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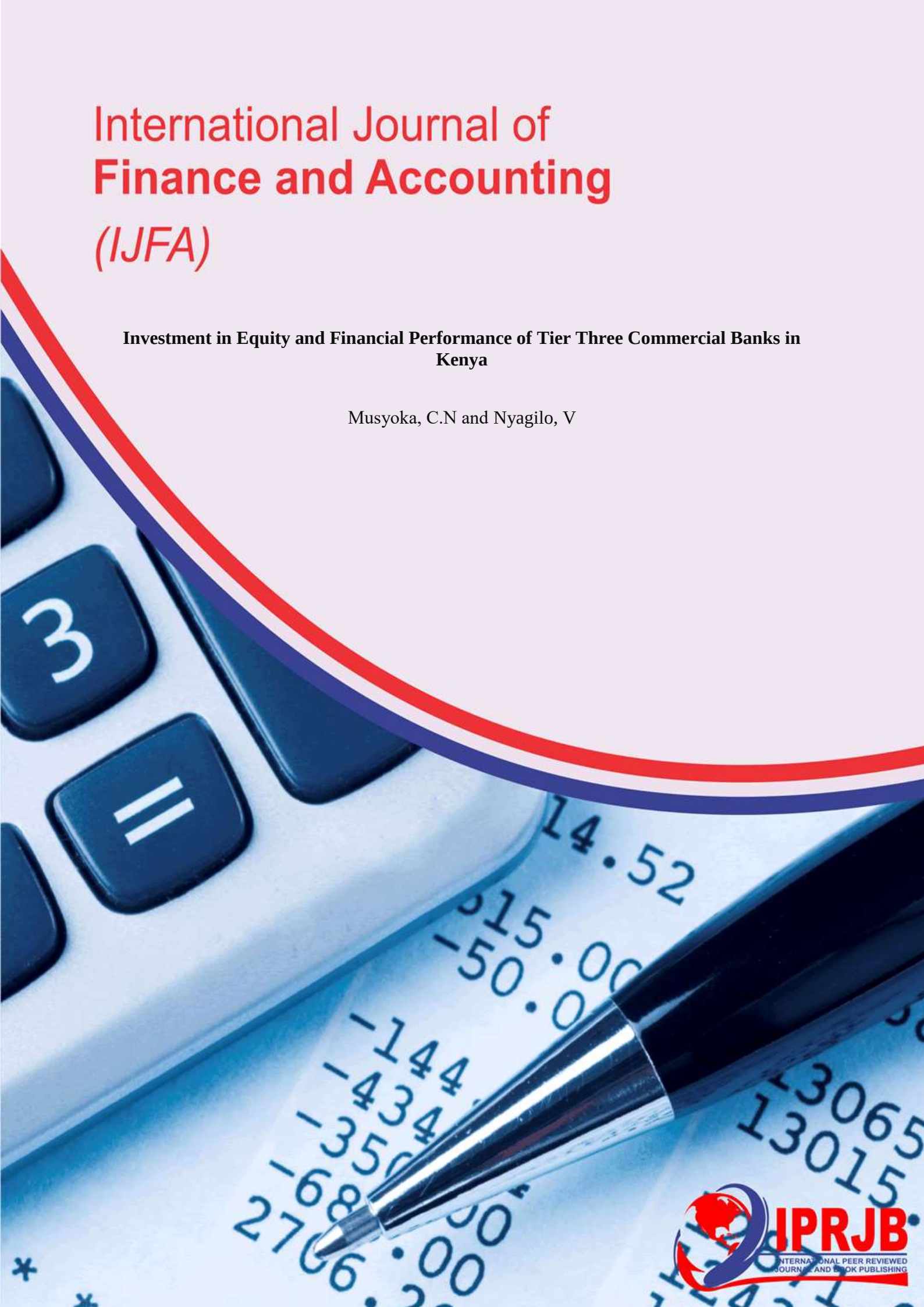

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Investment in Equity and Financial Performance of Tier Three Commercial Banks in Kenya

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Abstract

Purpose: Tier III commercial banks play a pivotal role in the Kenyan economy as intermediaries of connecting investors and savers to achieve the economic meaning of financial inclusion. These commercial banks effectively use their limited resources to perform the roles of extending banking services to the needy areas and the integrated development of Kenya's economy. However, the CBK reports pointed out several tier three commercial banks facing issues with their financial performance**.** Non-performing loans among the Tier III banks in Kenya have been rising over the past ten years, threatening the sustainability of these institutions. The aim was to establish the effects of investment in equity on the financial performance of tier three commercial banks in Kenya. The CAPM was employed to explain the study objective.

Methodology: A descriptive research design was adopted for a target population of 22 Tier III commercial banks in Kenya. Census technique and secondary data from 2015 to 2024, using the secondary data collection sheet, were utilized. Inferential statistical tools were employed that included Pearson's Product-Moment correlation and panel regression analysis.

Findings: The study finding revealed that equity investment had a significant positive effect with $\beta = 0.3386$ ($p = 0.0000$). The result further indicates that equity investment explained approximately 63.11% of the variation in financial performance, highlighting the critical role of equity investments in enhancing profitability.

Unique Contribution to Theory, Practice and Policy: The study also recommended that policymakers, particularly CBK, should develop policies that promote investment diversification, improve access to capital markets, and enhance regulatory frameworks to support efficient investment practices among Tier Three banks.

Keywords: *Investment, Equity, Financial Performance, Tier Three Commercial Banks, Kenya*

INTRODUCTION

Every organization's goal is to maximize shareholders' returns, considering that shareholders are the primary owners who commit capital investments, intending to earn a sufficient return on their risks. In the banking sector, this objective is achieved through sustained profitability, efficient resource utilization, and prudent risk management (Wanjohi, 2024). By maximizing shareholder value, banks can maintain their appeal to investors, which makes it easier to obtain the funding required for growth and innovation (Bach, 2024). Financial performance, as defined by Odhiambo and Saungweme (2023), is a multidimensional construct that encompasses not just profitability but also the bank's ability to sustain long-term viability by maintaining capital adequacy and withstanding economic shocks. Therefore, financial performance shows not only the potential to generate revenue but also how well risk management procedures function and how well enough capital buffers can be maintained following regulatory frameworks (Mwangi 2023 & Bach 2024).

Tier Three commercial banks occupy a distinct and increasingly significant role within the Kenyan banking industry. These banks are distinguished by having fewer branches and smaller asset bases. They also frequently target underserved rural communities and small and medium-sized businesses (SMEs) as well as other specialty markets (CBK, 2023). The financial stability and performance of these banks are, however, impacted by a number of challenges, among them a lack of capital, increased operating expenses, and intense rivalry from larger banks and non-bank financial institutions (Resa, Mithi, & Kosgei, 2022; Gathara, 2024). Therefore, these banks need to diversify and explore investment avenues to strengthen their financial standing and enhance the banks' ability to withstand adverse economic conditions, minimize volatility in earnings, and improve overall financial stability (Muriithi & Waweru, 2020).

Equity investment refers to the allocation of financial resources into equity instruments issued by companies, giving the investor ownership rights and the potential to earn returns through dividends and capital appreciation (Muturi & Karanja, 2023). Equity investment plays a crucial role in enhancing the financial performance of banks by offering potential high returns compared to fixed-income instruments, albeit with higher risk. Through strategic investment in shares, banks can improve Return on Assets (ROA), gain exposure to capital market growth, and balance risk across their portfolios (Muiruri & Kihara, 2023; Wanjiru & Njagi, 2021).

For Tier 3 banks with smaller capital bases and limited operational scale, careful selection of equities focusing on companies with stable earnings and growth potential can provide a sustainable source of profits while mitigating market volatility (Muturi & Karanja, 2023; Chepkemoi, 2024). Understanding the dynamics between investment in equity and financial performance in this segment will provide bank managers with actionable insights to optimize portfolio choices and enhance resource utilization. Additionally, policymakers and regulators will benefit from empirical evidence to tailor supportive frameworks that encourage prudent investment diversification while safeguarding financial system stability. Therefore, this study is significant as it contributes to the body of knowledge by offering a focused analysis of how investment portfolios impact financial performance in Tier Three commercial banks.

Statement of the Problem

Kenya's banking sector is a cornerstone of the nation's economic growth, employment creation, and financial inclusion efforts, all of which are integral to achieving the goals outlined in Vision 2030 and the government's broader development agenda (CBK2024). However, in recent years, the sector has experienced a noticeable decline in overall performance, with Tier

3 commercial banks bearing the brunt of this downturn. CBK report 2015 to 2024 shows that Tier 3 commercial banks in Kenya experienced a consistent decline in financial performance, as evidenced by a significant drop in ROA. For instance, individual bank financial statement reports and empirical assessments indicate a persistent deterioration in the financial performance of Tier 3 commercial banks in Kenya, as measured by Return on Assets (ROA), over the period 2019–2025. While Tier 3 banks historically maintained positive ROA levels above prudential benchmarks, recent performance trends reveal a sharp reversal into sustained negative territory, signaling financial distress. Specifically, ROA declined from approximately −4.7% in 2019 and −5.2% in 2020, reflecting worsening profitability and asset inefficiency. Although marginal stabilization was observed in subsequent years, ROA remained deeply negative at −5.0% in 2021, −4.6% in 2022, −5.3% in 2023, and −5.5% in 2024 and 2025 to –5.7%, underscoring a prolonged period of underperformance. According to CBK prudential and supervisory benchmarks, a sustainable ROA for commercial banks ranges between 1% and 2%, reflecting adequate profitability, efficient asset utilization, and resilience to operational and macroeconomic shocks (CBK, 2015; CBK, 2021; CBK, 2024). However, Tier 3 banks have consistently recorded ROA levels well below this threshold and remained negative for nearly a decade (Cytonn 2023). Notable failures include Imperial Bank, placed under receivership in 2015, Chase Bank, which collapsed in 2016, and Dubai Bank, liquidated in 2015 (CBK Reports, 2015–2017; Wanjiru & Njagi, 2021). More recently, First Community Bank was acquired by Premier Bank Limited, Somalia, in 2023 after prolonged distress (Cytonn, 2023). Globally, empirical evidence on the relationship between investment in equity and financial performance remains mixed. While Baker et al. (2023) reported a positive effect among U.S. manufacturing firms, Chen and Lin (2021) observed reduced performance in Chinese listed companies, Khalid et al. (2020) found no significant relationship in Malaysian banks, and Singh (2024) noted that diversification diluted managerial focus in Indian cooperative banks. Regionally, findings are similarly inconclusive. Ndlovu and Mutambara (2022) reported improved performance in Zimbabwean pension funds, whereas Okeke and Nwogu (2024) observed negative effects in Nigerian insurance firms. At the national level, Muchiri and Ombui (2022) found positive effects of investment in equity on Kenyan commercial banks, but Mwangi and Muturi (2023) found no significant effect for SACCOs, whereas Otieno (2025) highlighted that high costs and low returns constrained performance among smaller banks and MFIs. These studies highlight contextual, conceptual, and geographic gaps necessitating further investigation to inform policy and strengthen sector resilience.

Objectives of the Study

The objective of the study is to assess the effect of investment in equity on the financial performance of Tier 3 commercial banks in Kenya.

Theoretical Review

This section presents a comprehensive theoretical review relevant to investment in equity and the financial performance of Tier Three commercial banks.

Capital Asset Pricing Model

The Capital Asset Pricing Model (CAPM) was developed by Sharpe in 1964.CAPM posits that the expected return of a security is equal to the risk-free rate plus a risk premium, which is proportional to the systematic risk of the security, measured by beta (Sharpe, 1964; Lintner, 1965). This framework allows investors to estimate the return required for bearing market risk and compare it to the expected return from a specific investment. In essence, CAPM provides

a risk-adjusted benchmark to guide investment decisions, particularly in equity markets where volatility and uncertainty are significant (Fama & French, 2004; Elton, Gruber, Brown, & Goetzmann, 2014)

According to Sharpe (1964), Lintner (1965), and Bodie et al. (2014), the Capital Asset Pricing Model (CAPM) is predicated on several fundamental assumptions: investors are rational and risk-averse; capital markets are perfectly competitive and frictionless; there are no taxes or transaction costs; and all investors have uniform expectations regarding risk and return. The model also implies that all assets are infinitely marketable and divisible, as well as having a single-period investment horizon. While these assumptions simplify theoretical modeling, they may not fully reflect real-world market imperfections, particularly for smaller financial institutions like Tier 3 banks (Chen, 2019; Roll, 1977).

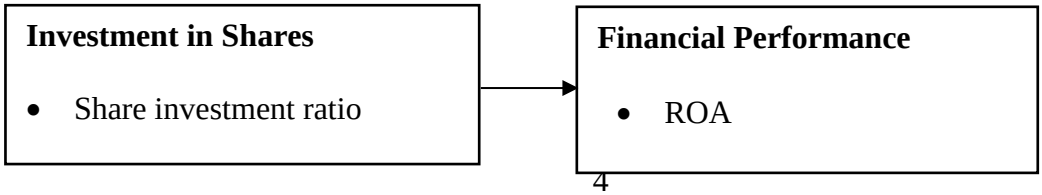
Despite its widespread use, CAPM has been critiqued for several reasons. The reliance on beta as the principal measure of risk may insufficiently convey idiosyncratic, liquidity, and operational concerns faced by smaller institutions (Fama & French, 2004; Chen, 2019). The premise of perfect market efficiency and homogenous expectations often does not hold in emerging economies like Kenya, where information asymmetry and regulatory constraints are crucial (Muturi & Karanja, 2023). Furthermore, the single-period horizon and the lack of macroeconomic shocks restrict its forecasting ability in volatile economies (Bodie et al., 2014; Otieno & Kanyi, 2021).

CAPM is commonly used by banks and financial institutions to analyze projected returns on equity investments, optimize portfolios, and make informed decisions on the acquisition or sale of shares (Elton et al., 2014; Bodie et al., 2014). CAPM offers a framework for evaluating risk-adjusted returns on shares for Tier 3 commercial banks, enabling managers to strategically distribute resources among stocks while controlling market exposure (Muturi & Karanja, 2023; Chepkemoi, 2024). By adopting the CAPM, these institutions can prioritize investments that give higher returns relative to systemic risk, which is critical for smaller banks with inadequate capital buffers and significant vulnerability to market volatility (Muiruri & Kihara, 2023; Wanjiru & Njagi, 2021).

Investment in shares or equities constitutes a significant alternative investment avenue for Tier 3 banks seeking to enhance financial performance. CAPM underpins the rationale for such investments by linking expected returns to market risk (Sharpe, 1964; Lintner, 1965). Through this model, Tier 3 banks can determine the risk-adjusted return on individual equities or a portfolio of shares, aligning investment decisions to maximize Return on Assets (ROA) while maintaining a prudent risk profile (Otieno & Kanyi, 2021; Muturi & Karanja, 2023). In the context of Kenyan Tier 3 banks, the model aids in navigating the trade-off between pursuing higher returns from equities and mitigating exposure to market volatility, thereby supporting sustainable financial performance (Chepkemoi, 2024; Muiruri & Kihara, 2023).

Conceptual Framework

A conceptual framework serves as a visual and narrative guide that links the independent variable to the dependent variable while clarifying the hypothesized direction and nature of these relationships (Creswell & Creswell, 2018).



Independent Variable **Dependent Variable**

Figure 1: Conceptual Framework

Empirical Review

Gea (2022) conducted a study with the aim of examining the effect of equity investments on the stock prices of sector manufacturing companies listed on the Indonesia Stock Exchange (IDX). The study was conducted for a period of 5 years from 2017 to 2021. The population of this study was all manufacturing companies that have been listed on the Indonesia Stock Exchange from 2017 to 2021. The sampling technique used in this study is an on-probability sampling method with a purposive sampling technique. From this technique, there are 19 companies that are sampled in this study. The data collection technique was carried out by collecting data from information on the financial statements of manufacturing companies that have been listed on the IDX from 2017 to 2021, while the data analysis method used in this study was descriptive statistical methods, classical assumption tests, and multiple linear regression analysis. The results indicated that equity investments have a significant effect on stock prices.

Almanaseer (2024) conducted a study to examine the impact of equity financing on the financial performance of Jordanian industrial companies. The study adopted a descriptive–analytical research design, which combined structured data collection with statistical analysis to test the study's hypotheses. The scope of the research covered 55 industrial firms in Jordan, targeting 393 board directors, from which 346 directors were selected through purposive sampling. Data were gathered using an online questionnaire, enabling the researchers to capture perceptions and practices related to equity financing across the industrial sector. Using descriptive and inferential statistical techniques, the study established that equity financing has a positive effect on firms' financial performance.

Ilo, Yinusa, and Elumah (2018) conducted a study on the effect of investment in shares and the performance evaluation of Nigerian Mutual Funds. The study covered the period 2012 to 2015 and utilized data from a population of 37 mutual funds operating in Nigeria. Employing a quantitative research design, the study adopted panel regression and a risk-adjusted performance measure of Jensen's alpha. The empirical findings revealed that stock investments had a significant positive effect on mutual fund performance, suggesting that fund managers who strategically diversified into equities achieved higher returns. The study was, however, done on mutual funds in Nigeria, which differs from the current study in terms of geographical location and the target population.

Oyucho, Ochieng, and Agong (2023) conducted a study on the effect of foreign investment in shares on market returns at the NSE 20 Share Index in Kenya. The research technique employed panel regression for inferential analysis and the Lagrange multiplier test to ascertain the pooled effect, utilizing STATA 18 software. Secondary data was obtained from the NSE annual reports, CMA bulletins, and CBK websites of the companies listed in the index for the period from 2013 to 2022. The study findings revealed a significant positive effect between foreign investment in shares and market returns at the NSE 20 share index. The study recommended policies that will stabilize macroeconomic factors such as interest rates and exchange rates, which will reduce the volatility of portfolio inflows, thus promoting stable portfolio inflows into the economy. The study, however, conducted a study on foreign shares to locally owned shares.

Kimorop (2025) sought to study the effect of investment in shares and the financial performance of listed investment firms in Kenya. The research philosophy adopted was positivism. The study employed an explanatory research design. The five Kenyan-listed investment businesses were the subject of the study. The study used a census technique to examine every investment company listed on Kenya's NSE. The study acquired data from secondary sources, spanning the period from 2011 to 2021 (11 years). The association between portfolio investment, firm size, and financial performance was established using panel estimation. The findings of the study revealed that equity investment favorably and considerably affected the profitability of listed investment enterprises in Kenya.

METHODOLOGY

This study employed a descriptive research design to examine the relationship between investment in equity and the financial performance of Tier 3 commercial banks in Kenya. The target population consisted of all Tier 3 commercial banks in Kenya, as classified by the Central Bank of Kenya (CBK). As of the latest CBK classification, there are 22 Tier 3 commercial banks operating in Kenya, and these institutions constituted the full population for the study. This study adopted a census approach, whereby all 22 Tier 3 commercial banks in Kenya will be included in the analysis. The data were collected from secondary sources using a secondary data collection sheet to capture the financial statements-related data. Data was obtained from audited annual financial statements of Tier 3 commercial banks (2015–2024), CBK Annual Bank Supervision Reports (2015–2024), and NSE databases for market-related investment data where applicable. The data were then imported into STATA 18 software for analysis. Inferential statistics were applied, beginning with Pearson correlation analysis to determine the strength and direction of the regression. Subsequently, a panel regression model was employed to account for both cross-sectional and time-series variations. The panel regression analysis model is expressed as follows.

$$Y_{it}=\beta_0 + \boldsymbol{\beta_2}\, X_{2it} +\boldsymbol{\varepsilon}$$

FINDINGS AND DISCUSSIONS

This section presents the empirical findings of the study and provides an in-depth discussion of the results in relation to the study objective, hypothesis, and theoretical foundations.

Descriptive Statistics Results

The descriptive statistics include the number of observations, minimum, maximum, mean, standard deviation, skewness, and kurtosis, which together provide insights into the central tendency, dispersion, and distributional properties of the study variables. Table 4.1 presents the descriptive results

Table 1: Descriptive Statistics Results

Statistics	Obs	Min	Max	Mean	SD	Skewness	Kurtosis
Financial Performance	154	-0.0594	0.0249	0.0067	0.0245	-1.7425	-4.4093
Equity Investment	154	0.0703	0.1491	0.1079	0.0235	-0.0284	1.7321

As per Table 1, ROA recorded a minimum value of −0.0594 and a maximum of 0.0249, indicating that Tier Three commercial banks experienced profitability levels ranging from a 5.94% loss to a 2.49% return on total assets during the study period. The negative lower bound suggests that some banks faced significant operational or structural challenges that eroded asset efficiency, while the positive upper bound indicates that certain institutions were able to generate reasonable returns despite sectoral pressures. The mean ROA of 0.0067 (0.67%) suggests that, on average, Tier Three commercial banks generated relatively low returns on their asset base during the study period. This average falls slightly below the commonly accepted sustainable banking benchmark of 1%–2% ROA for commercial banks, implying moderate profitability and potential structural constraints within this segment.

The relatively high standard deviation (0.0245) indicates notable variability in performance across banks and years. The skewness of −1.7425 indicates a negatively skewed distribution, meaning that extreme losses occurred in some years, pulling the distribution to the left. According to Hair et al. (2019), skewness values between −2 and +2 are considered acceptable for normality. The kurtosis value of 4.4093 exceeds the normal distribution benchmark of 3 (Field, 2018), indicating a leptokurtic distribution characterized by heavier tails and extreme observations. This suggests that Tier Three banks experienced occasional extreme profitability shocks, consistent with macroeconomic disruptions. The finding aligns with Muchiri and Ombui (2022), who reported modest profitability among smaller Kenyan banks, but contradicts Baker et al. (2023), who found higher ROA levels in more diversified U.S. firms. The lower mean in this study reflects the structural limitations of Tier Three banks.

Equity investment recorded a minimum of 0.0703 and a maximum of 0.1491, implying that Tier Three commercial banks allocated between 7.03% and 14.91% of their total assets to equity investments during the study period. The variation in allocation indicates differences in risk tolerance, capital capacity, and portfolio diversification approaches among the banks. A mean of 0.1079 shows that approximately 10.79% of total assets were invested in equities. The standard deviation of 0.0235 reflects moderate variation in equity exposure among Tier Three banks. The skewness of -0.0284 indicates a near-symmetrical distribution, while the kurtosis value of 1.7321, which is below the normal benchmark of 3 (Field, 2018), indicates a platykurtic distribution with fewer extreme outliers.

Trend Analysis

Trend analysis was used to examine the patterns and directional movements of the financial performance over the seven years from 2019 to 2025.

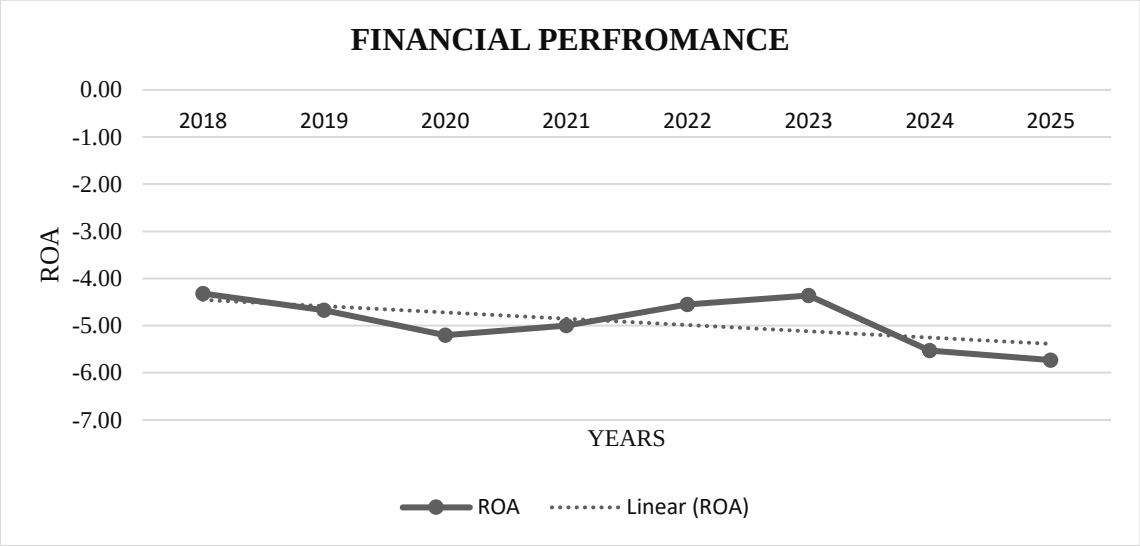


Figure 1: Trend Analysis for Financial Performance

In 2018, ROA stood at approximately -4.4%, indicating that Tier Three banks were already experiencing negative returns on total assets. In 2019, profitability slightly declined to around -4.7%, suggesting increased cost pressures or reduced income-generating capacity. The decline deepened in 2020, where ROA dropped further to nearly -5.2%. This deterioration may be associated with economic disruptions and increased credit risk exposure during that period, which adversely affected smaller banks more significantly due to limited capital buffers.

In 2021, performance showed slight improvement to approximately -5.0%, followed by further recovery in 2022 to about -4.6%. This improvement suggests partial stabilization, possibly due to improved asset allocation strategies or recovery in economic activity. However, in 2023, ROA marginally weakened again to approximately -4.8%, before declining sharply in 2024 to nearly -5.6%. The downward movement continued into 2025, reaching approximately -5.8%, marking the lowest performance level during the study period. The linear trend line confirms a gradual overall decline in financial performance over time.

The declining performance trend is consistent with findings from several empirical studies of Ongore and Kusa (2017), who found that smaller Kenyan banks experienced weaker profitability due to inefficiencies in asset utilization and management practices. Were and Wambua (2018) observed that excessive holdings of low-yield government securities could suppress profitability despite improving liquidity positions. Ngugi and Afande (2025) reported that suboptimal bond portfolio allocation negatively affected performance among Kenyan banks, and Athanasoglou, Brissimis, and Delis (2008) established that bank-specific factors such as asset quality and operational efficiency significantly influence profitability trends.

Inferential Analysis

This section presents the findings from inferential analysis.

Correlation Analysis

Pearson's correlation coefficient (r) was used because it is appropriate for measuring linear associations between continuous variables.

Table 2: Correlations Coefficients

	ROA	Equity Investment

ROA	Pearson Correlation		
	Sig.(2- tailed)	1.0000	
Equity Investment	Pearson Correlation	0. 5867	
	Sig.(2- tailed)	0.0012	1.0000
	N	154	154

Note: Values in parentheses represent p-values. All correlations are statistically significant at the 5% level ($p < 0.05$).

The results presented in Table 2 indicate that investment in equity shows a positive correlation with ROA ($r = 0.5867$, $p = 0.0012$). The positive and statistically significant p-values (all less than 0.05) indicate that increases in these investments in equity are associated with improvements in financial performance among Tier Three commercial banks in Kenya.

Model Summary

The model summary provides information on the overall goodness of fit of the regression model in explaining variations in the dependent variable, Return on Assets (ROA). A summary of the results is presented in Table 3

Table 3: Model Summary

Model 1	Multiple R	R Squared	Adjusted R Square	S.E. Regression	F-Statistic	Prob (F-Statistic)
Random Effects Model	0.7942	0.6311	0.6194	0.0157	64.2837	0.0003

The results in Table 3 indicate that the model has a correlation coefficient (R) of 0.7942, which signifies a moderately strong positive relationship. The R-squared value of 0.6311 implies that approximately 63.11% of the variation in ROA is explained by equity investment. The Adjusted R-squared of 0.6194, which accounts for the sample size ($n = 154$) and number of predictors, confirms that the model retains strong explanatory power even after adjusting for potential overfitting.

The standard error of regression (0.0157) is relatively low, suggesting that the model's predictions closely approximate the observed values, thereby enhancing the reliability of the estimates. Furthermore, the F-statistic of 64.2837 with a corresponding p-value of 0.0003 ($p < 0.05$) indicates that the model is statistically significant overall. Given the sample size of 154 observations, the high F-statistic strengthens the robustness of the model and reduces the likelihood that the results are due to random variation. However, the R-squared value also indicates that 36.89% of the variation in ROA remains unexplained, suggesting that other factors such as macroeconomic conditions, operational efficiency, regulatory environment, and management quality also influence financial performance.

Analysis of Variance (ANOVA)

The Analysis of Variance (ANOVA) was conducted to assess the overall significance of the regression model in explaining variations in financial performance (ROA). The results are presented in Table 4

Table 4: ANOVA

Source of Variation	Sum of Squares	df	Mean Square	F	Sig.
Regression	0.0639	4	0.0160	63.7525	0.0003
1 Residual	0.0374	149	0.000251		
Total	**0.1013**	**153**			

The ANOVA results in Table 4 indicate that the regression model is statistically significant. The model reports an F-statistic of 63.7525 with a corresponding p-value of 0.0003, which is less than the 0.05 level of significance. Therefore, the null hypothesis that the regression coefficient is equal to zero is rejected. This implies that equity investment has a significant effect on the financial performance of Tier Three commercial banks in Kenya. The regression mean square (0.0639) is substantially higher than the residual mean square (0.0374), indicating that the model explains a significant proportion of the variation in ROA relative to unexplained variation.

Regression Coefficient Results

Regression coefficient analysis was conducted to determine the magnitude, direction, and statistical significance of the relationship between the independent variable and financial performance (ROA). The results of the regression coefficients are shown in Table 5

Table 5: Regression Coefficients Result

Variable	Coefficient (β	Std. Err.	t-Statistic	p-value	95% Confidence Interval
Investment in	0.3386	0.0752	4.5027	0.0000	0.1902, 0.4870
Equity _cons	-0.0208	0.0079	-2.6329	0.0094	-0.0364, -0.0052

The output of the panel regression results is presented in Table 5; thus, the equation becomes;

$$Y = -0.0208 + 0.3386X_{it}$$

Hypotheses Testing Results

The result of equity investment shows a positive and statistically significant effect on financial performance, β = 0.3386 (p = 0.0000). The result implies that, when equity investment is controlled and all other factors remain constant, a unit increase of investment in equity will lead to an increase of the financial performance of Tier Three commercial banks by 0.3386 units. The study rejected the null hypothesis and concluded that equity investment significantly enhances profitability through capital gains and dividend income. This finding aligns with studies of Gea (2022), Chepkorir (2018), Kimorop (2025), and Oyucho, Ochieng, and Agong (2023), who found that equity investments improve return-generating capacity in financial institutions. Similarly, Choi et al. (2017) confirm that equity investments are critical for fueling business growth, allowing companies to finance expansion and innovation without incurring debt, ultimately driving long-term financial performance. However, Muema et al. (2021), Moenga (2024), and Ilo, Yinusa, and Elumah (2018) found that equity investments had an insignificant effect on ROA despite being positively related to liquidity. Almanaseer's (2024) study suggests that equity investments may increase risk exposure, which can negatively affect performance during market downturns.

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SUMMARY, CONCLUSION AND RECOMMENDATIONS

This section presents a synthesis of the key findings of the study, the conclusions drawn from the empirical analysis, and the recommendations derived from the results.

Summary

The study found that equity investment has the strongest positive and statistically significant effect on the financial performance of Tier Three commercial banks in Kenya. This indicates that increased allocation to shares substantially enhances profitability through capital gains and dividend income, making equity investment a key driver of ROA. The strength of this relationship underscores the importance of capital market participation in boosting income-generating capacity, particularly for smaller banks seeking to diversify beyond traditional lending activities. The findings further revealed that equity investment plays a critical role in maximizing returns and improving overall portfolio performance. By incorporating equities into their investment portfolios, Tier Three banks are able to access higher-yield opportunities compared to fixed-income securities, thereby enhancing their earnings potential. Equity investments also contribute to portfolio diversification by introducing assets with different risk-return characteristics, which can improve overall risk-adjusted returns when managed effectively.

Conclusion

The study concludes that equity investment is the most influential determinant of financial performance among the investment portfolio components examined. The strong positive relationship demonstrates that equity investments provide substantial return potential through capital appreciation and dividend income, making them a key driver of profitability. Equity investment enhances portfolio performance by introducing high-yield assets that improve overall returns and support long-term financial growth. However, this benefit comes with increased exposure to market volatility and price fluctuations, which can negatively impact performance if not properly managed. Therefore, while equity investments offer superior returns, their success depends on effective risk management strategies, including diversification across sectors and continuous market analysis. The study further concludes that strategic participation in equity markets is essential for Tier Three banks seeking to remain competitive and improve financial outcomes, but it must be accompanied by strong investment governance and analytical capacity.

Recommendations

Based on this finding, banks should strategically expand their participation in equity markets to take advantage of high return potential from capital gains and dividends. However, since equity investments are associated with higher risk, the recommendation is that banks adopt robust risk management strategies, including diversification across sectors and continuous market analysis. The strong coefficient observed in the findings justifies prioritizing equity investments within the portfolio, while the associated risks highlighted in the study necessitate prudent investment decision-making and capacity building in financial market analysis

Recommendations for Further Research

Despite the significant contributions of this study, several areas remain open for further investigation to deepen the understanding of the relationship between investment in equity and the financial performance of banks. First, the study established that the model explains a substantial proportion of financial performance, accounting for 63.11% of the variation in

ROA. However, this also implies that 36.89% of the variation remains unexplained, suggesting the presence of other influencing factors beyond the investment portfolio components examined. Therefore, future research should incorporate additional variables to capture external influences on bank performance.

Second, there is a need for comparative studies across different bank tiers (Tier One, Tier Two, and Tier Three) in Kenya. Such studies would help determine whether the effect of equity investment varies across banks of different sizes and operational capacities, thereby providing more generalized insights for the banking sector. Third, further studies may explore the impact of financial technology (fintech) and digital transformation on investment decisions and financial performance. As banks increasingly adopt digital platforms, it is important to understand how technological innovations influence portfolio management and profitability. Finally, there is scope for future studies to examine alternative investment instruments, such as real estate investments, private equity, and green finance, and their effect on financial performance. This would provide insights into emerging investment opportunities that could enhance portfolio diversification and profitability among Tier Three commercial banks in Kenya.

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