THE RELATIONSHIP BETWEEN CASHFLOWS AND PROFITABILITY OF COMMERCIAL BANKS IN KENYA

MONG’O MERCY GITIRI

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NOVEMBER, 2010
DECLARATION

STUDENT’S DECLARATION

This research proposal is my original work and has not been presented for a degree in any other university.

Signed ……………………………………… Date …………………………

Mong’o Mercy Gitiri

This research proposal has been submitted for examination with my approval as the candidate’s University Supervisor.

Supervisor Signed ……………….. Date…………………………..

Herrick Ondigo

Department of Business

University of Nairobi
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DEDICATION

The project is dedicated to my only daughter Kiky, “in my daughter’s eyes I am a hero”. She makes life worth living.
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<tr>
<td>DPS</td>
<td>Dividends per share</td>
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<tr>
<td>ROI</td>
<td>Return on Investment</td>
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<td>ROE</td>
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<td>ROA</td>
<td>Return on Assets</td>
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<td>Earnings before interest and tax</td>
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<td>EAT</td>
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<td>IPO</td>
<td>Initial Public Offering</td>
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<td>CF</td>
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<td>FASB</td>
<td>Financial Accounting Standards Board</td>
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<td>USA</td>
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<td>SPS</td>
<td>Statistical Package for social sciences</td>
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<td>ATM</td>
<td>Automated Teller Machine</td>
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<td>NSE</td>
<td>Nairobi Stock Exchange</td>
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ABSTRACT

This study has analyzed the impact of cash flow on profitability among commercial banks in Kenya over a period from 2005-2009. It was specifically conducted to explain the influence that various components of cash flows have on profitability growth. The objective of the study was to establish the causality that exists between the profitability and cash flow. This was prompted by the need to unravel the mystery on whether profits are driven by cash flow or the vice versa.

The study was carried out by analyzing the various banks profit measured by the profit after tax the dependent variable and the cash flow components (operating, financing and investing) as the independent variables. Multiple regression models were used to study the relationships between these variables. SPSS was used to support the analysis and to provide a basis for the conclusions drawn.

The findings for the study indicated that profits among commercial banks improved tremendously during the last five years. Cash flow from operating activities experienced the same trend which was occasioned by the improved performance which translated to financing and investing cash flow which have shown consistent increase over the five years. Cash flow from the financing and the investing activities were found to have a great influence (positive) of the banks profit while operating cash flow have a negative effect.

This implies that increase in financing cash flows by way of borrowing positively contributes to the bank’s profitability. Consequently, the more they borrow the more they boost profitability. It also means that banks with high loan portfolios will definitely experience higher profitability as compared to banks with stringent lending practices. In order to increase profitability it is important that banks focus on boosting the financing and investing cash flow as they have a significant and a positive impact on profitability. Banks should invest in activities such as branch network expansions, Installing ATM machines as well as borrowing and increasing loan portfolios. The central bank therefore need to provide the right conditions to facilitate lending by commercial banks by adopting sound monetary policies such as reduced lending rates as well as liquidity ratios among the commercial banks to enhance the lending potential by the banks.

Banks should also supplement their incomes through borrowing either from other banks or by floating bonds as this will boost their profitability.