helped to overcome market risks and insecurities. The finding concur with observation made by Kaaya and Pastory (2013) Income generating activity are focused on future earnings and increasing the value of a business rather than the immediate return on their investment in the form of interest payments or dividends. As a result, businesses can rely on equity capital to finance projects for which the earnings or returns may not occur for some time, if at all.

#### 4.1.2 Capital Structure Management and Financial Performance

Participants were asked to indicate their level of agreement with the following statements relating to capital structure management as shown in Table 2.

**Table 2: Capital Structure Management and Financial Performance**

Statements	N	Mini	Max	Mean	Std. Dev
The bank has fully utilized the debt facility according to its capabilities	78	3.00	5.00	3.97	0.81
Management conducts yearly budget cost variance analysis on capital structures	78	3.00	5.00	4.12	0.70
The bank employs capital structure policy to achieve the optimal capital mix	78	2.00	5.00	3.99	0.75
The institution relies on equity capital than any other capital	78	2.00	5.00	4.10	0.80
Capital structure decisions are formulated based on the profit after tax	78	3.00	5.00	3.99	0.71

*Source: Research data, (2020)*

Majority of the respondents agreed that management of the banks conduct yearly budget cost variance analysis on capital structures (M=4.12 SD=0.70) this mean that capital plays a function in ensuring quality running of banks operations and in realization of investment thus making high profit. This finding supports the assertion by Saah, (2015) that capital structure ensures that a business enterprise adopts procedures and mechanisms that ensure a firm is managed and directed in such a way that guarantees accountability and maximization on financial performance. Results also revealed that financial institution relied on equity capital than any other capital (M=4.10 SD=0.80) sufficient equity capital helped by cushioning banks on risk such as default in loan repayment. The finding concurs with observation made by Agbaje, Busari, and Adeboye, (2014), found a positive relationship between financial management practices and financial performance.

The bank employs capital structure policy to achieve the optimal capital mix (M= 3.99 SD=0.75) this means that capital structure policy enhanced the flexibility in raising resources, results Eiteman (2015) Show that sound capital structure helps in utilization of available funds, maximization of return, solvency or liquidity position and minimization of financial risk. These

findings goes hand in hand with conclusion by Alkadamani (2015) using equity capital, firms no obligation to make interest payments or to repay equity investors' initial investment as opposed to Debt capital, which requires periodic interest payments and repayment of the borrowed principal Capital structure decisions are formulated based on the profit after tax (M=3.99 SD=0.71) this implies that tax were policies designed in view of encouraging the utilization of equity financing. These findings concur with conclusion by Deloof (2015) equity investors are focused on future earnings and increasing the value of a business rather than the immediate return on their investment in the form of interest payments or dividends. Results show that most of the banks have fully utilized the debt facility according to its capabilities (M=3.97 SD=0.81) this means that by using long term debt banks can have the required working capital necessary to keep operations running smoothly and profitably year round. These findings contradicts research studies by Beckmann (2017) that use of debt financing on business operations and growth is only feasible udders confined circumstances adding that excess debt can limits business development.

#### 4.1.3 Credit Risk Management and Financial Performance

Participants were asked to indicate their level of agreement with the following statements relating to credit risk management as shown in Table 3.

**Table 3: Credit Risk Management and Financial Performance**

Statements	N	Mini	Max	Mean	Std. Devi
The bank has risk eliminating strategy	78	3.00	5.00	3.87	0.80
The institution prioritized risk analysis in financial planning activities	78	3.00	5.00	3.95	0.77
The bank has risk diversification plans	78	2.00	5.00	4.04	0.67
The bank has knowledge of customers and their associated credit risk	78	2.00	5.00	4.21	0.74
The bank ensures capital reserves accurately reflect risks	78	3.00	5.00	4.10	0.64
Loan loss reserves adequately cover potential short-term credit losses	78	2.00	5.00	3.88	0.62

Source: Research data, (2020)

Majority of the respondents agreed that most of the financial institutions have knowledge of customers and their associated credit risk (M=4.21 SD=0.74), this implies that banks-maintained customer credit scores register, this mean that banks accorded trust to customers with high credit ratings via lower point structures and interest costs. These findings concur with study findings by Alshatti, (2015) who revealed a positive relationship between effective credit risk management and banks 'profitability. Result also show that banks ensured capital reserves accurately reflect credit risks (M=4.10 SD=0.64) this implies that banks had sufficient reserve to cushion them during economic turbulences. These findings are in support of the Musa (2012) found a strong positive relationship between credit risk components and the banks' financial performance, although the direction of the effect is not specified. Studies show that most of the financial

institutions have a credit risk diversification plans ( $M=4.04$   $SD=0.67$ ) this implies that credit risk diversification reduced the impact of market volatility, it also helped in reducing total time consumed in the process of monitoring the portfolio. These findings concur the research conclusion by Juanjuan (2009), credit management practices helped in bank in achieve long-term investment plans, it also avails of benefit of compounding of interest and keeping capital safe.

Descriptive results also show that most of the financial institutions prioritized credit risk analysis in financial planning activities ( $M=3.95$   $SD=0.77$ ) this implies that understanding the financial threats facing the bank helped the top management development of mitigating strategies that aided in elimination of those risks. These findings support the study findings by Gupta and Huefner, (2012), the effective management of credit risk is a critical component of comprehensive risk management which is essential for long-term success of a banking institution. It was established that loan loss reserves adequately cover potential short-term credit losses ( $M=3.88$   $SD=0.62$ ) lowering the reserve requirement pumps money into the economy by giving banks excess reserves, which promotes the expansion for bank credit and lowers rates. These findings concur with conclusion by Shin and Soenen (2016) with reserve requirements, banks can also influence their levels of lending, the volume of deposits and credits, deposits rates. Results show that most of financial institutions have credit risk eliminating strategy ( $M= 3.87$   $SD=0.80$ ) this implies that embracing credit risk management practices, corrective action after can be affected immediately on threats identified. The threats identified include non-performing loans and risks on liquidity. These findings concur with study observations by Coyle, (2016) proper credit risk management, companies can turn a potential financial pitfall into an advantage by working to mitigate market losses.

#### 4.1.4 Working Capital Management and Financial Performance

Participants were asked to indicate their level of agreement with the following statements relating to working capital management as shown in Table 4.

**Table 4: Working Capital Management and Financial Performance**

Statements	N	Mini	Max	Mean	Std. Devi
The bank has a working capital management system	78	3.00	5.00	4.01	0.63
Prepares cash flow forecasts to identify future surpluses and deficits	78	3.00	5.00	4.22	0.68
The institution ensures there is sufficient cash flow to meet daily needs	78	3.00	5.00	4.19	0.68
The bank maintains proper records for all payables	78	2.00	5.00	3.83	0.61
Optimal cash balances are maintained by the bank at all times	78	2.00	5.00	4.04	0.71
Receivables management system is fully automated	74	2.00	5.00	3.96	0.75
The bank maintains inventory records which are updated regularly	78	2.00	5.00	3.91	0.71

Source: Research data, (2020)



Majority of the respondents agreed that their financial institution prepared cash flow forecasts to identify future surpluses and deficits (M= 4.22 SD=0.68) this implies that statement of cash flows provides important insights about the liquidity and solvency of a company which are vital for survival and growth of any organization. These management practices are in line suggestion by Nthenge and Ringera (2017) that working capital management strategy designed to ensure that business entities operate efficiently by monitoring and spending its current resources and liabilities up to the optimal levels. It was established the optimal cash balances are maintained by the bank at all times (M=4.04 SD=0.71). Results also show that most of the banks have a working capital management system (M=4.01 SD=0.63), this means that working capital management system helped to ensure that a banks operates efficiently by monitoring and using its current assets and liabilities to the best effect, these findings goes hand in hand with the findings by Addo (2017), that assessment of optimal cash balances is paramount in that making economic decisions, due to the fact that assessment results unveils the ability of an enterprise to generate cash and cash equivalents, which is provided by the cash flow statement

Further the study established that most of the financial institution ensured there is sufficient cash flow to meet daily needs (M=4.19 SD=0.68), the study also established that most of the financial institutions have already an automated receivables management system (M=3.96 SD=0.75) in other words cash flow statement helps in internal financial management as it is useful in formulation of financial plans. These strategies are in line with the contention by Odongo (2018) that cash flow analysis together with the ratio analysis helps measure the profitability and financial position of business. The banks-maintained inventory records which are updated regularly (M=3.91 SD=0.71) this deemed critical given that a projected cash flow statement enabled the management to plan and control the financial operations properly. again banks maintained proper records for all payables (M=3.83 SD=0.61) this implies that critical given that information through the cash flow statement is useful in assessing the ability of any enterprise to generate cash and cash equivalents and the needs of the enterprise to utilize those cash flows. These findings concur with research evidence provided by Uwonda and Okello (2013), found a positive connection between management of working capital and share performance of manufacturing firms listed on the NSE.

#### 4.1.5 Financial Performance

**Table 5: Financial Performance**

Year	Minimum	Maximum	Mean	Std deviation
2015	11.72	19.17	15.81	1.57
2016	11.53	19.24	15.98	1.53
2017	11.55	19.46	16.38	1.81
2018	11.59	19.66	16.55	1.78
2019	11.62	19.77	16.66	1.79

*Source: Research data, (2020)*

From the findings in 5, it can be noted that the year 2019 recorded the highest value in financial performance as shown by a mean of value of 16.66 while the year 2015 recorded the lowest value

for financial performance at 15.81, in addition, values for standard deviation depicts variability in financial performance during the 5 –year period with the highest deviation 1.81 in the year 2017 and the lowest 1.53 in the year 2016, the findings revealed that there have been slight increase in financial performance of banks during the 5-year period.

#### 4.2 Multiple Regression

A linear regression analysis was conducted to test the influence among predictor variables. The research used statistical package for social sciences (SPSS V 21.0) to code, enter and compute the measurements of the multiple regressions. The model summary is presented in the table below.

**Table 6: Model Summary**

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.665 <sup>a</sup>	.442	.414	.55985

Source: Research data, (2020)

The coefficient of determination (R-Square) shows how liquidity management, capital structure management, credit risk management and working capital management relates with financial performance of commercial banks. Table 4.28 shows that the R-square for the model was 0.442. This implies that, liquidity management, capital structure management, credit risk management and working capital management accounts for 44.2% of the variation on financial performance of commercial banks. Additionally, the coefficient suggests that other factors account for 55.8% of the variation in financial performance of commercial banks.

The ANOVA was generated to help evaluate whether the model was statistically significant in explaining the link between the study variables (liquidity management, capital structure management, credit risk management and working capital management) and financial performance of commercial banks. Table 4.29 displays the results of the ANOVA.

**Table 7: ANOVA<sup>a</sup>**

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	19.86	4	19.86	15.841	.001 <sup>b</sup>
	Residual	25.075	73	25.075		
	Total	44.935	77	44.935		

Source: Research data, (2020)

From the ANOVA statics, the study established the regression model had a significance level of 0.000% which is an indication that the data was ideal for making a conclusion on the population parameters as the value of significance (p-value) was less than 5%. The calculated value was greater than the critical value (15.841 > 4.49) an indication that liquidity management, capital structure management, credit risk management and working capital management all have a significant effect on financial performance of commercial banks. The significance value was less than 0.05 indicating that the model was significant.

In addition, the study used the coefficient table to determine the study model. The findings are presented in the table 8 below.

**Table 8: Coefficients**

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	$\beta$	Std. Error	Beta		
1 (Constant)	1.470	.575		2.555	.013
Liquidity Management	.381	.182	.197	2.098	.039
Capital Structure Management	.279	.179	.136	1.555	.024
Credit Risk Management	.790	.171	.414	4.614	.000
Working Capital Management	.510	.214	.223	2.378	.020

Source: Research data, (2020)

As per the SPSS generated output as presented in table above, the equation ( $Y = \beta_0 + \beta_1A_1 + \beta_2A_2 + \beta_3A_3 + \beta_4A_4 + \epsilon$ ) becomes:

$$Y = 1.490 + 0.381A_1 + 0.279A_2 + 0.790A_3 + 0.510A_4$$

The findings imply that holding the (liquidity management, capital structure management, credit risk management and working capital management) at constant, financial performance of commercial banks would remain at 1.470. Additionally, unit change in liquidity management while holding other factors constant would enhance the financial performance of commercial banks by a factor of 0.381. This conforms to the argument by Alemayehu & Ndung'u, (2012) that liquidity management and bank performance are key factors that determine the development, sustainability, survival, growth and performance. Results show that a unit change in capital structure management while holding the other factors constant would the financial performance of commercial banks by a factor of 0.279 The finding concurs with observation made by Agbaje, Busari, and Adeboye, (2014), found a positive relationship between financial management practices and financial performance.

Results show that a unit change in credit risk management while holding the other factors constant would enhances the financial performance of commercial banks by a factor of 0.790 These findings concur the research conclusion by Juanjuan (2009), credit management practices helped in bank in achieve long-term investment plans, it also avails of benefit of compounding of interest and keeping capital safe. Finally1 test regression1 results show1 that unit1 change in1 working capital management while holding1 the other factors constant1would enhance the financial performance of commercial banks by a factor of 0. 510, these findings support the conclusion by Odongo (2018) that cash flow analysis together with the ratio analysis helps measure the profitability and financial position of business.

## 5.0 CONCLUSIONS AND RECOMMENDATIONS

### 5.1 Conclusion

Based on the study results, this study concludes that liquidity management had positive significant effect on the financial performance of commercial banks in Kenya, measuring liquidity risk is important to making sure that liquidity problems are identified in time. Owing to this function necessity, Banks in Kenya embraced various strategies in view of keeping liquidity levels at

standard rate. Financial institutions had favorable dividend plans in place to boost liquidity, bank management conducted a continuous assessment on bank's liquidity position, and financial institutions conducted other income generating activities to boost liquidity. The study concludes that capital structure management practice has positive significant effect on the financial performance of commercial banks in Kenya, The management of these financial institutions conducts yearly budget cost variance analysis on capital structures and that capital structure ensures that a business enterprise adopts procedures and mechanisms that ensure a firm is managed and directed in such a way that guarantees accountability and maximization on financial performance. The study concludes that credit risk management practice has positive significant on the financial performance of commercial banks in Kenya. most of financial institutions have risk eliminating strategy in place, proper risk management, companies can turn a potential financial pitfall into an advantage by working to mitigate losses, most of the financial institutions in Kenya prioritized risk analysis in financial planning activities and that effective management of credit risk is a critical component of comprehensive risk management which is essential for long-term success of a banking institution. Based on the statistical evidence, the study concludes that working capital management practice has positive significant on the financial performance of commercial banks in Kenya. Working capital management helped to ensure that banks operated efficiently by monitoring and spending its current resources and liabilities up to the optimal levels. Also prepared cash flow forecasts to identify future surpluses and deficits, they also maintained proper records for all payables and that bank maintained inventory records which are updated regularly.

## 5.2 Recommendations

Based on the study's findings, the study makes various recommendations. To begin with, the study established that financial management practices have a significantly positive effect on the financial performance of commercial banks. The study thus recommends that the managers in commercial banks should highly prioritize financial management practices during the formulation of the organizations' strategies. This will enhance transparency, accountability and consistency in their financial operations. However, the study recommends that the managements should carefully evaluate their companies' structures before adopting the financial management practices. This will ensure that the practices adopted are well suited for that particular bank as commercial banks differ in capital structures. In addition, based on the above conclusion, the study recommends that corporate governance should also incorporate best practice in terms of financial management practices where the board is tasked on continuous monitoring and improvement on key aspects of financial management practices like, capital structure, liquidity management, credit risk management and working capital. Capital structure should be given higher emphasis since it has a bigger impact on performance. The study also recommends that regulatory bodies should formulate appropriate policies and regulations which will facilitate the implementation of financial management practices in commercial banks. This will enhance efficiency and effectiveness in managing commercial banks as well as foster consistency in the implementation of financial management practices.

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