

Abstract

Purpose

The study evaluates the influence of human capital efficiency (HCE) and market power on bank performance.

Design/methodology/approach

The study employs two measures of bank performance: profitability and stability. Unbalanced panel data of 35 banks operating in Kenya for 2005–2020 collected from published financial statements is utilized. The study employs the feasible generalized least squares (FGLS) method in the analysis and the two-step system generalized method of moments (GMM) for robustness check.

Findings

The study affirms an inverted U-shaped relationship between market power and bank performance. The effect of market power on bank profitability is enhanced when a bank has highly efficient human capital. Further, HCE significantly impacts bank stability for banks with low HCE. Interestingly, a further increase in HCE narrows the net interest margins for banks with high HCE, conferring welfare benefits to customers as interest rate spreads shrink.

Practical implications

This study provides important insights into the role of human capital in bank performance. First, banks ought to invest in promoting HCE through training and development. As regulators root for bank consolidation, attention to HCE is imperative for fostering profitability and stability.

Originality/value

The study fills an essential gap in the literature by evaluating the effect of firm-level market power on bank performance in an emerging market. We adopt a novel stochastic frontier estimator to generate the Lerner index. Further, this is the first study known to the authors to evaluate the effect of market power on bank performance in the context of human capital efficiency variations.