PROFITABILITY DRIVERS OF COMMERCIAL BANKS: AN EMPIRICAL INVESTIGATION

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TABLE OF CONTENTS

CHAPTER TWO: LITERATURE REVIEW

ABSTRACT

Commercial banks are important to the financial segment, particularly in developing economies where capital markets are not well developed and strong. Commercial banks' profitability is important because the soundness of an industry is closely connected to the soundness of the whole economy. Profitability of the banking sector is also central to the well-being of the industry is closely associated with the wellness of the whole economy in general. Thus, a proficient and productive banking sector is able and better placed to endure negative economic shocks. This study investigated determinants of profitability of Malaysian commercial banks. The study explored the effect of the liquidity, capital adequacy and bank size on banks' profitability. The study used secondary data from 16 Malaysian commercial banks from the years 2007 to 2016. The data collected was edited, sorted for completeness and then analyzed using Fixed Effect Model and Pearson correlation using the statistical package for social studies and the established insignificant relationship between capital adequacy and bank profitability and a significant negative relationship between liquidity, bank size and bank profitability. The study concluded that liquidity plays a key role in determining commercial banks profitability and higher levels of liquidity provide adequate funds to lend which in turn increase interest income hence banks' profitability. The study recommended that regulatory authorities like the central bank of Malaysia should develop effective policies on capital adequacy, liquidity and credit risk management to ensure that banks are in a position where they can enhance their profitability.