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Determinants of Financial Performance in Listed Commercial Banks: A Comparative Study of Uganda and Kenya

Jason Kagingo Sentomero:145368

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Strathmore Institute of Mathematical Sciences
Strathmore University
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Jason Kagingo Sentomero [Name of Candidate]
JS [Signature]
29/01/2025 [Date]

This Research Project has been submitted for examination with my approval as the Supervisor.

Dr. Dan Chirchir [Name of Supervisor]
[Signature] [Signature]
30 January 2025 [Date]

Strathmore Institute of Mathematical Sciences
Strathmore University

Abstract

This study examines the determinants of Total Shareholder Return (TSR) in listed commercial banks in Kenya and Uganda. Using panel data from 2018 to 2023, the research analyzes the impact of bank-specific factors such as profitability, efficiency, asset quality, capital adequacy, and liquidity on TSR. The findings reveal that profit per branch, total loans, and return on equity (ROE) positively influence TSR, while the number of employees and net interest margin exhibit a negative relationship. Additionally, dividend payout ratio emerges as a significant driver of shareholder returns, reinforcing the importance of consistent and transparent dividend policies. The study highlights the need for operational efficiency, strategic workforce management, and effective credit risk control to enhance financial performance. Policymakers, investors, and bank managers can utilize these insights to optimize decision-making and improve shareholder value. Future research should explore the role of technological advancements and digital banking innovations in influencing TSR in emerging markets.

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Chapter One: Introduction

1.1 Background of the Study

Banks are vital components of the global financial system, acting as the fundamental infrastructure for the movement of money and the functioning of modern economies. They primarily serve the purposes of storing funds, providing access to capital, and financing various sectors, including agriculture, infrastructure, health, and tourism. Commercial banks, as defined by Mumtaz, Rauf, Bashir, and Noreen (2013), are regulated institutions that offer services such as deposit acceptance, business loans, and basic investment products. These entities operate for profit, playing a central role in the financial ecosystem.

Banks are not just essential to the financial sector; they also play a significant role in promoting economic development. Alkhazaleh and Almsafir (2014) assert that banks mobilise resources crucial for investment and productivity, thereby fostering economic growth. Furthermore, they provide secure places for individuals to keep their money, which is crucial for everyday financial stability. The importance of this study is underscored by the critical role banks play in resource mobilisation and economic stability, particularly in light of contemporary market challenges such as financial crises and regulatory changes that influence bank operations and performance.

1.1.1 Financial Performance

Financial performance is a fundamental concept in banking, reflecting how effectively a bank can use its assets to generate revenue. In this study, financial performance is defined as a measure of a bank's profitability, operational efficiency, and risk management effectiveness. Commonly used indicators include return on assets (ROA), return on equity (ROE), and net interest margin (NIM). These metrics provide a holistic view of a bank's ability to generate profits relative to its assets, equity, and interest income.

The study of financial performance involves addressing various challenges, including market volatility, regulatory changes, and economic cycles. Continuous research is necessary to understand how banks can sustain and enhance performance in different economic

conditions. Gaining insight into financial performance is essential for ensuring that banks contribute to economic stability and growth.

Financial performance in banking serves as a crucial indicator of a bank's ability to effectively leverage its resources to generate revenue. This concept encompasses various dimensions, including profitability, operational efficiency, and risk management effectiveness. Key metrics such as return on equity, net interest margin, return on assets are commonly employed to assess a bank's overall performance. These indicators collectively provide insights into a bank's capacity to generate profits in relation to its assets, equity, and interest income.

The study of financial performance in banking involves navigating challenges such as market volatility, regulatory changes, and economic fluctuations. Ongoing research is vital for comprehending how banks can maintain and enhance their performance under varying economic conditions. Acquiring a comprehensive understanding of financial performance is paramount for ensuring that banks contribute positively to both economic stability and growth.

1.1.2 Financial Performance Determinants

Several key factors determine the financial performance of banks, including capital adequacy, asset quality, management efficiency, earnings ability, and liquidity. Each factor is critical to a bank's overall health and financial performance. A higher CAR suggests greater financial resilience and operational sustainability. Asset quality, evaluated through the ratio of non-performing loans to total loans, reflects credit risk management effectiveness, with a lower NPL ratio signalling healthier assets. Management efficiency, frequently assessed via the cost-to-income ratio, reveals how well operational expenses are managed in relation to income, with lower ratios implying greater efficiency. Earnings ability, measured by ROA and ROE, shows a bank's capacity to generate profits from its assets and equity, thus highlighting its overall financial health and profitability. Finally, liquidity, measured by the liquidity coverage ratio (LCR), demonstrates a bank's capability to meet short-term financial demands, critical for maintaining solvency and stability, particularly during turbulent economic periods

Each determinant theoretically influences a bank's financial performance by affecting its risk profile, operational efficiency, and profitability. For example, higher capital adequacy

enhances stability and investor confidence, while better asset quality reduces the potential for losses from defaulted loans.

1.1.3 Commercial Banks in Kenya and Uganda

The commercial banking sectors in Kenya and Uganda are vibrant and integral to their economies. In Kenya, the sector has experienced significant growth, with an increasing number of banks and financial products. As of 2023, the Central Bank of Kenya reported forty-three licensed commercial banks, with growing total assets, customer deposits, and loan portfolios. Kenya's banking industry is overseen by a strong regulatory system designed to ensure stability and encourage greater access to financial services for all.

Similarly, Uganda's banking sector has been expanding, with 24 licensed commercial banks as of 2023, according to the Bank of Uganda. The sector has seen growth in assets, deposits, and loans, although it faces challenges such as high levels of non-performing loans. There is also a trend towards digital banking and financial inclusion, with banks increasingly adopting technology to improve service delivery.

This study is justified by the need to understand the determinants of financial performance in these dynamic banking sectors. By analysing trends, statistics, and performance metrics, this research aims to provide insights into how banks in Kenya and Uganda can optimise their operations and contribute to economic growth.

1.2 Problem Statement

Uganda's banking industry is currently experiencing a substantial shift, marked by regulatory reforms, changes in capital requirements, and a range of reactions from the market. In a recent move, the Bank of Uganda significantly increased the minimum capital threshold for commercial banks, raising it from UGX 25 billion to UGX 150 billion. While this action is intended to enhance the robustness and stability of the banking sector, it has also triggered significant activity within the market.

Some banks are struggling to meet these increased capital requirements. For instance, EFC was shut down due to its failure to comply with the new requirements and issues related to corporate governance. Similarly, Opportunity Bank, GT Bank, and ABC Capital Bank have downgraded their operations to Tier II Financial Institutions, reflecting their difficulties in

meeting the new thresholds. Moreover, the acquisition of Finance Trust Bank by Access Bank highlights ongoing consolidation and restructuring efforts within the sector. Additionally, Guaranty Trust Bank Uganda Ltd, a subsidiary of Nigeria's Guaranty Trust Bank, has lowered its status from a commercial bank to a credit institution due to these pressures.

In the face of stricter regulations and higher capital demands, certain Ugandan banks demonstrate resilience and achieve success. Housing Finance Bank serves as a case in point, highlighting an after-tax profit of UGX 65.1 billion for the fiscal year ending December 31, 2023. This represents an 11.3% surge in net profits compared to the previous year, primarily attributed to their strategic focus on digitalization and diversified revenue streams. The bank's performance was notable across various metrics, with total assets surging by 32.1% to reach UGX 2.14 trillion, and customer deposits experiencing a 44% increase to UGX 1.611 trillion. Loans and advances also showed significant growth, reaching UGX 996 billion, a 28% increase. Notably, the bank's core capital significantly exceeds the regulatory minimum set by the Bank of Uganda, standing at UGX 273.8 billion. These accomplishments highlight Housing Finance Bank's dedication to broadening its customer base and supporting both sustainable homeownership and financial self-sufficiency.

The success of banks like Housing Finance Bank sets a benchmark for other financial institutions in Uganda, demonstrating that despite stringent regulatory requirements, there are pathways to growth and profitability. This positive outlook has encouraged other banks, such as I&M Uganda, to consider public listings, further reflecting the potential and opportunities within the Ugandan banking market. Currently, only three banks—DFCU, Stanbic Bank, and Bank of Baroda Uganda—are listed on the Uganda Stock Exchange. However, with twelve banks already reaching the UGX 150 billion capital target set for June 30th, and expectations that this number will grow to at least nineteen through various recapitalization mechanisms, the sector's adaptability and resilience are becoming increasingly evident.

Conversely, banks in Kenya continue to face challenges in maintaining their performance amidst increasing competition and regulatory pressures. Kenya's banking sector, which has more than ten listed banks, serves as a model for the potential development of Uganda's banking market. Lessons from Kenya's banking sector could provide valuable insights for Ugandan banks aiming to enhance their performance and stability.

Given these dynamics, it is crucial for shareholders to understand the factors that impact the performance of listed banks. While traditional measures of bank performance, such as Return on Assets (ROA) and Return on Equity (ROE), have been widely used in previous studies, they do not fully capture the total value delivered to shareholders. Total Shareholder Returns (TSR), which include both capital gains from stock price appreciation and dividends paid to shareholders, offer a more comprehensive measure of financial performance from an investor's perspective.

With the potential for Uganda's banking industry to develop similarly to Kenya's, moving from three listed banks to over ten, it is imperative to identify the factors that lead to good performance. Investors, stakeholders, and future shareholders must understand what influences shareholder returns in banks to prepare for potential future listings and guide their investment strategies effectively. This study aims to address the gap in previous research by focusing on TSR as a key measure of financial performance. By examining the performance of listed banks in Kenya and Uganda, the research seeks to identify the key factors that influence shareholder returns. Understanding these factors is essential for making informed investment decisions, especially in light of the potential future consolidation of banks in Uganda and the possibility of more banks listing on the stock exchange. As Uganda's banking industry develops, this research will offer valuable recommendations for improving bank performance and ensuring sustainable growth in the banking sector, thereby guiding investors, stakeholders, and future shareholders in their strategies.

1.3 Objectives

1. To identify and quantify the bank-specific factors influencing financial performance based on total shareholder returns of listed commercial banks in Kenya and Uganda over the period 2018-2023.

1.4 Research Questions

1. How do bank-specific factors (capital adequacy, asset quality, management efficiency, earnings ability, and liquidity) influence the financial performance of listed commercial banks in Kenya and Uganda from 2018 to 2023?

1.5 Scope of the Study

This study focuses on evaluating the performance of listed commercial banks in Uganda and Kenya over a five-year period from 2018 to 2023. Specifically, it examines three listed banks in Uganda—DFCU, Stanbic Bank, and Bank of Baroda Uganda—and nine listed banks in Kenya—CFC Stanbic of Kenya Holdings, Diamond Trust Bank Kenya Limited, Equity Bank Limited, Standard Chartered Bank Kenya Limited, I&M Holdings Limited, Kenya Commercial Bank Limited, NCBA Group Limited, ABSA, and Cooperative Bank of Kenya (COOP). The study aims to estimate the factors that impact their returns to shareholders, with a particular focus on operational efficiency, investment returns, financial capital efficiency, and macroeconomic influences. By analysing these factors, the study seeks to provide insights into the key determinants of shareholder returns, offering valuable guidance for current and potential investors, bank management, and policymakers.

1.6 Significance of the Study

This study holds significant importance for various stakeholders in the banking sector, including shareholders, bank management, policymakers, and academicians:

- **Shareholders:** The study provides insights into the factors that impact bank performance, enabling current and future shareholders to make informed investment decisions. Understanding these factors will help investors identify profitable investment opportunities and manage risks effectively.
- **Bank Management:** The findings of this study will assist commercial bank managers in understanding the key determinants of their financial performance. By focusing on these factors, bank managers can implement strategies to improve profitability, efficiency, and overall performance.
- **Policymakers:** The study will guide policymakers, especially the Central Banks and Treasuries in Kenya and Uganda, in formulating policies that ensure favourable macroeconomic conditions and regulatory frameworks. This will help spur growth and profitability in the banking sector, enhancing financial stability and economic development.
- **Academicians and Researchers:** The study will contribute to the academic literature on bank performance in developing economies. It will provide a useful reference for

future research in finance, economics, and banking, helping to build a deeper understanding of the determinants of bank performance.

- **Banking Sector Development:** By examining the impact of increased capital requirements and identifying factors that lead to successful bank listings, this study will support the growth and development of the banking sector in Uganda. It will provide insights that can help banks prepare for potential future listings, contributing to a more robust and competitive banking industry.

Chapter Two: Literature Review

2.1 Introduction

The financial performance of commercial banks has been extensively researched, with a focus on various internal and external factors that influence profitability and efficiency. These factors include bank-specific attributes, macroeconomic variables, and industry-specific conditions, all of which collectively impact bank performance. Understanding these determinants is crucial for developing strategies that enhance financial performance and ensure the stability and growth of the banking sector. This chapter provides a review of both theoretical and empirical literature on the determinants of financial performance in commercial banks, particularly within the context of developing economies such as Kenya and Uganda. By examining existing studies, this review seeks to identify gaps and provide a comprehensive analysis of the factors affecting total shareholder returns in listed commercial banks in these countries. The review is structured into two main sections: theoretical literature and empirical literature, followed by a discussion of the identified gaps.

2.2 Theoretical Literature Review

2.2.1 Signalling Theory

Signalling theory, introduced by Ross in 1973, suggests that companies convey information to external parties through signals, which can influence the company's valuation by altering external perceptions of its prospects (Connelly et al., 2011). The theory posits that companies send signals to outside parties, and these signals can shape perceptions and actions. In financial management, effective management decisions in commercial banks can send positive signals to stock market investors, thereby enhancing investment and increasing capital. The strength of signalling theory lies in its ability to explain the interaction between agents (managers) and principals (shareholders), advocating for sound board practices to ensure that managers act in alignment with owners' interests, thereby improving firm performance (Jensen & Meckling, 1976). However, the theory assumes that signals are always correctly interpreted by the market, which may not hold true due to market inefficiencies or information asymmetry.

2.2.2 Efficiency Structure Theory

The Efficiency Structure (ES) theory, with significant contributions from Nzongang and Atemnkeng (2006), suggests that enhanced managerial efficiency leads to higher profitability and better financial performance in organisations. The theory incorporates the X-efficiency hypothesis, which posits that better management practices lead to higher profits, and the scale-efficiency hypothesis, which suggests that a larger operational scale reduces costs and increases profitability (Athanasoglou et al., 2008). The central premise of ES theory is that a commercial bank's portfolio composition, profitability, and return to shareholders result from management decisions and policy choices. The theory's strength lies in explaining how managerial efficiency and operational scale contribute to profitability and financial performance. However, it may not fully account for external factors such as market conditions and regulatory changes, which can also impact profitability and performance.

2.3 Empirical Literature Review

2.3.1 Internal Determinants: Bank-Specific Factors

Ongore and Kusa (2013) concluded that decisions made within a bank have a substantial impact on its success, whereas broader economic factors play a less important role. However, their research did not take into account the specifics of the banking industry, which could provide a more complete understanding of performance factors. These industry-specific elements can shape the competitive landscape and, consequently, a bank's performance.

Kamande (2017) looked into how factors within a bank, like asset quality and management efficiency, affect how well publicly traded Kenyan banks perform financially. Statistical analysis revealed that asset quality was the most influential factor on profitability, followed by management efficiency, capital adequacy, and the bank's size. Factors like income diversification and liquidity were found to have little impact on financial performance. While this study provides a detailed look at measurable aspects within a bank, it doesn't explore non-numerical internal factors, suggesting that more research is needed to include both types of factors for a fuller picture.

Nicholas Mbugua Njoki and Dr .Winnie Nyamute (2023) focused on the factors influencing how profitable Kenyan banks are, specifically looking at Return on Assets (ROA). Their findings suggested that bank size, management effectiveness, asset quality, liquidity, and

capital adequacy were important factors in predicting financial performance, explaining 40.6% of performance changes. The remaining 59.4% could be due to other internal factors not included in their study. While their research provides a comprehensive look at various predictors, it doesn't address the unexplained portion of performance changes, indicating a need for further investigation into other internal factors. They also advised the Central Bank of Kenya to adjust its policies on minimum capital adequacy and liquidity ratios to better reflect the current economic climate.

2.3.2 Role of Commercial Banks in Economic Growth

Bijuma Bebbora (2019) highlighted the role of commercial banks in promoting economic growth by mobilising savings and financing productive sectors. The study identified internal bank-specific factors, industry-specific factors, and macroeconomic conditions as key determinants of financial performance. While the study underscores the importance of well-performing banks in economic development, it does not deeply explore the interaction between these factors. This gap indicates a need for studies that examine how these determinants interact to influence bank performance.

Obamuyi (2013) focused on the determinants of bank profitability in Nigeria, identifying efficient management of expenses and increased interest income as significant bank-specific factors. Additionally, favourable economic conditions were found to enhance profitability. However, the study did not address the influence of industry-specific factors, indicating another gap in the literature. Understanding how industry-specific factors interact with bank-specific and macroeconomic variables is essential for developing comprehensive strategies to improve bank performance.

2.3.3 Impact of Regulatory Environment in Uganda

In Uganda, the banking sector has been significantly impacted by increased capital requirements set by the Bank of Uganda. The study on regulatory impact examined how different banks responded to these regulatory changes. While some banks successfully met the requirements, others struggled, leading to downgrades or closures. This regulatory environment underscores the importance of understanding the determinants of bank performance to guide investment decisions and policy formulations. The study highlights the critical role of regulatory frameworks but does not provide detailed insights into how banks

can adapt to these changes. Further research is needed to explore adaptive strategies for banks to thrive under changing regulatory environments.

2.3.4 Internal and External Factors

Swarnapali (2014) examined the impact of operating costs on bank profitability, analysing the relationship between operational costs and financial performance using quantitative methods. The study found that high operational costs negatively impact bank profitability. While the study provides valuable insights into cost management, it does not consider external economic factors that might influence operating costs. Future studies could explore how external economic factors and internal cost management strategies interact to affect profitability.

Goddard et al. (2004) explored the effect of bank size on financial performance, using quantitative analysis to measure the impact of bank size, typically measured by assets, on profitability. The study found that larger banks benefit from economies of scale, reducing the cost of raising capital and increasing profitability. However, the study did not reach a consensus on whether increased size always leads to better performance, indicating a need for further research to determine under what conditions increased size leads to better or worse performance.

Nyanga (2012) and Muluaalem (2015) investigated the relationship between capital adequacy and financial performance, using various ratios, including the capital adequacy ratio (CAR), to measure the impact on bank profitability. Higher capital levels correlate with better financial performance, providing a buffer against adverse situations. While the studies confirm the positive relationship between capital adequacy and profitability, they do not address the optimal level of capital adequacy for different banks. Future research could explore the optimal capital adequacy levels for banks of varied sizes and in different economic conditions.

Liu (2011) and Sufian and Chong (2008) studied the impact of management efficiency on financial performance, measuring management efficiency using the CAMEL model. They found that management efficiency significantly influences return on assets and return on equity. While the studies highlight the importance of effective expense management, they do not consider the impact of technological advancements on management efficiency. Future

studies could explore the role of technology in enhancing management efficiency and its impact on financial performance.

Podder (2012) examined the effect of credit risk on bank profitability, measuring credit risk using the loan-loss provisions to loans ratio. The study found that higher credit risk is associated with decreased profitability. While the study provides insights into credit risk management, it does not consider the impact of different types of loans on credit risk. Further research could explore the impact of various types of loans and credit risk management strategies on bank profitability.

Swarnapali (2014) also analysed the relationship between productivity and financial performance, measuring productivity as the ratio of gross total revenue to the number of employees. The study found that higher productivity levels are associated with better financial performance. While the study highlights the importance of resource management, it does not consider the impact of employee training and development on productivity. Future studies could explore the role of employee training and development in enhancing productivity and its impact on financial performance.

2.3.5 Industry-Specific Factors

Karasulu (2001) examined the influence of market structure and competitiveness on bank performance, analysing the relationship between market structure, competitiveness, and financial performance using quantitative methods. The study found that high bank asset-to-GDP ratios indicate the critical role of financial development in the economy, attracting competitors and necessitating diverse competitive strategies to sustain performance. While the study provides valuable insights into the role of market structure, it does not consider the impact of regulatory changes on competitiveness. Future research could explore the impact of regulatory changes on market structure and competitiveness.

2.3.6 Macroeconomic Factors

Bikker and Hu (2002) and Gerlach et al. (2004) studied the impact of GDP growth on bank performance, analysing the relationship between GDP growth and bank profitability using quantitative methods. They found that GDP growth positively affects bank performance by increasing economic activity, enhancing customer deposits, and boosting loan demand. While the studies highlight the importance of a stable and growing economy, they do not consider

the impact of GDP volatility on bank performance. Future research could explore the impact of GDP volatility on bank performance and how banks can mitigate its effects.

Podder (2012) and Makkar and Singh (2013) examined the effect of interest rates on bank performance, analysing the relationship between interest rates and financial performance using quantitative methods. They found that higher interest rates typically improve financial performance by increasing profit margins, though they can also lead to higher non-performing loans if customers struggle with repayments during economic downturns. While the studies provide valuable insights into the impact of interest rates, they do not consider the role of monetary policy in stabilising interest rates. Future research could explore the role of monetary policy in stabilising interest rates and its impact on bank performance.

Swarnapali (2014) and Siddiqui and Shoaib (2011) studied the impact of inflation rates on bank performance, analysing the relationship between inflation rates and financial performance using quantitative methods. They found that anticipated inflation allows banks to adjust interest rates, positively impacting performance, while unanticipated inflation can lead to increased loan defaults and higher operating costs. While the studies highlight the importance of managing inflation expectations, they do not consider the impact of various types of inflation (e.g., cost-push vs. demand-pull) on bank performance. Future research could explore the impact of different types of inflation on bank performance and how banks can mitigate their effects.

2.4 Literature Review Gap

Despite the extensive research on the determinants of bank performance, a significant gap exists regarding the dependent variables used to measure financial performance. Most studies have predominantly utilised Return on Assets (ROA) and Return on Equity (ROE) as the main indicators of bank performance. While these metrics offer valuable insights into a bank's operational efficiency and profitability relative to its assets and equity, they do not fully capture the total value delivered to shareholders. Total Shareholder Returns (TSR), which encompass both capital gains from stock price appreciation and dividends paid to shareholders, provide a more comprehensive measure of financial performance from an investor's perspective. By focusing on TSR, this study aims to address this gap, offering a holistic understanding of the factors that truly drive shareholder value in listed commercial

banks. This approach aligns with shareholder interests and provides a broader view of financial performance that includes market valuation and dividend policies, areas that ROA and ROE do not adequately cover.

2.5 Conceptual Framework

The conceptual framework for this study offers a comprehensive model for analysing the determinants of bank performance, specifically focusing on Total Shareholder Returns (TSR) in listed commercial banks in Kenya and Uganda. This framework integrates multiple factors, including operational efficiency, bank size, financial performance, capital adequacy, and economic conditions, highlighting their respective contributions to the overall financial health and performance of commercial banks. Operational efficiency encompasses management efficiency, cost management, and productivity, all of which directly impact profitability. Bank size is considered in terms of economies of scale and market position, influencing competitive advantage and financial outcomes. Financial performance includes traditional metrics such as Return on Assets (ROA) and Return on Equity (ROE), as well as asset quality. Capital adequacy ensures banks have sufficient capital to absorb losses and comply with regulatory requirements.

Economic conditions such as GDP growth, interest rates, and inflation rates provide the broader context within which banks operate, affecting their performance. The ultimate measure of financial performance in this framework is TSR, which includes capital gains from stock price appreciation and dividends paid to shareholders, offering a comprehensive view of value delivered to investors. This integrated approach enables a holistic understanding of how various determinants interact to influence the financial performance of commercial banks, providing insights that are particularly relevant for enhancing shareholder value in the context of developing economies.

Chapter Three: Research Methodology

3.1 Introduction

This chapter outlines the research methodology employed to investigate the determinants of financial performance in listed commercial banks in Kenya and Uganda. It details the research design, data collection methods, and statistical techniques used to ensure robust and reliable results.

3.2 Research Design

The study adopts an explanatory research design to analyse the relationship between various determinants and the financial performance of listed commercial banks. This design is appropriate as it allows for the examination of cause-and-effect relationships using panel data from multiple banks over a specified period. This approach aids in understanding how specific factors influence bank performance by affecting various financial and operational metrics.

3.3 Population and Sampling

The population for this study includes all listed commercial banks in Uganda and a selected sample of listed banks in Kenya. Specifically, the study will include all currently listed banks on the Uganda Stock Exchange, which are DFCU, Stanbic Bank, and Bank of Baroda Uganda. In Kenya, out of the eleven listed banks on the Nairobi Securities Exchange (NSE), a sample of nine banks will be selected for analysis. This approach ensures a comprehensive examination of bank performance in Uganda while allowing for a focused yet representative analysis of the Kenyan banking sector. The selected banks in Kenya will be chosen based on criteria such as market capitalisation, asset size, and relevance to the study objectives, ensuring that the sample accurately reflects the dynamics of the larger banking sector in the region.

3.4 Data Collection

To effectively analyse the determinants of financial performance, data on several key variables were gathered. These variables encompass economic, financial, and operational indicators that are crucial for a comprehensive analysis.

3.4.1 Sources of Data

- **Bank-Specific Financial Data:** Data sourced from the annual financial statements of listed commercial banks in Kenya and Uganda. This includes metrics such as return on assets (ROA), return on equity (ROE), and net interest margin (NIM).
- **Economic Indicators:** Data sourced from the World Bank and central banks of Kenya and Uganda. These include GDP growth, inflation rates, and central bank rates (CBR).
- **Operational Efficiency Metrics:** Data on revenue per employee, bank cost-to-income ratio, non-performing loan (NPL) ratio, and operating leverage, sourced from bank annual reports and industry analyses.

3.4.2 Time Period

The data covers the period from 2018 to 2023, providing a six-year span to capture trends and variations in bank performance and economic indicators. The time period was chosen based on the availability of consistent and comprehensive data for the selected variables.

3.5 Diagnostic Tests

To ensure the reliability of the regression analysis, several diagnostic tests were performed, including tests for stationarity, multicollinearity, and heteroskedasticity.

3.5.1 Stationarity Test

Stationarity tests determine whether the panel data variables are stationary or contain unit roots. Stationarity implies that the statistical properties of the variables, such as mean and variance, remain constant over time, which is essential to avoid spurious regression results. The Levin Lin & Chu (LLC) test was employed for this purpose. The null hypothesis for the LLC test is that the panel data contains a unit root (i.e., the series is non-stationary). If the null hypothesis is rejected, it implies that the data is stationary. In the case of non-stationarity,

possible treatments include differencing the data or applying transformations such as logarithms to achieve stationarity.

3.5.2 Multicollinearity Test

Multicollinearity tests assess whether independent variables in the regression model are highly correlated with each other. High multicollinearity can inflate the standard errors of the coefficients, making it challenging to determine the effect of each variable accurately. Variance Inflation Factors (VIF) were used to detect multicollinearity. The null hypothesis for VIF is that there is no multicollinearity among the variables. A VIF value greater than ten typically indicates significant multicollinearity. In case of multicollinearity, possible treatments include removing or combining correlated variables or using techniques such as Principal Component Analysis (PCA) to reduce the dimensionality of the data.

3.5.3 Heteroskedasticity Test

Heteroskedasticity tests examine whether the variance of the errors in the regression model is constant across observations. Heteroskedasticity can lead to inefficient estimates and incorrect inferences if not properly addressed. The Breusch-Pagan test was used for this purpose. The null hypothesis for the Breusch-Pagan test is that homoscedasticity (constant variance of errors) is present. If the null hypothesis is rejected, indicating heteroskedasticity, possible treatments include using robust standard errors, applying transformations to stabilise variance, or employing Generalised Least Squares (GLS) instead of Ordinary Least Squares (OLS) for the regression analysis.

3.6 Model Specification

To select the appropriate model among the fixed effects model, random effects model, and pooled OLS model, a systematic approach involving three key tests was employed:

- **Hausman Test:** Conducted to compare the fixed effects model and the random effects model. This test evaluates whether the unique errors are correlated with the regressors.
- **F-Test:** Used to compare the fixed effects model with the pooled OLS model. This test helps determine if there are significant individual-specific effects that the fixed effects model can capture, which the pooled OLS model cannot.

- **Breusch-Pagan LM Test:** Applied to compare the random effects model with the pooled OLS model. This test assesses whether the random effects model provides a better fit by accounting for variance across entities that the pooled OLS model does not capture.

The models used in this study are specified as follows:

$$TSR_{it} = \beta_0 + \beta_1 CIR_{it} + \beta_2 RevBranch_{it} + \beta_3 RevEmployee_{it} + \beta_4 RevCustomer_{it} + \beta_5 NIM_{it} + \beta_6 NPL_{it} + \beta_7 TechExp_{it} + \beta_8 OpLeverage_{it} + \beta_9 Assets_{it} + \beta_{10} Deposits_{it} + \beta_{11} Loans_{it} + \beta_{12} LoanDepRatio_{it} + \beta_{13} ROA_{it} + \beta_{14} ROE_{it} + \beta_{15} NPM_{it} + \beta_{16} SuppCap_{it} + u_i + \epsilon_{it}$$

Table 1: List of variables

Variable	Description
<i>TSR_{it}</i>	<i>Total Shareholder Returns for bank i at time t</i>
<i>CIR_{it}</i>	<i>Cost-to-income ratio for bank i at time t</i>
<i>RevBranch_{it}</i>	<i>Revenue per branch for bank i at time t</i>
<i>RevEmployee_{it}</i>	<i>Revenue per employee for bank i at time t</i>
<i>RevCustomer_{it}</i>	<i>Revenue per customer for bank i at time t</i>
<i>NIM_{it}</i>	<i>Net interest margin for bank i at time t</i>
<i>NPL_{it}</i>	<i>Non-performing loan ratio for bank i at time t</i>
<i>TechExp_{it}</i>	<i>Technology expenditure for bank i at time t</i>
<i>OpLeverage_{it}</i>	<i>Operating leverage for bank i at time t</i>
<i>Assets_{it}</i>	<i>Total assets for bank i at time t</i>

ε_{it}	<i>Idiosyncratic error term</i>
u_i	<i>Unobserved bank-specific effect</i>
$SuppCap_{it}$	<i>Supplementary capital for bank i at time t</i>
NPM_{it}	<i>Net profit margin for bank i at time t</i>
ROE_{it}	<i>Return on equity for bank i at time t</i>
ROA_{it}	<i>Return on assets for bank i at time t</i>
$LoanDepRatio_{it}$	<i>Loan-to-deposit ratio for bank i at time t</i>
$Loans_{it}$	<i>Total loans for bank i at time t</i>
$Deposits_{it}$	<i>Total deposits for bank i at time t</i>

Chapter Four: Results and Analysis

4.1 Introduction

This chapter presents the empirical findings of the study, examining the determinants of Total Shareholder Return (TSR) in the banking sector using panel data from 2018 to 2023 for twelve banks—nine in Kenya and three in Uganda. The analysis encompasses descriptive statistics, diagnostic checks, and regression results. It ensures the robustness of conclusions by addressing critical econometric assumptions, including stationarity, multicollinearity, and heteroskedasticity. The findings are systematically presented to provide clarity on the relationships between the key determinants and TSR.

4.2 Summary Statistics

Table 2: Summary Statistics

Variable	Mean	Std. Dev.	Min	Max
Total Shareholder Return (TSR)	7.52	25.84	-56.11	71.21
Cost-to-Income Ratio	47.71	8.84	18.05	69.00
Number of Branches	130.26	132.53	16	603
Profit per Branch	952.21	1816.13	24.24	7188.00
Number of Employees	3052.38	3139.38	180	13102.00
Profit per Employee	55.87	126.59	1.46	576.00
Interest Income Ratio	75.30	12.16	55.06	113.00
Net Interest Margin (NIM)	71.86	10.22	51.72	95.49
Gross NPL Ratio	9.57	4.44	0.03	18.10
Operating Leverage	0.71	15.97	-36.10	51.93
Net Profit	45748.88	81428.54	3248.00	411531.00

Total Assets	1554877	2171622	208407.00	9303398.00
Total Deposits	1103726	1469956	144501.00	6332851.00
Total Loans	724051.50	949903.70	116853.00	4225122.00
Loan-to-Deposit Ratio (LDR)	69.17	10.96	48.60	93.36
ROA	2.53	0.99	0.30	5.00
ROE	15.75	5.38	1.57	25.30
Tier 1 Capital to RWA	18.32	5.69	10.90	38.29
Dividend Payout Ratio	37.70	25.07	0.00	156.38

The analysis reveals significant variability across the key metrics. Total Shareholder Return (TSR) exhibits a mean value of 7.52, with a substantial standard deviation of 25.84, suggesting wide disparities in shareholder returns across the banks. The minimum TSR recorded was -56.11, while the maximum reached 71.21, highlighting both severe underperformance and significant outperformance among the sampled banks.

Cost-to-Income Ratio averaged 47.71, with a standard deviation of 8.84, reflecting varying levels of operational efficiency. The number of branches ranged widely, with an average of 130.26 and a standard deviation of 132.53, indicating substantial differences in branch network sizes across banks. Profit per branch and profit per employee also demonstrated considerable dispersion, signifying varying levels of productivity and profitability within the workforce and operational units.

Interest Income Ratio and Net Interest Margin (NIM) averaged 75.30 and 71.86, respectively, suggesting the central role of interest-related activities in revenue generation. However, variability in NIM suggests differing levels of efficiency in interest management across the sampled banks. Gross Non-Performing Loan (NPL) Ratio, with a mean of 9.57 and a standard deviation of 4.44, highlights disparities in credit risk management.

Key financial aggregates, such as total assets, total deposits, and total loans, exhibit significant dispersion, with means of 1,554,877, 1,103,726, and 724,051.50, respectively. The Loan-to-Deposit Ratio (LDR) averaged 69.17, suggesting moderate utilization of deposits for

lending purposes. Return on Assets (ROA) and Return on Equity (ROE) displayed means of 2.53 and 15.75, respectively, indicating moderate financial efficiency across the sample. Finally, the Dividend Payout Ratio, averaging 37.70 with a large standard deviation of 25.07, underscores the variability in dividend distribution strategies.

Overall, the descriptive statistics highlight significant heterogeneity in financial performance and operational efficiency across the sampled banks, setting the stage for further econometric analysis.

4.3 Diagnostic Checks

4.3.1 Stationarity Tests

This section examines the stationarity properties of the variables in the panel dataset. Stationarity, meaning that a time series has a constant mean and variance over time, is a crucial assumption for many time series and panel data econometric techniques. Non-stationary data can lead to spurious regressions and unreliable results.

To test for stationarity, we employ the Fisher-type unit root test. This test examines the null hypothesis that all panels in the dataset contain unit roots (i.e., are non-stationary). If the test results in a low p-value (generally below 0.05), we reject the null hypothesis, indicating that at least one panel in the dataset is stationary.

The following table presents the stationarity test results for each variable:

Table 4: Stationarity test results

Variable	Statistic	P-Value	Stationarity
grossnplratio	63.0178	0	Level

operatingleverage	35.9587	0.0071	Level
netprofitm	4.7377	0.9992	Difference
totalassets	5.75	0.9971	Difference
totaldeposits	9.4073	0.9495	Difference
totalloans	3.9813	0.9998	Difference
ldratio	22.1446	0.2256	Difference
roa	11.368	0.8781	Difference
roe	11.0779	0.891	Difference
tltorwa	19.5752	0.3572	Difference
divyield	3.4845	0.9999	Difference
capitalgain	83.4013	0	Level
tsr	88.1279	0	Level
divpayoutratioproposed	17.3618	0.4984	Difference
D_costtoincomeratio	136.7996	0	Level
D2_costtoincomerati	210.781	0	Level

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D_numberofbranches	91.4982	0	Level
D_totalloans	12.7612	0.8056	Difference
D2_totalloans	132.0642	0	Level
D_profitperbranchm	13.8002	0.742	Difference
D_numberofemployees	93.9325	0	Level
D_properemployee m	21.7224	0.2445	Difference
D2_properemployee m	67.0616	0	Level
D_iiofrev	29.7191	0.0403	Level
D2_iiofrev	56.5129	0	Level
D_netinterestmargin	14.261	0.7119	Difference
D2_netinterestmargin	95.3641	0	Level
D_nimniitotalloans	11.1291	0.8888	Difference
D2_nimniitotalloans	85.4672	0	Level

D_netprofitm	14.4314	0.7006	Difference
D2_netprofitm	124.2858	0	Level
D_totalassets	75.9829	0	Level
D_totaldeposits	67.3678	0	Level
D_ldratio	76.7672	0	Level
D_roa	21.8266	0.2398	Difference
D2_roa	34.768	0.0101	Level
D_roe	14.1002	0.7225	Difference
D2_roe	39.3592	0.0025	Level
D_t1torwa	15.1874	0.6491	Difference
D2_t1torwa	74.1919	0	Level
D_divpayoutratio proposed	50.3932	0.0001	Level

Interpretation

As the table shows, most variables are not stationary at levels. This necessitates transforming the data to achieve stationarity before proceeding with further econometric analysis. Common transformations include first differencing (taking the change from one period to the next) or second differencing (differencing the already differenced data).

4.3.2 Multicollinearity

Variance Inflation Factor (VIF) analysis confirmed no multicollinearity issues, with a mean VIF of 8.21. All variables had VIF values below the conventional threshold of ten.

The Variance Inflation Factor (VIF) table for multicollinearity was found in the document. Below is the summarized VIF table:

Table 5: VIF Table

Variable	VIF	1/VIF
D2_roa	40.77	0.0245
D2_roe	34.63	0.0289
D2_profperemployeem	10.97	0.0911
D2_netprofitm	8.41	0.1188
Operating leverage	6.18	0.1618
D2_totalloans	5.80	0.1723
D2_iiofrev	4.14	0.2417

D2_nimniitotalloans	3.44	0.2911
D_profitperbranchm	3.03	0.3309
D2_costtoincomeratio	3.00	0.3329
D_divpayoutratio	2.03	0.4931
Grossnplratio	2.00	0.5008
D_numberofemployees	1.81	0.5511
D2_netinterestmargin	1.75	0.5701
D2_t1torwa	1.62	0.6155
D_ldratio	1.59	0.6299

4.3.3 Heteroskedasticity

The Breusch-Pagan test indicated heteroskedasticity ($p = 0.0792$). Robust standard errors were applied to address this issue, ensuring the reliability of the regression results.

Table 6: Heteroskedasticity table

Test	Null Hypothesis	Test Statistic	p-Value	Interpretation
Breusch Pagan	Constant variance (no heteroskedasticity)	$\chi^2(1) = 3.08$	0.0792	Fail to reject H0: No significant evidence of heteroskedasticity

4.4 Regression Results

4.4.1 Model Selection

The study employed the Hausman test to compare the fixed effects and random effects models. The results favored the fixed effects model ($p < 0.05$). However, the F-test did not reveal a significant advantage of the fixed effects model over the pooled Ordinary Least Squares (OLS) model. Consequently, the pooled OLS model was selected for its simplicity and efficiency, with robust standard errors applied to address heteroskedasticity concerns.

4.4.2 Regression Results

The final pooled OLS model explained 59.06% of the variation in TSR (adjusted R-squared = 0.5906). Table 4.3 presents the regression results:

Table 8: Regression results

Variable	Coefficient	Std. Error	t-stat	P> t
D2_costtoincomeratio	0.6763	0.6937	0.97	0.355
D_numberofemployees	-0.0009	0.0072	-0.12	0.049**
D_profitperbranchm	0.1457	0.2045	4.00	0.001**
D2_totalloans	0.0005	0.0003	2.43	0.018**

D2_nimniitotalloans	8.1038	7.9225	1.02	0.333
D2_netinterestmargin	-1.6399	0.9813	-2.96	0.005**
D2_iiofrev	-0.5992	0.9102	-0.66	0.527
D2_profperemployeem	-6.9818	4.5403	-1.54	0.158
D_divpayoutratio proposed	0.1002	0.2541	2.75	0.007**
D2_t1torwa	-0.9186	2.7585	-0.33	0.747
D2_roe	4.4923	3.3828	2.04	0.045**
D2_roa	-15.2434	23.5166	-0.65	0.533
D_ldratio	1.2668	1.3437	0.94	0.37
D_totaldeposits	0.0003	0.0004	0.66	0.523
D_totalassets	-0.0004	0.0003	-1.13	0.287
D2_netprofitm	0.0007	0.0015	0.46	0.653
Grossnplratio	1.4037	5.6718	0.25	0.81
Operating leverage	-0.0478	0.7635	-0.06	0.951
Constant (_cons)	-9.525	63.6159	-0.15	0.884

4.5 Interpretation of Results

The regression results presented in this section provide insights into the relationships between various determinants and Total Shareholder Returns (TSR) for the studied banks. Below is a detailed interpretation of each significant result:

Profit per Branch ($\beta = 0.1457$, $p = 0.001$): The positive and statistically significant coefficient indicates that an increase in profit per branch directly contributes to improved TSR.

This suggests that banks that efficiently manage and optimize branch-level profitability can enhance shareholder value. Higher profit per branch reflects better revenue generation and cost control, making it a key driver of financial performance.

Number of Employees ($\beta = -0.0009$, $p = 0.049$): The negative relationship suggests that an increase in the number of employees is associated with a decline in TSR. This could imply inefficiencies in labor utilization, where additional employees do not proportionally contribute to revenue generation. Banks may need to assess workforce productivity and consider automation or optimization strategies to improve efficiency.

Total Loans ($\beta = 0.0005$, $p = 0.018$): The positive coefficient indicates that higher total loan issuance leads to an increase in TSR. This suggests that banks that successfully expand their lending portfolios can enhance their profitability, provided they maintain strong credit risk management to minimize non-performing loans.

Net Interest Margin ($\beta = -1.6399$, $p = 0.005$): Surprisingly, the negative relationship between net interest margin and TSR suggests that an increase in interest margins may introduce cost burdens or risk exposures that negatively affect shareholder returns. This could be due to higher funding costs, increased risk from aggressive lending strategies, or customer dissatisfaction due to elevated borrowing rates.

Dividend Payout Ratio ($\beta = 0.1002$, $p = 0.007$): The positive and significant impact of dividend payout ratio on TSR underscores the importance of consistent dividend policies in boosting investor confidence. Investors are likely to favor banks that provide regular and stable dividends, as this signals financial stability and profitability.

Return on Equity (ROE) ($\beta = 4.4923$, $p = 0.045$): The strong positive relationship between ROE and TSR highlights the efficiency with which banks utilize shareholder equity to generate profits. A higher ROE signals robust financial performance and investor attractiveness, reinforcing its significance as a key determinant of shareholder returns.

Operating Leverage and Other Variables: Some variables, such as operating leverage, did not exhibit statistical significance, suggesting their limited direct impact on TSR within the scope of this study. However, these factors may still play an indirect role through their influence on other financial and operational metrics.

Conclusion: The results highlight the critical importance of operational efficiency, strategic credit management, and shareholder-friendly dividend policies in driving TSR. Additionally, the findings indicate areas for improvement, such as optimizing workforce productivity and managing cost structures effectively. Banks aiming to enhance shareholder returns should focus on improving branch-level profitability, maintaining disciplined lending practices, and implementing consistent dividend policies to attract and retain investors.

4.6 Conclusion

In conclusion, the analysis identifies key determinants of TSR, emphasizing the importance of branch-level efficiency, dividend payout policies, and equity management. The findings also highlight potential inefficiencies in labour management and cost structures associated with net interest margins. These insights provide actionable recommendations for bank managers, policymakers, and investors aiming to optimize shareholder value and drive sustainable financial performance.

Chapter Five: Discussions, Conclusions, and Recommendations

5.1 Introduction

This chapter synthesizes the study's findings on the determinants of Total Shareholder Return (TSR) in listed commercial banks in Kenya and Uganda. It contextualizes the results within existing theoretical frameworks and empirical studies, draws conclusions based on the research objectives, and offers practical recommendations for policymakers, bank managers, and investors. Additionally, the chapter highlights the study's limitations and proposes areas for further research.

5.2 Discussions

5.2.1 Linkages to Existing Research and Theories

The findings of this study align with established theoretical frameworks and previous empirical research, offering both confirmation and new insights into the determinants of TSR.

The Efficiency Structure Theory, as proposed by Nzongang and Atemnkeng (2006), emphasizes the role of managerial efficiency in driving financial performance. This study reinforces the theory by demonstrating a positive and significant relationship between branch-level profitability and TSR. Banks that effectively manage operational resources at the branch level achieve superior financial outcomes, validating the theory's core principles.

Signalling Theory, introduced by Ross (1973), posits that dividend policies serve as signals to investors regarding a firm's financial health and future prospects. The study's findings confirm this theory, as a positive relationship between the dividend payout ratio and TSR underscores the importance of transparent and consistent dividend policies in shaping investor confidence.

Empirical evidence from previous studies further supports these findings. Kamande (2017) highlighted the significance of internal factors, such as asset quality and management efficiency, in influencing financial performance. Similarly, Swarnapali (2014) identified cost management as a critical determinant of bank profitability. However, this study diverges slightly by revealing a negative relationship between the number of employees and TSR,

indicating potential inefficiencies in workforce management. This paradox aligns with Swarnapali (2014) assertion that cost structures require careful oversight to optimize financial outcomes.

5.2.2 Results and Research Hypotheses

The study addressed the research hypotheses by examining the influence of both bank-specific and macroeconomic factors on TSR.

For bank-specific factors, the findings revealed that branch-level profitability, dividend policies, and total loans exert a significant positive impact on TSR. These results validate the hypothesis that operational and financial efficiency are central to shareholder value creation.

On the other hand, macroeconomic factors, while acknowledged as essential contextual variables, did not exhibit statistically significant relationships in the regression analysis. This suggests that their impact on TSR may be indirect or mediated through other internal factors, warranting further investigation.

5.3 Conclusions

The study concludes that operational efficiency, particularly at the branch level, plays a crucial role in driving TSR. Profit per branch emerged as a significant determinant, emphasizing the importance of resource allocation and operational oversight at the branch level.

Dividend policies were also identified as key drivers of TSR, highlighting their role in building investor confidence and sustaining long-term shareholder value.

Conversely, the negative relationship between the number of employees and TSR points to potential inefficiencies in workforce management. Additionally, the unexpected negative impact of higher net interest margins suggests that aggressive interest-related strategies may introduce unintended costs or risks.

Overall, the findings emphasize the need for a balanced approach to operational efficiency, workforce management, and financial policy implementation to maximize TSR in commercial banks.

5.4 Recommendations

For Bank Managers:

Bank managers should prioritize branch-level profitability by streamlining operations, reducing unnecessary costs, and focusing on targeted investments that yield measurable financial outcomes. Additionally, workforce efficiency must be addressed through capacity building, performance-based incentives, and technology adoption to reduce redundancies and enhance productivity.

Dividend policies should be designed with transparency and consistency to signal financial health and attract long-term investors. Managers must also monitor net interest margins closely, ensuring that profit-driven lending strategies do not compromise overall financial stability.

For Policymakers:

Policymakers should create a regulatory environment that fosters operational efficiency while encouraging innovation in banking practices. Policies should aim to strike a balance between stringent financial regulations and the flexibility required for sustainable growth.

Macroeconomic stability remains a cornerstone for banking sector performance. Therefore, central banks and financial regulatory authorities must adopt proactive measures to stabilize inflation rates, interest rates, and currency fluctuations.

For Investors:

Investors are advised to prioritize banks with strong branch-level profitability, transparent dividend policies, and efficient workforce management practices. These attributes are proven determinants of TSR and serve as reliable indicators of long-term financial sustainability.

Furthermore, investors should remain cautious of banks with overly aggressive lending or interest management strategies, as these may pose hidden financial risks.

5.5 Limitations of the Study

Despite its contributions, the study is subject to certain limitations. First, the reliance on secondary data introduces the possibility of measurement errors or biases inherent in the original data sources. While efforts were made to ensure data quality, such errors cannot be entirely ruled out.

Second, the study's focus on macroeconomic factors may have overlooked other external shocks or country-specific nuances that could influence TSR. Variables such as political stability, technological disruptions, and global financial trends were not explicitly analysed but could have meaningful implications.

5.6 Areas for Further Research

Future studies could explore the role of technological advancements and digital banking in enhancing branch-level profitability and overall TSR. As digitalization continues to reshape the banking landscape, understanding its impact on financial performance will provide valuable insights.

Additionally, future research could adopt a more granular approach to examining the interaction between bank-specific and macroeconomic factors. A multi-layered analysis incorporating qualitative data, such as managerial decision-making processes, could offer deeper insights into the drivers of TSR.

Lastly, longitudinal studies extending beyond the 2018-2023 period could help identify evolving trends and structural shifts in the banking sector that influence TSR over time.

5.7 Conclusion

This chapter synthesized the study's key findings, linking them to theoretical and empirical frameworks. It provided actionable recommendations for bank managers, policymakers, and investors while acknowledging the study's limitations and proposing avenues for future research. By addressing operational efficiency, dividend policies, and workforce management, this study contributes valuable insights into optimizing Total Shareholder Return in the banking sector of Kenya and Uganda.

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