Financial Risks Analysis and Performance of Commercial Banks in Kenya

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Abstract

Commercial banks in Kenya often record inconsistent financial performance with some ending up under statutory receivership due to inability to meet their commitments to the stakeholders. Central Bank of Kenya usually put sound risk management guidelines to be followed by all the commercial banks yet losses are experienced in the banking sector. This study sought to investigate the effects of financial risks on performance of Commercial banks in Kenya. Specifically, the study sought to determine the effect of Liquidity risk, credit risks, interest rate risks and foreign exchange risks on return of assets of commercial banks in the country. The study was anchored within, enterprise risk management theory and adopted explanatory research design. Financial performance of commercial banks was assessed in terms of return on assets where secondary data of the 42 commercial banks was collected for six years from 2010 to 2015.The source data collected was annual reports and financial statements of the commercial banks and Central Bank of Kenya and was analyzed by use of statistical panel data model. Diagnostics tests such as multicollinearity, autocorrelation and heteroscedasticity tests were performed to eliminate unbiasedness. The study found out that liquidity risk and return on assets are positively and significantly related (β=0.039, p=0.000).Credit risk and return on assets were negatively and significantly related (β=-0.014, p=0.041); interest rate and return on assets were positively and significantly related (β=0.002, p=0.000) while foreign exchange risk and return on assets were negatively and significantly related (β=-0.003, p=0.000). The study concluded that liquidity risk and interest rate have a positive and significant effect on performance while credit risk and exchange risk have a negative and significant on performance of Commercial banks in Kenya. Based on the findings and conclusion, the study recommended that commercial banks to have a sound process for measuring, identifying, controlling and liquidity risk. It is essential that banking corporations have a comprehensive risk management process in place and that is subject to appropriate board and Senior Management oversight. Commercial banks should also determine the risk appetite of its key stakeholders such as directors. The study also recommends that commercial banks should explore avenues to enhance capacities within banks for managing interest rate risks. Lastly, the study recommends the use of Forward exchange contract. Forward exchange contract helps businesses to cushion from the adverse shifts in exchange rates by fixing an exchange rate until future date.