

**CENTRAL BANK OF KENYA REGULATORY REQUIREMENT AND FINANCIAL
PERFORMANCE OF COMMERCIAL BANKS IN KENYA, CASE OF EMBU TOWN.**




**A RESEARCH PROJECT SUBMITTED TO THE SCHOOL OF BUSINESS IN
PARTIAL FULFILMENT OF THE REQUIREMENTS FOR THE AWARD OF THE
DEGREE OF MASTER OF BUSINESS ADMINISTRATION
MOUNT KENYA UNIVERSITY**

9 September 2024

DECLARATION AND APPROVAL

DECLARATION

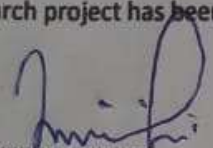
This research project is my original work and to the best of my knowledge has not been submitted for an award to any University.

Reg No.	Names	Sign
MBA/2021/40186	Wario Abduba Hassan	

APPROVAL

This research project has been submitted with my approval as Mount Kenya project Supervisor.

Signature



Date

29/04/2024

Dr. Jennifer Wanjiku Muriuki

Lecturer

Department of Accounting and Finance, Mount Kenya University

DEDICATION

I dedicate this work to my mother, sisters and wife for their love, commitment and financial support towards this project.



ACKNOWLEDGEMENT

I want to use this opportunity to express my gratitude to everyone who helped me with my project. My heartfelt gratitude and appreciation are extended to my supervisor, Dr. Jennifer Muriuki, for taking the time to guide in the development of this study project. I also want to thank my coworker for their kind assistance with my study project. May the All-Powerful Allah provide them a bountiful life.



TABLE OF CONTENTS

DECLARATION AND APPROVAL	Error! Bookmark not defined.
DECLARATION	Error! Bookmark not defined.
APPROVAL	Error! Bookmark not defined.
DEDICATION	iii
ACKNOWLEDGEMENT	iv
LIST OF FIGURE.....	vii
LIST OF TABLES	viii
ABSTRACT.....	x
LIST OF ABBREVIATIONS AND ACRONYMS.....	xii
CHAPTER ONE	1
INTRODUCTION	1
1.1 Background of the study	1
1.2 Statement of the problem.....	6
1.3 Objectives of the study.....	7
1.3.1 Purpose of the Study	7
1.3.2 Specific Objectives	7
1.4 Research questions.....	8
1.5 Significance of the study.....	8
1.6 Scope of the study.....	9
1.7 Limitations of the study	11
1.9 Definition of operational terms.....	13
CHAPTER TWO	15
LITERATURE REVIEW	15
2.1 Introduction.....	15
2.2 Theoretical literature.....	15
2.2.1 Agency Theory.....	15
2.2.2 Capital Buffer Theory	21
2.2.2 Loanable theory	27
2.2.3 The Economic Theory of Regulation.....	31
2.2.4 Empirical review	32
2.3 Corporate governance and financial performance	34

2.4 Minimum Capital Requirement and monetary Performance	36
2.5 Reserve requirement and financial performance	37
2.6 Publications of bank charges and financial performance	39
2.8 Conceptual Framework.....	40
CHAPTER THREE.....	41
RESEARCH METHODOLOGY.....	41
3.1 Introduction.....	41
3.2 Research Design.....	41
3.4 Data Collection Procedure	42
3.5 Sampling and Sampling Procedures	42
3.6 Data Validity and Reliability	42
3.7 Data analysis and Data presentation	43
3.8 Ethical Considerations	45
CHAPTER FOUR.....	46
DATA ANALYSIS, PRESENTATION AND DISCUSSION	46
4.1 Background of Statistics.....	46
4.2 Reserve Requirement.....	46
4.3 Minimum Capital.....	49
4.4 Corporate Governance	55
CHAPTER FIVE.....	64
SUMMARY OF FINDINGS, CONCLUSIONS AND RECOMMENDATIONS	64
5.1 Summary of Findings.....	64
5.3 Conclusions.....	67
5.4 Recommendations	69
5.5 Suggestions for further research	70
MKU RESEARCH PERMIT	73
.....	73
NACOSTI RESEARCH PERMIT.....	74
.....	74
APPENDIX TWO: RESEARCH QUESTIONNAIRE.....	75
APPENDIX THREE: RESEARCH BUDGET	80

LIST OF FIGURE

Figure 2.1 Conceptual Framewor.....40

Figure 4.1 maintenance of minimum reserve requirements.....32

Figure 4.2 capital requirements is one effect of CBK regulatory.....33

Figure 4.3 transfer of ownership influence bank performance.....34

Figure 4.4 high capital requirement in banks leads to low profits.....35

Figure 4.5 bank is able to supervise and oversight their systems.....37

Figure 4.6 firm publishes and distributes its financial results and management analysis..38

Figure 4.7 Banks holds self-assessment of good corporate governance.....38

Figure 4.8 bank regularly holds self-assessment of good corporate governance.....39

Figure 4.9 bank has well written corporate governance.....39

Figure 4.10 comparison of income earned to expenses.....41

LIST OF TABLES

Table 4.1 Reserve requirements is one of the major challenges that commercial banks face.....	31
Table 4.2 Reserve requirements serve as a safeguard against a sudden inordinate demand.....	31
Table 4.3 Capital requirement structures of banks is highly regulated.....	34
Table 4.4 policy concerning definition of capital requirements beyond cash or government security.....	35
Table 4.5 The bank has a clear list of share owned by members of the Board of Directors.....	36
Table 4.6 The audit section of the firm is performing its duties as expected.....	37
Table 4.7 potential conflicts of interest between the bank and Board of Directors.....	39
Table 4.8 Proper utilization of financial information on profitability.....	40
Table 4.9 Increased financial efficiency has helped to save cost.....	40
Table 4.10 Disclosure of financial information reduce information asymmetry.....	42

LIST OF APPENDICES

Appendix 1: Introduction letter.....	19
Appendix 2: Study Questionnaire.....	20
Appendix 3: Nacosti.....	24
Appendix 4: ERC.....	25



ABSTRACT

Despite the 2013 CBK prudential standards' implementation, which governs commercial banks in Kenya, proposed project aimed at investigating the impact of various prudential standards set by the Central Bank of Kenya (CBK) on monetary ability of banks in Embu town. The study focused on three specific prudential standards: minimum capital requirements, reserve requirements, and central bank publication of commercial bank charges on loans. The study aimed in determining the connection between corporate governance and commercial banks' financial success.

To achieve these objectives, the researchers planned to collect primary data from 22 significant bank officials selected randomly from the Kenyan Commercial Bank and the Family Bank in Embu Town. They will use a questionnaire to gather quantitative data. To examine data gathered, descriptive and inferential statistics were used. Theoretical foundations of research are Agency Theory and the Loanable Theory, which guide the interpretation and analysis of the findings. The ultimate goal of the study is to provide empirical data that can help Kenya's central bank in evaluating financial stability of commercial banks in Embu town. Potential benefits in this project include shedding light on impact of prudential standards on bank performance, providing insights into the effectiveness of corporate governance in the banking sector, and offering valuable data for further studies in this area. Fifty nine point one percent of Survey respondents are aged between 25 to 30 years thus most of participants are aged between 25 to 30 years in commercial banks. Sixty eight point two percent of survey respondent have degree and twenty seven point three percent of the respondents have masters level. Therefore most of respondents have degree level in their education. Forty five point five percent of respondents have worked for 2 to 5 years as credit manager in this institution, twenty seven point three percent of respondents have worked for 6 to 10 years and four point five percent of respondents have worked for 11 years and above thus most of the respondents have worked for 2 to 5 years. The research findings indicate that the financial performance is impacted by the regulatory requirements of the Central Bank of Kenya, specifically in terms of capital requirements.. Thirty one point eight percent of respondents depicted capital requirement structures of banks are highly regulated, eighteen point two percent of the respondents agree, while forty five point five percent of respondents were uncertain. The study recommends central bank should have a policy which ensures commercial bank should have adequate capital

requirement. This policy will ensure banks are well regulated thus protecting the welfare of all the stakeholders. The bank should also supervise and oversight their systems which enables them to compute minimum capital requirements adequately.



LIST OF ABBREVIATIONS AND ACRONYMS

CAMEL	Capital, Asset, Management, Earnings and Liquidity
CBK	Central Bank of Kenya
NBFI	Non-Banking Financial Institution
ROA	Return on Assets
ROE	Return on Equity
SPSS	Statistical Package for Social Sciences
ROCE	Return on capital employed
GDP	Gross Domestic Product
NIM	Net Interest Margin
CRR	Cash Reserve Ratio

CHAPTER ONE INTRODUCTION

1.1 Background of the study

Bank regulation is type of governmental mandate that imposes limitations and standards on banks. This regulatory framework, among other things, fosters openness between financial institutions and the people and businesses they do business with. Given how interconnected the banking sector is and how much the national and international economies rely on banks, it is crucial that regulatory bodies continue to exercise control over the institutions' standardized procedures. The "Too big to fail" theory is a common pillar of the arguments made by proponents of such policies.

According to the "Too Big to Fail" notion, a lot of financial sectors, especially investment banks with a commercial component, have much influence over economic activity to fail without severe repercussions. Hence this is the underlying idea behind government bailouts, of which the government offers financial support to banks and other financial organizations that seem to be in danger of failing. It is thought that without assistance, troubled banks will not only fail but also have a cascading impact on the rest of the economy, resulting in systemic catastrophe. The following are some regulatory criteria on the financial standing of the banking institutions employed by the central bank of Kenya in an effort to lessen this systemic failure.

One of the bank regulatory criteria, the minimum capital requirement, establishes the guidelines for the capital management requirements for banks and depository organizations. It is possible to weight risk by categorizing assets and capital in a highly consistent manner. The central bank of Kenya establishes the capital adequacy standard, which all commercial banks in the country must meet. Central Bank of Kenya releases capital adequacy requirements and conducts an onsite examination to assure compliance; banks work to maintain compliance because failing to comply results in fines (Musioka, 2017). Due to the fragility and susceptibility of deposits to bank runs, capital adequacy in banks generates liquidity for the institution. Financial turmoil is less likely when banks have more capital. Capital adequacy ratio (CAR) is used to assess a company's capital sufficiency. This ratio demonstrates the bank's ability to bear losses during crisis. A study on bank adequacy conducted in Kenya revealed a correlation between bank a and bank performance.

According to Kombo and Dang (2016), the requirement is crucial for commercial banks since it enhances credit risk management strategies and contributes to the financial stability of the Kenyan economy. Performance is impacted by Kenyan commercial banks' capital sufficiency (Kamande & Ariemba, 2016). The big capital base is advantageous since it reduces risks and financial issues associated to Kenya's capital limitations, which led to Dubai Bank's receivership in 2015 and eventual liquidation. Due to alleged fraudulent operations at the bank, Imperial Bank was placed into receivership that same year. A bank run occurred at Chase Bank in April 2016. For its recovery, the Kenyan Central Bank had to establish a plan. Receivership of three minor banks had an effect on the interbank market's liquidity distribution, enhancing segmentation and sharply reducing the amount of interbank credit lines available to small and medium-sized banks (Kibet, 2014). All commercial banks have as their main objective financial performance since without it, they cannot sustain their operations over the long term.

The goal of corporate governance requirements is to promote effective management of the bank. Corporate governance is a set of principles that aims to ensure accountability, transparency, and fairness in an organization's operations. This is particularly crucial in financial institutions due to their significant impact on the economy and people's trust in financial system.

Accountability: Good corporate governance holds management accountable for their actions and decisions, ensuring that they act in the best interests of institution and its stakeholders.

Transparency: Transparent governance practices help build trust between the institution and its investors, clients, and the public. Openness in reporting financial performance and other relevant information is vital for maintaining credibility.

Organizational structure: Having a well-defined organizational structure with various offices and officers, such as a corporate secretary, helps streamline operations and maintain oversight.

Articles of Association: The constitution or articles of association containing specific clauses related to financial performance and governance can provide a framework for decision-making and ensure compliance with best practices.

Financial performance: Good corporate governance positively impacts a financial institution's financial performance, as it helps identify and mitigate risks, prevent mismanagement, and enhance operational efficiency.

Impact beyond joint stock corporations: Although joint stock corporations are frequently linked with corporate governance, family businesses, state-owned firms, and cooperatives can all benefit from it in order to achieve long-term profitability and performance.

Connection to public trust: Openness, clarity, honesty, and accountability are the hallmarks of good corporate governance, which boosts public confidence in the organization and promotes civic involvement.

In conclusion, implementing effective corporate governance practices is vital for financial institutions as it can lead to better financial performance, increased public trust, and reduced instances of mismanagement and corruption. By adhering to good governance principles, these institutions can maintain their credibility and support the general stability of the financial system.

The reserve requirement is indeed a regulation imposed by a central bank on commercial banks, dictating the minimum amount of customer deposits that each bank must keep as reserves. This requirement is used as a monetary control policy to influence country's borrowing powers and interest rates.

Adjusting reserve requirement ratio, the central bank can control the amount of money that banks can lend to customers. When the reserve requirement is increased, A greater amount of bank deposits must be held in reserves, reducing the funds available for lending. This can lead to higher interest rates and less borrowing, which can help curb inflationary pressures.

On other hand, when the reserve requirement is decreased, banks are left with more funds to lend, leading to lower interest rates and increased borrowing, which can stimulate economic growth.

However, as you mentioned, central banks tend to use other monetary policy tools, such as open market operations, more frequently than adjusting the reserve requirement. Open market operations encompass the purchase and sale of government securities as a means of influencing both the money supply and interest rates. This method is preferred because it offers more flexibility and immediate control over the money supply, and it does not create immediate liquidity problems for banks.

Changing the reserve requirement can indeed pose challenges, especially for banks with low excess reserves. If the reserve requirement is suddenly increased, some banks may not have enough reserves to meet the new requirement, potentially leading to liquidity issues and affecting their ability to lend. Hence, central banks often opt for open market operations as a more precise and less disruptive way to implement their monetary policies.

The Central Bank of Kenya plays a significant role in regulating and promoting transparency in the banking sector. One of its initiatives is the quarterly publication of commercial bank charges on loans. This information helps the public make informed borrowing decisions, as they can compare the lending rates of different banks.

By addressing lending rates for all banks, the Central Bank of Kenya aims to promote market discipline and competition among players in the banking industry. The quarterly survey on lending rates educates the public and empowers them to make informed banking decisions based on the prevailing interest rates.

Financial performance of banks is crucial for economic well-being of a country. Banks serve as intermediaries between borrowers and depositors, and their ability to use assets efficiently and generate sufficient revenues impacts the overall health of the economy.

Interest rates play a central role in the banking industry, as they are the main revenue stream for banks. The interest rate represents the amount paid by borrowers above the principal amount for using the lenders' funds over a specific period.

Governments and central banks across the world use interest rates as a strategic tool to influence and manipulate the economy. By adjusting interest rates, they can impact employment and inflation levels, making it a vital macroeconomic tool for policymakers.

Interest rate capping is a government intervention by legislation, employed when authorities believe that commercial banks are charging excessively high interest rates, and equilibrium levels of market forces have failed to be achieved. This measure is taken into consideration to ensure credit facilities remain accessible, also to the less affluent, by reducing the cost of funds.

Previously interest rate caps have been used in various business environments, both developed and developing, so as to achieve certain political and economic targets. After the 2008 economic crisis, many countries implemented interest rate caps or added more restrictions to stabilize their economies.

The responsibility for setting interest rates and implementing monetary policy lies with the Monetary Policy Committee. Higher interest rates can lead to increased costs of credit, resulting in decreased affordability, and vice versa.

Overall, interest rates and their regulation play a crucial role in shaping the economic landscape of the country, and Central Bank efforts to ensure transparency and market competition are essential for a well-functioning financial system.

1.2 Statement of the problem

Prudential regulations play crucial role in ensuring stability and soundness of banking sector. They are designed to establish standards and guidelines that banks must follow to maintain their financial health and minimize risks.

In Kenya, the Kenya Bankers Association conducted a study in 2015 on prudential regulations and their impact on financial health of banks. The study aims to examine how these regulations contribute to effective governance, financial reporting, risk reduction, improved performance, and overall growth in the banking sector.

It is clear that there is a strong desire to comprehend how regulatory requirements affect the functioning of commercial banks in Kenya. Agoraki, Delis & Pasiouras (2011): This study found that capital requirements have a positive effect on reducing credit risk, particularly for commercial banks with a larger market share. This suggests that having higher capital requirements can lead to improved stability and risk management for banks.

Ekong & Udonwa (2015): This study pointed out several policy options that can contribute to sustained commercial bank performance in Nigeria, including banking regulations. Although this study focuses on Nigeria, it highlights the importance of regulatory measures in enhancing the performance of commercial banks in the region.

Tsuma & Gichinga (2016): This study discovered that changes in capital requirements affect the monetary performance of commercial banks. When banks are required to increase their capital, funds that could have been lent out to generate interest income are instead set aside as capital, potentially impacting the banks' revenue.

Kirimi (2015): This study found that lending rates positively influence the financial stability of financial institutions, as lending rates significantly impact interest income, a critical component of their financial health.

The lack of extensive studies particularly assessing how prudential policies of the Central Bank of Kenya (CBK), based on CAMEL framework, have impacted the financial health of Kenyan commercial banks. International organizations like the Basel Committee on Bank Supervision and others frequently utilize and endorse the CAMEL framework for assessing the banks operational efficiency and effectiveness. Therefore, concentrating on this framework and its effect on the performance of Kenyan banks would probably offer useful insights for policymakers, regulators, and industry stakeholders.

It is essential to comprehend the connection between regulatory requirements and financial results, as well as the potential trade-offs between enhanced stability and the banks' ability to generate revenue and remain competitive. Such studies can guide policymakers in developing effective and Regulatory measures that foster both growth and stability within Kenya's banking industry.

1.3 Objectives of the study

1.3.1 Purpose of the Study

Influence of Regulatory Requirements imposed by Kenyan central bank on monetary performance of the banking sector in Embu town.

1.3.2 Specific Objectives

- i. To evaluate impact of corporate governance, a Kenyan central bank regulation, on monetary results of commercial banks in Embu Town.
- ii. To determine the impact of the minimum capital requirement, a Kenyan central bank regulation, on monetary results of commercial banks in Embu Town.
- iii. To evaluate the impact of reserve requirement, a Kenyan central bank regulation, on monetary results of commercial banks in Embu town.
- iv. To assess the effects of quarterly publishing of commercial bank charges on loans, on monetary results of commercial banks in Embu town.

1.4 Research questions

- i. To what degree does adherence to corporate governance, as mandated by the Central Bank of Kenya, influence the financial performance of commercial banks in Embu town?
- ii. To which degree does minimum capital as a central bank of Kenya regulatory requirement affect Economic performance of commercial banks in Embu town?
- iii. In what ways does the reserve requirement regulatory requirements imposed by the Central Bank of Kenya significantly shape the financial well-being of commercial banks in Embu town.?
- iv. What are the effects of quarterly publication of commercial bank charges on loans as a central bank of Kenya regulatory requirement regarding commercial banks' monetary performance?

1.5 Significance of the study

Study aims in contributing to area of strategic management by expanding knowledge of financial regulatory requirements. It focuses on understanding whether or not Central Bank of Kenya (CBK) should intervene financial distress. Study's findings and insights benefit various stakeholders, including:

Academicians in Financial Control Research: For researchers specializing in financial control and related areas, this study serves as a valuable resource. It can be used as a working document to explore and analyze the implications of CBK's intervention in financial distress scenarios. By providing new insights into regulatory requirements, the study aid academicians in developing deeper understanding of the role and impact of financial regulations on distressed financial institutions.

Researchers and Students in Business Administration: Students and researchers, both at the undergraduate and postgraduate levels, pursuing business administration studies find this study beneficial. Aspiring researchers can draw upon the findings and methodologies of this study to

inform their own research projects related to financial regulation and strategic management. For students studying business administration, the study provided a practical case to understand the role and significance of regulatory interventions in managing financial distress situations.

Central Bank of Kenya (CBK): The CBK itself benefit from the study's insights. The research may provide the CBK with valuable information and recommendations about the effectiveness of their intervention strategies in dealing with financial distress scenarios. By understanding the implications of their actions, the CBK can potentially improve and fine-tune their regulatory measures to better support financial stability in the country.

Financial Institutions and Industry Professionals: The study's findings were also of interest to financial institutions and professionals in the banking and finance industry. By shedding light on the regulatory requirements and the potential impacts of CBK intervention, the study can help these stakeholders make informed decisions and develop appropriate risk management strategies.

Government and Policy Makers: For policymakers and government officials responsible for shaping financial regulations and policies, the study can provide valuable insights into the effectiveness of regulatory interventions in managing financial distress. It may assist them in designing more robust and effective frameworks to safeguard stability of financial system. Overall, the results of this investigation should be beneficial in the understanding of financial regulatory requirements and their role in strategic management, benefiting a wide range of stakeholders in academia, industry, and policymaking

1.6 Scope of the study

Studies objective look at how central bank regulatory requirements affect commercial banks' financial results. The specific regulatory requirements being investigated are related to corporate governance, minimum capital requirement, reserve requirement, and the central bank's quarterly publication of commercial bank charges on loans.

Corporate Governance: Corporate governance relates to the code of conduct, practices, and processes by which a company's direction of control is laid upon. It includes relationships

among management, board of directors, shareholders, and other stakeholders. Study will likely examine how effective corporate governance practices affect a bank's financial performance and whether stricter regulations lead to better financial outcomes.

Minimum Capital Requirement: Capital requirement required to hold as percentage of their risk-weighted assets. It serves as a buffer against unexpected losses and aims to ensure stability of the banking system. The study may investigate how variations in the minimum capital requirement impact a bank's financial performance, such as profitability, risk management, and resilience during economic downturns.

Reserve Requirement: It is portion of customer deposits that banks are obligated to hold in reserve and not lend out. This requirement is set by the central bank and can influence a bank's lending capacity, liquidity, and profitability. The study could analyze the effects of changes in reserve requirements on a bank's lending behavior and overall financial performance.

Central Bank Quarterly Publication of Commercial Bank Charges on Loans: The central bank's publication of commercial bank charges on loans can influence consumer behavior and competition among banks. It may impact the interest rates and fees banks charge on loans, affecting their income and lending volume. The study might investigate how this transparency measure affects financial performance of commercial banks and if it leads to changes in customer preferences and banking behavior.

To conduct the study effectively, researchers will likely collect data on various financial indicators of commercial banks, Examples of metrics used to assess the performance of banks include return on assets (ROA), net interest margin (NIM), return on equity (ROE), loan portfolio quality, and capital adequacy ratios. They may also use statistical methods to analyze the data and draw conclusions about relationships between regulatory requirements and financial performance.

The timelines of this study will enable banks to produce information that will be valuable to stakeholder groups in the industry of banking.

1.7 Limitations of the study

Encountering constraints in research studies is common occurrence, and in the context of studying banks or financial institutions, there are indeed several potential constraints that researchers might face. Some major constraints include:

- **Confidentiality and Privacy Concerns:** As mentioned, banks deal with sensitive and confidential information of their clients, and they are often bound by legal and ethical obligations to protect this data. Respondents may be hesitant to share certain details, especially if they believe it could compromise the privacy of their customers or the bank itself.
- **Reluctance to Share Information:** Alongside confidentiality concerns, respondents might be generally hesitant to share certain information about their bank's operations, strategies, or financial performance due to competitive reasons or fear of repercussions.
- **Limited Access to Data:** Banks may restrict access to certain internal data, particularly when it involves proprietary or strategic information. Researchers might face challenges in obtaining comprehensive and detailed data for their study.
- **Sample Size and Representation:** Depending on the research scope, finding a sufficient and diverse sample of banks or respondents to ensure a representative study might be challenging. Limited participation from certain banks could affect the study's overall validity and generalizability.
- **Time Constraints:** Banks and financial institutions often operate in a fast-paced environment, and key personnel may have limited time to participate in research activities or complete lengthy questionnaires.
- **Resistance to Change:** If your research involves proposing changes or improvements to current banking practices, there might be resistance from the industry or certain banks to adopt new approaches.
- **Regulatory Hurdles:** Research involving financial institutions might have to navigate through additional regulatory requirements, which can add complexity and time to the study.

- **Language and Jargon:** Understanding and interpreting the technical language and jargon used in the banking industry might be challenging for researchers from non-financial backgrounds.

1.8 Delimitation

To address the constraints, researchers can consider the following strategies:

- **Assuring Confidentiality:** Clearly and succinctly inform participants that their data will be treated with utmost confidentiality and exclusively utilized for research purposes.
- **Anonymity:** Allow respondents to answer certain sensitive questions anonymously to encourage honest responses.
- **Building Trust:** Establishing a good rapport with key contacts within banks can help in gaining access to essential data and information.
- **Limited Scope:** Be mindful of the information you request and focus on obtaining data that is essential to your research objectives.
- **Collaboration with Banks:** Collaborating with banks on the research can provide insights into their concerns and potentially lead to better data access.
- **Clear Communication:** Clearly explain the purpose and benefits of the research to banks, demonstrating how it can be valuable for industry as a whole.
- **Ethics Approval:** Ensure that your research complies with all ethical considerations and obtain the necessary approvals from relevant bodies if required.

Ultimately, navigating these constraints will require careful planning, effective communication, and a willingness to adapt as the research progresses.

1.9 Definition of key terms

- **Liquidity Management:** It refers to financial institution's ability to meet all legitimate demands for funds, ensuring that it has enough liquid assets to cover its obligations without facing severe financial distress.
- **Bank Regulatory Requirements:** These regulations are governmental measures that impose specific requirements, restrictions, and guidelines on banks, aiming to ensure stability and safeguard depositors as well as the overall financial system.
- **Capital Requirement:** This concept, commonly known as capital adequacy, signifies the mandated level of working capital that a bank or financial institution must uphold in accordance with regulations established by its financial oversight authority. This capital functions as a protective buffer, helping to mitigate potential losses in unfavorable circumstances.
- **Reserve Requirement:** Central bank regulations stipulate the minimum portion of customer deposits that commercial banks are required to retain as reserves. These reserves, which cannot be lent out, serve as a protective measure against bank runs and liquidity crises..
- **Commercial Bank;** This entity is a financial institution that provides a range of services, encompassing the acceptance of deposits, provision of loans for both businesses and consumers, mortgage lending, as well as offering fundamental investment products such as savings accounts and certificates of deposit.
- **Financial Performance of Banks:** This term refers to overall profitability of a bank, taking into account its financial soundness, capacity for bearing risk, and proficiency in managing liquidity effectively.
- **Corporate Governance:** It involves accountability of a company's management in making routine financial decisions. It also includes financial ratios that analyze how much of the gross revenue is allocated to interest payments, operating expenses, depreciation, and the remaining balance for net bank income.

- **Basel Committee:** The Basel Committee on Banking Supervision serves as the principal global authority for establishing standards in prudential regulation within the banking industry. Its objective is to bolster financial stability by reinforcing the regulation, supervision, and operational practices of banks on a global scale. The committee achieves this goal by fostering cooperation and collaboration among its member countries.



CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

The chapter plays a crucial role in a research study, as it presents a comprehensive summary of existing knowledge and research conducted by other scholars in the same field of study. Its primary purpose is to provide a strong theoretical foundation for the current research, guaranteeing its pertinence to the research problem and objectives. The typical organization of this chapter is based on specific objectives to effectively address the research problem.

2.2 Theoretical literature

In endeavor to elucidate ramifications of central bank regulations Regarding the financial well-being of commercial banks in Kenya, numerous theories have been put forth. The regulatory requisites imposed by central banks have garnered considerable attention in both theoretical and empirical domains. Several studies have sought to evaluate the extent to which the regulatory framework shapes the conduct and performance of banks. In subsequent section, various theories, such as, will be expounded upon and discussed:

2.2.1 Agency Theory

Agency theory is a principle in economics and management that deals with the relationship between principals and agents. In many organizations, principals (such as shareholders, owners, or stakeholders) delegate decision-making authority to agents (such as managers, executives, or employees) to act on their behalf. However, there may be a misalignment of interests between principals and agents because agents may prioritize their own interests over those of the principals.

The principal-agent problem arises due to information asymmetry and the divergence of interests. Principals often face challenges in monitoring and controlling the behavior of agents, leading to potential conflicts of interest and agency costs. These costs can include managerial

compensation, monitoring expenses, and potential losses resulting from agent opportunism or moral hazard.

Agency theory seeks to mitigate these conflicts and costs by designing incentive mechanisms, such as performance-based compensation, stock options, and managerial contracts, to align the interests of principals and agents. Additionally, corporate governance mechanisms, such as board oversight and shareholder activism, play a crucial role in monitoring agent behavior and ensuring accountability.

Michael C. Jensen and William H. Meckling are the architects of agency theory, as elucidated in their groundbreaking paper titled "Theory of the Firm: Managerial Behavior, Agency Costs, and Ownership Structure," published in 1976. The paper is widely recognized as the foundational work for agency theory. This theory explains the significance of corporate governance on financial health of commercial banks (Sanda et al., 2016). In agency theory, the fundamental problem arises from the principal-agent relationship, where the principal (shareholders or owners) hires agents (managers) to act on their behalf. Agents may not consistently act in the principal's best interests because of conflicting interests, information asymmetry, and moral hazards. This situation can result in agency costs, which are the expenses borne by the principal when attempting to ensure that agents prioritize the principal's best interests. The application of agency theory to commercial banks suggests that these financial institutions may face Challenges stemming from the division of ownership and control include the presence of professional managers. who act as agents, run the banks on behalf of dispersed shareholders, the principals, and there might be a misalignment of interests. To reduce the agency problems in commercial banks, several mechanisms are proposed in the context of agency theory:

Managerial Incentive Mechanism: This involves designing compensation packages for managers that align their interests with those of shareholders. For example, tying executive compensation to the performance of the bank's stock or linking bonuses to achieving specific financial targets.

Dividend Mechanism: Paying out dividends can reduce agency problems by limiting the amount of excess cash available to managers for potentially wasteful projects. By distributing profits to shareholders, there's less temptation for managers to make overinvestment decisions.

Bonding Mechanism: Bonding mechanisms help reduce moral hazards by imposing constraints on managers. For example, requiring managers to hold a significant amount of the bank's stock or requiring personal guarantees can align their interests with those shareholders.

The board of Directors: Choosing reputable and independent board of directors can provide oversight and monitoring of managerial actions, reducing the agency problems.

Shareholder Intervention: Shareholders can directly intervene by voicing concerns, voting on important decisions, and advocating for changes in management or strategy.

Threat of Firing and Takeover: The threat of being fired or facing a hostile takeover by activist shareholders can motivate managers to operate in the best interest of shareholders.

These mechanisms are aimed at mitigating the agency problems that arise in commercial banks and promoting better corporate governance, ultimately leading to improved financial performance.

Eugene F. Fama 2018, a Nobel laureate in economics, has made significant contributions to agency theory through his research on various aspects of corporate governance, executive compensation, and the relationship between agency costs and firm performance. While Fama is perhaps best known for his work on efficient markets, his insights into agency theory have also been influential. Some key aspects of Eugene F. Fama's contributions to agency theory:

Fama's research spans various aspects of corporate governance and agency theory, with a focus on the implications of efficient markets. He contends that in such markets, where stock prices reflect all available information, shareholders become effective monitors of managerial behavior. Consequently, corporate governance mechanisms should prioritize facilitating information flow and market transparency to align managerial interests with those of shareholders. Additionally, Fama delves into executive compensation practices, advocating for performance-based schemes to tie managerial pay to firm performance, thereby aligning incentives. However, he acknowledges the complexity of designing optimal compensation contracts amidst uncertainty. Furthermore, Fama explores the detrimental impact of agency costs, such as managerial entrenchment and

conflicts, on firm value and profitability. He underscores the importance of effective corporate governance mechanisms, including board oversight and shareholder activism, in mitigating these issues. Lastly, Fama highlights the role of market discipline in regulating managerial behavior and reducing agency costs. He argues that competitive markets pressure firms to prioritize shareholder value, leading to efficient resource allocation and decision-making, with market-based mechanisms like takeovers and shareholder activism serving as crucial tools in this process.

Overall, Eugene F. Fama's contributions to agency theory underscore the importance of aligning the interests of managers with those of shareholders and designing effective corporate governance mechanisms to mitigate agency costs and enhance firm performance. His research has provided valuable insights into the dynamics of principal-agent relationships and their implications for corporate behavior and shareholder value.

Bengt Holmström, a Finnish economist and Nobel laureate, has made profound contributions to agency theory, particularly through his work on the design of optimal contracts in situations characterized by asymmetric information. Key contributions of Bengt Holmstrom to agency theory:

Holmstrom's seminal concept, the "informativeness principle," stands as a cornerstone of his contributions. This principle advocates for structuring compensation contracts to incentivize agents to disclose information regarding their actions and performance. By tying compensation to performance metrics that convey valuable insights to principals, agents are incentivized to exert effort and make decisions that optimize overall welfare.

Holmstrom's research illuminates the intricate dynamics of moral hazard and risk-sharing within agency relationships. He demonstrates that optimal contracts must strike a delicate balance between incentivizing effort and sharing risk between principals and agents, offering a pathway to mitigate moral hazard and achieve efficiency. Additionally, his work underscores the significance of multi-dimensional contracts in navigating the complexities of agency dynamics, particularly when agents' performance defies single-dimensional evaluation. By enabling incentives across various performance dimensions, multi-dimensional contracts facilitate nuanced management of agency issues, especially in multifaceted performance contexts. Holmstrom's exploration of

optimal contracting under uncertainty reveals the necessity of carefully tailored contracts in environments of unpredictability and incomplete information. These contracts must incentivize while allowing adaptability to unforeseen circumstances, emphasizing the role of adaptive contracting and dynamic incentives in mitigating agency problems amidst uncertainty. Furthermore, his research extends to corporate governance and compensation design, highlighting the pivotal role of mechanisms like boards of directors and executive compensation in addressing agency challenges. Holmstrom advocates for aligning managerial incentives with shareholder interests through suitable compensation structures and governance mechanisms, while acknowledging the complexity of designing optimal governance arrangements.

Generally, Bengt Holmstrom's contributions to agency theory have deepened our understanding of how to design optimal contracts and governance mechanisms to mitigate agency problems and align the interests of principals and agents. His insights have had a profound impact on both academic research and practical applications in the fields of economics, finance, and management. Oliver E. Williamson, an American economist and Nobel laureate, has made significant contributions to agency theory, particularly through his work on transaction cost economics and the theory of the firm. While Williamson's contributions extend beyond agency theory, his research has provided valuable insights into the nature of contractual relationships and governance mechanisms in mitigating agency problems. Contributions of Oliver E. Williamson to agency theory are;

Williamson's transaction cost economics framework delineates the pivotal role of transaction costs in determining the selection between market and hierarchical governance structures. He posits that when faced with asset specificity, uncertainty, and bounded rationality, firms may opt for internal governance mechanisms like hierarchical control to curtail transaction costs associated with opportunism and holdup. Furthermore, Williamson underscores the significance of asset specificity in shaping governance decisions and contractual arrangements, highlighting distinctions among physical, human, and site specificity and their impact on governance efficiency. In contexts where assets are uniquely tailored to specific transactions, hierarchical governance may be favored over market-based solutions to mitigate opportunistic behavior. Acknowledging the

inadequacy of formal contracting in addressing opportunism and holdup, Williamson advocates for relational contracting and adaptive governance mechanisms in complex and uncertain environments. His concept of "bounded rationality" underscores agents' cognitive constraints in foreseeing and addressing all potential sources of opportunism upfront. Moreover, Williamson's research delves into the nexus between governance structures and organizational performance, particularly concerning vertical integration and contractual arrangements. He suggests that firms may opt for vertical integration to internalize transaction-specific investments and diminish transaction costs linked with market exchanges, yet the performance outcomes vary contingent upon factors like asset specificity, market competition, and regulatory landscape. Lastly, Williamson's transaction cost economics framework reverberates through agency theory, illuminating the role of governance mechanisms in mitigating agency problems. He contends that hierarchical governance structures within firms aid in aligning principals' and agents' interests by mitigating the risk of opportunism and holdup, though the efficacy of these mechanisms hinges on transaction-specific characteristics and institutional context.

In conclusion, Oliver E. Williamson's contributions to agency theory have provided a valuable framework for understanding the nature of contractual relationships, governance mechanisms, and their implications for organizational behavior and performance. His insights have influenced both theoretical research and practical applications in the fields of economics, management, and organizational theory.

Together, these scholars have enriched agency theory by offering frameworks and concepts that help organizations design effective governance mechanisms, align incentives, and manage agency costs. Their research has practical implications for corporate governance, executive compensation, and organizational design, contributing to the development of strategies to enhance firm performance and shareholder value.

2.2.2 Capital Buffer Theory

In accordance with this theory, banks secure insurance against asset risk exposure by maintaining a surplus of wealth beyond the minimum regulatory requirement. In other words, banks hold a certain level of capital beyond what is mandated by regulators to act as a cushion against potential losses and uncertainties. This surplus is referred to as the "capital buffer." The capital buffer theory proposes that banks with insufficient capital buffers will seek to bolster them by raising additional capital. The purpose of building a stronger capital buffer is to be better prepared to absorb potential shocks or losses in case they arise. By having a larger capital buffer, banks can reduce the likelihood of facing financial distress or even collapse during adverse economic conditions or unexpected events.(Jokipii & Milne, 2011). This theory posits that as portfolio risk increases, the bank's capital should also increase in proportion to the level of risk.

Anil K. Kashyap, a prominent economist and Professor of Economics and Finance at the University of Chicago Booth School of Business, has made significant contributions to the understanding of capital buffers, banking regulation, and financial stability. While he may not have explicitly formulated a theory called "Capital Buffer Theory," his research has greatly influenced the development of regulatory frameworks and risk management practices in the banking sector. Key contributions of Anil K. Kashyap in this are:

Kashyap's research delves into the intricate connections among banking regulation, financial stability, and macroeconomic outcomes, with a particular focus on the role of capital buffers. He emphasizes the necessity of regulatory frameworks that bolster the resilience of the banking sector while fostering economic growth. Through empirical studies, Kashyap evaluates the efficacy of capital buffers in fortifying financial institutions against systemic risk and examines the impact of regulatory measures on banks' risk-taking behavior.

Additionally, his analysis extends to international financial regulation, where he scrutinizes the challenges of harmonizing regulatory standards across jurisdictions to address cross-border banking activities. Kashyap's policy-oriented approach includes proposals to strengthen capital buffers, enhance risk management practices, and tackle vulnerabilities in the financial system, making his insights invaluable to policymakers, central bankers, and international organizations striving to fortify financial stability.

Patrick Bolton, a distinguished economist and academic, has made significant contributions to the understanding of financial intermediation, banking regulation, and systemic risk management. While he may not have specifically formulated a theory called "Capital Buffer Theory," his research has certainly contributed to the broader understanding of capital buffers and their role in banking regulation and financial stability. The following are key contributions of Patrick Bolton in this area:

Bolton's research has primarily focused on designing regulatory frameworks to enhance financial stability and mitigate systemic risk within banking regulation and risk management. He scrutinizes the efficacy of capital buffers in diminishing the probability of bank failures and financial crises. His work underscores the necessity of aligning regulatory incentives with the goals of risk management and prudential supervision. Additionally, Bolton delves into optimal contracting and incentive alignment, exploring how different regulatory regimes influence the behavior of financial institutions. He highlights the significance of aligning managerial incentives with the long-term stability and sustainability of financial institutions.

Furthermore, Bolton investigates the ramifications of financial innovation and regulatory arbitrage on banking regulation and systemic risk management. He elucidates how banks might exploit regulatory loopholes for risky activities or off-balance-sheet transactions, emphasizing the need for regulatory adaptability to evolving market dynamics and technological advancements.

Bolton's research also extends to market discipline and transparency's role in fortifying financial stability, exploring how mechanisms like disclosure requirements and investor monitoring complement regulatory endeavors to foster sound banking practices. He emphasizes the importance of information transparency and market discipline in mitigating agency issues and reducing systemic risk. Moreover, Bolton's research often yields policy implications and reform proposals to bolster banking regulation and risk management practices.

His recommendations encompass measures to enhance capital buffers' effectiveness, refine risk assessment methodologies, and address regulatory deficiencies, shaping regulatory discussions and guiding policymakers' decisions.

While Patrick Bolton's contributions may not be explicitly labeled as "Capital Buffer Theory," his research has significantly advanced our understanding of capital buffers, banking regulation, and financial stability. His insights into the incentives, behavior, and risk management practices of financial institutions have informed regulatory reforms and contributed to the ongoing efforts to enhance the resilience of the global financial system. Douglas Diamond, an influential economist and Professor of Economics at the University of Chicago Booth School of Business, has made significant contributions to the field of banking and financial economics. His work has greatly influenced our understanding of capital buffers, banking regulation, and financial stability. Here are some key contributions of Douglas Diamond in this area:

Diamond's contributions to the understanding of banking and financial economics are extensive and influential, particularly in elucidating the dynamics of bank runs and liquidity risk. His seminal work with Philip Dybvig in 1983, "Bank Runs, Deposit Insurance, and Liquidity," remains a cornerstone in the field, providing a model that explains why banks, despite solvency, may encounter runs due to liquidity mismatches between assets and liabilities. This research underscores the vital role of liquidity buffers and regulatory measures in averting systemic banking crises.

Furthermore, Diamond's research delves into the relationship between capital structure and financial fragility within banking systems. He analyzes how banks' capital adequacy influences their stability and resilience to shocks, emphasizing the importance of capital buffers in absorbing losses and upholding confidence during periods of stress. Additionally, Diamond's contributions extend to optimal bank regulation, where he investigates the trade-offs between regulatory measures aimed at bolstering financial stability and the potential costs of excessive regulation on banks' lending activities and

economic growth. His insights inform discussions on designing regulatory frameworks that balance safety and soundness objectives effectively.

Moreover, Diamond has explored the role of market discipline and bank monitoring in mitigating agency problems and systemic risk. His research examines how creditors, shareholders, and other market participants discipline banks' risk-taking behavior through monitoring and investment decisions, emphasizing the significance of transparency, disclosure, and investor confidence in fostering market discipline and financial stability. Lastly, Diamond's work delves into the analysis of systemic risk and financial interconnectedness within banking systems, exploring how the structure of financial networks and the transmission of shocks through interconnected institutions can amplify systemic risk and lead to contagion. His research provides valuable insights into the systemic implications of capital buffers and regulatory interventions, contributing significantly to the understanding of financial stability and systemic risk management.

Raghuram Rajan, an esteemed economist and former Governor of the Reserve Bank of India, has made substantial contributions to various areas of economics and finance, including banking regulation and financial stability, his research and policy work have significantly influenced our understanding of capital buffers, banking regulation, and systemic risk management. Here are some key contributions of Raghuram Rajan in this area:

Financial System Stability: Rajan has extensively studied the stability of financial systems and the factors that contribute to financial crises. His research emphasizes the importance of robust regulatory frameworks, including capital buffers, to enhance the resilience of banks and mitigate systemic risk. Rajan's insights have informed policy discussions on strengthening banking regulation and crisis prevention.

Bank Capital and Risk Management: Rajan has analyzed the role of bank capital in mitigating risks and enhancing financial stability. He has emphasized the importance of adequate capital buffers to absorb losses during periods of economic stress and uncertainty.

Rajan's research highlights the trade-offs between capital requirements, risk-taking behavior, and the stability of the banking sector.

Regulatory Reform Proposals: Rajan has proposed various regulatory reforms aimed at enhancing the effectiveness of capital buffers and risk management practices in banking. He has advocated for stricter capital requirements, stress testing, and improved risk assessment methodologies to address vulnerabilities in the financial system. Rajan's policy recommendations are influential in shaping regulatory debates and responses to financial crises.

Market Discipline and Transparency: Rajan has explored the role of market discipline and transparency in promoting financial stability. He has analyzed how market-based mechanisms, such as disclosure requirements and investor monitoring, can complement regulatory efforts to mitigate systemic risk. Rajan's research underscores the importance of information transparency and accountability in fostering market discipline and reducing moral hazard.

International Financial Regulation: Rajan has also contributed to the analysis of international financial regulation and coordination efforts among regulatory authorities. He has examined the challenges of implementing consistent regulatory standards across different jurisdictions and the implications for cross-border banking activities. Rajan's insights inform discussions on the harmonization of regulatory frameworks to address global financial stability concerns.

Adi Sunderam, a Professor of Business Administration at Harvard Business School, has made significant contributions to the understanding of banking and financial regulation..

The following are some key contributions of Adi Sunderam in this area:

Sunderam's research delves into the intricate nexus of banking regulation and risk management, focusing on their design and implications for financial stability. His analyses elucidate the pivotal role of capital buffers in curbing systemic risk and averting banking crises, offering valuable insights into the delicate balance between capital requirements, risk-taking behavior, and banking sector stability. Furthermore, Sunderam explores the relationship between bank capital and credit provision to the real economy, investigating how capital adequacy influences lending decisions, economic growth, and financial stability. His findings underscore the significance of capital buffers in supporting banks' lending activities while upholding prudential standards.

Moreover, Sunderam's research often encompasses policy implications and reform proposals to fortify banking regulation and risk management practices. Through various measures proposed to strengthen capital buffers, refine risk assessment methodologies, and address regulatory gaps, Sunderam's policy insights enrich discussions on regulatory reforms and crisis prevention strategies. Additionally, Sunderam delves into the ramifications of financial innovation and regulatory challenges for banking regulation and systemic risk management. His analyses delve into how technological advancements, market developments, and regulatory changes impact the efficacy of capital buffers and prudential supervision, informing policymakers' responses to evolving market dynamics and technological disruptions.

Lastly, Sunderam extends his research to the realm of financial intermediation and corporate finance, exploring the roles of banks and financial institutions in capital allocation, risk-sharing, and economic growth. By shedding light on the intricate interactions between banking regulation, financial markets, and the real economy, Sunderam's research provides valuable insights into the functioning of financial systems and the promotion of economic stability.

2.2.2 Loanable theory

As described in the passage, is an economic concept that originated from the Swedish economist Knut Wicksell. Its goal is to elucidate how interest rates are determined through the interplay of the supply of loanable funds (savings available for lending) and the demand for credit (funds required for investment and other purposes). This theory takes into account both monetary and non-monetary factors to grasp fluctuations in income levels (Wensheng, Wung, and Shu, 2012).

In accordance with loanable funds theory, the equilibrium interest rate is at which demand for loans equals supply of funds available for lending. At equilibrium, both savers (those supplying funds) and investors (those demanding funds) are content. Changes in the interest rate occur due to fluctuations in either demand for loans or the supply of available funds. Ngugi (2011) contended that interest represents price at which demand for loanable funds aligns with supply of loanable funds.

Supply of funds available for lending is influenced by people's savings and the addition of money to the economy, often through credit creation by banks. Conversely, the demand for loanable funds is shaped by the need for investment and the inclination to hold money (Turnovsky, 1985).

The implications of the loanable funds theory have an impact on banks, savers, and borrowers. According to the theory, these two groups should receive fair compensation at the equilibrium interest rate.. The interest rate spread, which refers to the difference between the rate at which banks lend money and the rate they pay to savers, should not be excessively wide, so both parties feel satisfied and not exploited. The goal is to structure interest rates in a way that all parties involved feel comfortable and fairly treated Emmanuelle (2003) argued.

John Maynard Keynes, a prominent economist of the 20th century, is best known for his work "The General Theory of Employment, Interest, and Money," which challenged the classical economic theory prevailing at the time, including the loanable funds theory.

Keynes' contribution to the understanding of interest rates and investment behavior was groundbreaking and influential. Here are Keynes' contribution:

Keynes introduced the liquidity preference theory, which posits that interest rates are primarily determined by the demand and supply of money, rather than the supply and demand for loanable funds as suggested by conventional theories. Central to Keynes' theory is the notion that individuals and businesses hold money not only for transactions but also for precautionary and speculative motives, reflecting their preference for liquidity. This preference influences their willingness to hold money rather than invest in long-term assets, potentially leading to situations where interest rates do not adjust adequately to equate saving and investment, as assumed in the loanable funds theory.

Moreover, Keynes introduced the concept of "animal spirits" to describe the psychological factors shaping investment decisions, emphasizing the role of investor confidence and future expectations in driving investment levels, independent of interest rates. This insight challenges the loanable funds theory's premise that investment decisions are solely influenced by interest rate considerations. Furthermore, Keynes' theory of aggregate demand emphasizes the significance of effective demand in determining output and employment levels, contrasting with the loanable funds theory's focus on financial market dynamics.

Keynesian economics underscores the potential for monetary and fiscal policies to manage aggregate demand and stabilize the economy, particularly during economic downturns or recessions. This approach diverges from the loanable funds theory's reliance on interest rate adjustments alone to balance saving and investment. Overall, Keynes' theories have profound policy implications, especially in the realm of macroeconomic stabilization, advocating for active government intervention to manage economic fluctuations and promote stability.

James Tobin, an influential economist and Nobel laureate, made significant contributions to macroeconomics, monetary theory, and financial economics. Some of key contribution are:

Tobin expanded upon Keynes' liquidity preference theory by integrating considerations of risk into individuals' demand for money, positing that people hold money not solely for transactions but also as a hedge against uncertainty and to accommodate fluctuating liquidity needs. This perspective underscores the significance of risk aversion and uncertainty in shaping the demand for money and influencing interest rates. Additionally, Tobin's portfolio choice theory delves into how individuals distribute their wealth among various assets, including money, bonds, stocks, and real assets. He introduced the "Tobin's separation theorem," which delineates the process of determining the optimal risky portfolio separately from deciding the allocation to risk-free assets like money or bonds. Furthermore, Tobin introduced the concept of "q" as a gauge of the relationship between a firm's market value and the replacement cost of its assets.

According to Tobin's q theory, firms' investment decisions are swayed by the relationship between market value and replacement cost, with higher q values signaling more favorable investment prospects. Tobin's research also delves into the transmission mechanism of monetary policy and its impact on interest rates and economic activity, contending that central banks can shape interest rates and aggregate demand through adjustments in the money supply and monetary policy tools like open market operations and discount rates. Moreover, Tobin made notable contributions to the efficient market hypothesis and financial asset pricing, exploring the implications of rational expectations and market efficiency for asset valuation, investment choices, and resource allocation within financial markets.

Ben Bernanke, an economist and former Chairman of the Federal Reserve, has made significant contributions to the understanding of monetary economics and macroeconomic policy. Here are some ways in which Bernanke's contributions relate to the loanable funds theory:

Monetary Policy and Interest Rates: Bernanke's research and policy decisions as Chairman of the Federal Reserve have centered on the management of interest rates and the implementation of monetary policy tools. He has emphasized the importance of central bank actions in influencing short-term interest rates, which play a key role in the loanable funds market.

Financial Intermediation and Credit Markets: Bernanke's expertise in financial intermediation and credit markets provides insights into the functioning of the banking sector and its relationship to the loanable funds theory. His research on bank lending, credit supply dynamics, and the transmission mechanism of monetary policy sheds light on how changes in interest rates affect borrowing and investment decisions by households and businesses.

Liquidity Provision and Financial Crises: Bernanke's academic work on liquidity provision and financial crises addresses some of the key issues related to the loanable funds theory. He has studied the role of central banks as lenders of last resort and the importance of liquidity support in stabilizing financial markets during periods of stress.

The Great Depression and Macroeconomic Stabilization: Bernanke's research on the Great Depression and his role in implementing policy responses to the 2008 financial crisis offer valuable lessons for understanding the dynamics of interest rates, credit markets, and aggregate demand. His insights into the causes of financial crises and the effectiveness of monetary and fiscal policy interventions contribute to our understanding of macroeconomic stability and economic growth.

Secular Stagnation and Low Interest Rates: Bernanke has contributed to the debate on secular stagnation and the implications of persistently low interest rates for monetary policy and economic performance. His analysis of factors driving long-term interest rates, such as demographic trends, productivity growth, and global savings dynamics, offers insights into the challenges facing central banks in the current economic environment.

2.2.3 The Economic Theory of Regulation

Proposed by Arrow (1985), this theory posits that the means to address the shortcomings of unbalanced markets, imperfect competition, and undesirable market outcomes is government regulation (F. M, 2014). The government, specifically through the central bank, regulates banks in accordance with the public interest perspective to promote the efficient functioning of banks by mitigating market failures, ultimately benefiting civil society at large. Notably, the significance of this model underscores that Central Bank of Kenya, as regulator of commercial banks, must consistently monitor liquidity positions of banks to prevent market failures.

The economic theory of regulation also examines the role of government intervention in markets to correct market failures and promote economic efficiency. It provides a framework for understanding the rationale behind regulatory interventions, the design of regulatory policies, and their impact on market outcomes. Here are some key components of the economic theory of regulation:

The economic theory of regulation acknowledges that markets may fail to allocate resources efficiently due to various factors, including externalities, imperfect competition, information asymmetry, and the nature of public goods. Such market failures can yield outcomes that are suboptimal from a societal standpoint, leading to inefficiency and welfare losses. Regulation becomes justified when market failures impede the achievement of socially optimal outcomes, prompting government intervention to correct these failures and enhance economic efficiency. This intervention may involve internalizing externalities, fostering competition, safeguarding consumer interests, and providing public goods. Regulatory efforts encompass both economic and social dimensions, with economic regulation targeting industry-specific behavior to promote competition and prevent market power abuse, while social regulation addresses broader societal goals like health, safety, environmental protection, and consumer rights. Regulators utilize diverse instruments, such as price and quantity regulation, quality standards, licensing requirements, and information disclosure, selected based on the nature of market failure, industry characteristics, and regulatory objectives. Crucially, the economic theory of regulation underscores the necessity of conducting cost-benefit analyses to evaluate regulatory interventions' effectiveness and efficiency, weighing factors like compliance costs, administrative burden, and overall welfare impacts.

However, challenges like regulatory capture, where vested interests influence regulatory agencies to prioritize their own agendas, pose risks to effective regulation. Moreover, regulatory interventions can have dynamic effects on market behavior, innovation, and economic growth, influencing firms' incentives for research and development, technology adoption, and market participation. Understanding these dynamics is crucial for assessing regulation's long-term impact on economic performance.

2.2.4 Empirical review

In exploration of performance of Kenya's commercial banks, numerous studies have predominantly concentrated on monetary policy and various facets of bank performance. Across these studies, the literature consistently highlights that Kenya has received relatively less attention, underscoring the necessity for additional information to inform planning. This study serves as an effort to bridge the knowledge gap within the Kenyan banking sector.

Prof. Njuguna Ndung'u, a prominent Kenyan economist and academic, served as the Governor of the Central Bank of Kenya (CBK) from 2007 to 2015. During his tenure, Ndung'u made several contributions to the analysis and oversight of the performance of commercial banks in Kenya. Some of his notable contributions include:

Under Ndung'u's leadership, the Central Bank of Kenya (CBK) regularly released Banking Sector Stability Reports, offering comprehensive evaluations of the performance and health of commercial banks in Kenya. These reports delved into vital metrics like profitability, asset quality, liquidity, and capital adequacy to gauge the overall stability and resilience of the banking sector. Ndung'u prioritized bolstering regulatory oversight and prudential supervision of commercial banks to safeguard financial stability and safeguard depositors' interests.

Introducing measures to fortify risk-based supervision, stress testing, and compliance monitoring, he aimed to mitigate risks and vulnerabilities in the banking sector. Moreover, Ndung'u championed initiatives to advance financial inclusion, especially in rural and marginalized areas, supporting the establishment of microfinance institutions and mobile banking services to reach unbanked populations and spur inclusive economic growth. Tackling the persistent challenge of

non-performing loans (NPLs), Ndung'u implemented strategies to enhance loan classification and provisioning standards, elevate credit risk management practices, and refine debt recovery mechanisms. He also spearheaded policy reforms and improvements to the regulatory framework governing Kenya's banking sector, advocating for the adoption of international best practices such as Basel III capital standards and risk management guidelines.

Recognizing the potential of digital banking technologies, Ndung'u supported innovation and the adoption of services like M-PESA, creating regulatory conditions conducive to their expansion while ensuring financial stability and consumer protection. Additionally, he stressed the importance of transparency, accountability, and corporate governance in the banking sector, urging banks to uphold sound governance practices, transparency in financial reporting, and robust internal controls to foster trust and confidence among stakeholders.

Overall, Prof. Njuguna Ndung'u made significant contributions to the performance of commercial banks in Kenya through his leadership at the Central Bank of Kenya. His efforts to strengthen regulatory oversight, promote financial inclusion, address NPLs, and foster innovation have helped to enhance the resilience and stability of Kenya's banking sector, supporting sustainable economic development and inclusive growth.

Dr. Eric K. M. Munene, an economist and researcher, has made notable contributions to the analysis and understanding of the financial performance of commercial banks in Kenya. While specific empirical studies conducted by Dr. Munene on this topic may vary, his research generally focuses on various aspects of banking sector performance, including profitability, efficiency, risk management, and regulatory compliance. Here are some potential contributions of Dr. Munene to the analysis of commercial banks' financial performance in Kenya:

Dr. Munene's research likely encompasses a broad array of topics pertinent to the performance and operations of commercial banks in Kenya. Through empirical studies, he may have delved into profitability analysis, scrutinizing metrics like net interest margins, return on assets (ROA), return on equity (ROE), and operational efficiency ratios to gauge the financial health and competitive standing of these banks. Moreover, his research may extend to assessing efficiency, where he

scrutinizes cost-to-income ratios, overhead costs, and productivity measures to identify areas of inefficiency and devise strategies for enhancing cost management and operational effectiveness within the banking sector. Dr. Munene may also delve into risk management practices within Kenyan commercial banks, evaluating their handling of credit, liquidity, and market risks, along with the efficacy of regulatory oversight in mitigating these risks and ensuring financial stability.

Additionally, his contributions may encompass studies on regulatory compliance and corporate governance standards, examining banks' adherence to prudential regulations, accounting norms, and governance codes, and assessing how these factors impact financial performance and stability. Furthermore, Dr. Munene's research may investigate the influence of macroeconomic factors such as economic growth, inflation, interest rates, and exchange rate volatility on the performance and operations of commercial banks in Kenya, providing insights into how these variables shape bank profitability, credit quality, and liquidity management. Lastly, he may engage in comparative studies, benchmarking Kenyan banks against their counterparts in other countries or regions to discern industry trends, regulatory environments, and market dynamics, thereby offering valuable insights into Kenya's banking landscape within a global context.

Overall, Dr. Eric K. M. Munene's contributions to the analysis of financial performance in the Kenyan banking sector are likely to provide valuable insights for policymakers, regulators, investors, and other stakeholders. His research may help inform policy decisions, regulatory reforms, and strategic planning efforts aimed at enhancing the stability, efficiency, and resilience of Kenya's banking system.

2.3 Corporate governance and financial performance

Corporate governance process within a bank is multifaceted framework. This governance structure involves various stakeholders, including the bank's shareholders, its management team and employees, and the board of directors. Additionally, banks function within a distinct framework of public oversight, overseen by bank supervisors and governed by an extensive body of banking laws and regulations. The interplay among all these elements plays a pivotal role in determining how effectively a bank's performance aligns with the interests of its shareholders while also

adhering to public objectives. Consequently, for investigators and regulators alike, this corporate governance framework within banks holds paramount importance in the success and day-to-day operations of a bank.

Corporate governance plays a pivotal role in shaping firm's financial performance. It acts as a preventive measure to ensure that company avoids potential financial distress and operates in a responsible and sustainable manner. The governance structure of a firm influences how it responds to external factors, which, in turn, affects its overall financial performance.

According to Donaldson (2010), well-managed firms tend to exhibit improved performance compared to those with poor or no corporate governance structure. This is because effective governance practices lead to better decision-making, risk management, and accountability, all of which contribute to the firm's success.

One significant benefit of having a solid corporate governance structure is that it makes the business more attractive to investors. Davis (2012) points out that investors are more likely to invest in companies that have strong corporate governance practices in place. This, in turn, helps the firm raise funds more easily, providing a solid financial foundation for its operations and growth. On the contrary, firms with weak governance structures may struggle to attract investors and may face financial difficulties.

The empirical research examining the connection between corporate governance and financial performance has yielded diverse findings. In their study on corporate governance and bank performance, Brown and Caylor (2017) discovered that companies with weaker corporate governance structures tend to exhibit lower profitability. They further noted that such firms could carry higher risk profiles and distribute fewer dividends.

Conversely, various studies, including those conducted by Gompers. (2019), Marry and Stangeland (2018), and Klapper and Love (2016), have established positive correlation between governance standards and bank performance. These studies have shown that higher governance scores are associated with improved profitability ratios.

However, it is worth noting that research is not unanimous, and Bauer et al. (2018) made a surprising discovery, as they identified a negative correlation between governance scorecards and performance. It's possible that these differing results may be influenced by various factors, such

as the specific industries studied, the measurement of corporate governance, or the methodologies used in the research.

In conclusion, good corporate governance is essential for financial success and sustainability of firm. While there is evidence supporting the positive results of strong governance on financial health, conflicting results in the literature also highlight the complexity of the relationship and the need for further research in this area. Nonetheless, most studies emphasize the importance of implementing effective corporate governance practices to enhance a firm's financial performance and reduce the risk of financial distress.

2.4 Minimum Capital Requirement and monetary Performance

Different research has been conducted to investigate effects of capital capital sufficiency y on financial performance of commercial banks and savings and credit co-operative societies (SACCOs) in Kenya. Here are some key findings and conclusions from each study:

Alemayeh (2014) focused on commercial banks in Kenya and analyzed capital adequacy using financial ratios. Capital adequacy ratio was found to be more applicable to the monetary performance of commercial banks. There was a notable and inverse correlation between capital sufficiency and bank size. Asset quality and liquidity did not show a significant relationship with financial stability. Study recommended managers of commercial banks in Kenya should ensure sufficient capital levels to enhance financial performance. They should also invest in more assets to enjoy economies of scale, effectively manage credit risk, maintain cost efficiency, and ensure adequate levels of liquidity.

Clair (2014) Study also focused on commercial banks in Kenya but analyzed capital adequacy based on financial regulations and profitability. Capital adequacy was found to be important for financial stability in the Kenyan economy, improved credit risk management, and reduced vulnerability to liquidity shocks. Capital adequacy affected financial performance of commercial banks in Kenya. Smaller banks without the minimum capital requirements were advised to merge or seek additional capital injection, while middle-tier banks sought capital from stock markets through rights and bond issues.

Almazari (2014) This study looked at effects of capital adequacy on monetary performance in savings and credit co-operative societies (SACCOs) in Kenya. Capital adequacy was found to be beneficial for meeting regulatory requirements, managing credit risk, and facilitating growth. Challenges related to reduced payout on members' lending capacity were observed. SACCOs that adhered to capital adequacy requirements were found to have profited from it and overcame challenges related to capital separation and ratio calculations. Strategies to increase capital were also implemented.

The Kenya Centre for Research conducted a study highlighting the advantages of capital adequacy, including the limitation of excessive risk-taking by shareholders with limited liability, the facilitation of risk-sharing between owners and depositors, and the reduction of the risks associated with bank collapse and insolvency. Banks with elevated capital levels were considered more capable of offering services to both corporate entities and households during financial difficulties, enabling them to fulfill their lending responsibilities effectively. Nevertheless, some scholars contended that capital requirements impose costs on banks. Overall, these studies emphasize the importance of capital adequacy in enhancing financial performance, stability, and risk management for both commercial banks and savings and credit co-operative societies in Kenya. Adequate capital levels are seen as a protective measure against financial distress and insolvency, enabling financial institutions to better serve their customers and contribute to the overall health of the economy. However, there are differing perspectives on the costs associated with capital requirements.

2.5 Reserve requirement and financial performance

Extensive research has been conducted in the past to examine the relationship between alterations in reserve requirements set by central banks, specifically through Cash Reserve Ratio (CRR) and Statutory Liquidity Ratio (SLR), and financial performance of banks. This financial performance is typically assessed using widely accepted metrics such as Return on Assets (ROA), Return on Equity (ROE), and Return on Investment (ROI).

A positive correlation between CRR and SLR and bank profitability has been found by (UREMADU2012). Their examination of CRR-related factors within the economy spanning from 1980 to 2006 revealed a favorable influence on banking profitability. However, they also identified

adverse effects stemming from balances held with central bank, inflation rates, and foreign private investments. They discovered that balances with the central bank come in second to gross national savings and foreign private investments in terms of importance to bank earnings. Liquidity ratio comes in third.

In his paper on "cash reserve ratio and the bank lending channel in China," Laurent (2015) claims that the cash reserve ratio is one of the most successful strategies in China for managing the money supply and maintaining the target inflation rate. A shift in the cash reserve ratio indicates a policy intention to restrict or expand bank lending. A higher cash reserve ratio makes it harder for businesses to extend loans to its deficit units, which hurts their performance. The central bank has more choice when deciding on the cash reserve ratio, making it more immediate in its effects. This is an advantage of employing the cash reserve ratio over interest rates.

Lending rates have been noted to exhibit a positive correlation with banks' profits, suggesting that an uptick in lending rates can potentially bolster banks' profitability. However, when incorporating the Bank Rate and Cash Reserve Ratio (CRR) into the regression analysis, the coefficient becomes statistically insignificant in elucidating the relationship between bank profitability and monetary policy instruments, particularly in the case of public sector banks. This implies that the Reserve Bank's rigorous credit policy, designed to mitigate inflationary pressures, persists in governing and overseeing the banking sector.

Significantly, CRR plays a substantial role in influencing both interest rates and the liquidity of banks, as highlighted by K. Ravi Teja in 2015. Moreover, alterations in CRR demonstrate an inverse correlation with domestic investor institutions but a direct correlation with foreign institutions.

Fluctuations in the cash reserve ratio directly impact the stock market and the overall economy. Observations indicate that in instances of rising inflation due to excess liquidity, an escalation in CRR results in upward shifts in repo rates and reverse repo rates, subsequently influencing borrowing costs for industries.

2.6 Publications of bank charges and financial performance

Understanding how interest rates affect a bank's financial performance requires considering two key principles. Firstly, banks make a profit from the difference between the lending rates they charge borrowers and the deposit rates they offer to customers. This profit is known as the lending spread, which narrows when the yield curve flattens. (Genay, 2014).

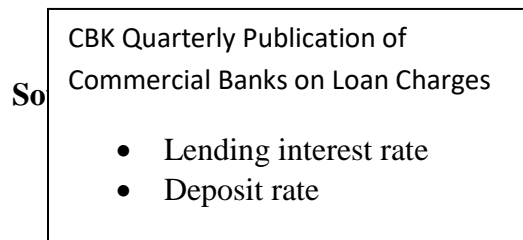
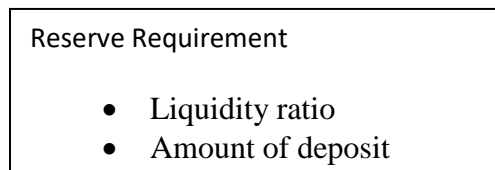
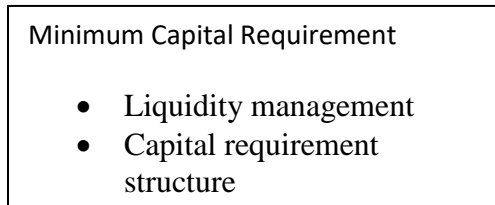
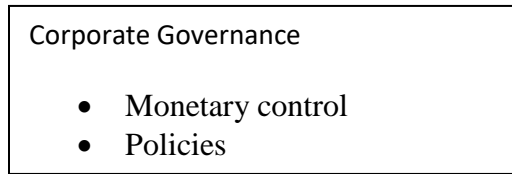
Secondly, higher interest rates can negatively impact a bank's financial performance because they decrease the present discounted value of the bank's assets. Banks usually maintain fixed-income assets like loans and bonds. When interest rates increase, the value of these assets may decline, potentially resulting in losses for the bank. Additionally, banks may face greater losses when the duration of their assets (i.e., the time until the assets generate cash flows) exceeds the duration of their liabilities (the time until they have to repay their obligations) (King, 2015).

The correlation between interest rates and the financial health of commercial banks has been the focus of extensive research efforts. For example, a study conducted by Sattar and Khan (2014) concluded that interest rates exert a significant influence on a bank's interest income. Their research also indicated a strong link between financial stability of commercial banks and interest rates they offer to investors, emphasizing the inseparable nature of this relationship.

In summary, the persistently high interest rates in Kenya and the government's efforts to regulate them. It also discusses how interest rates affect a bank's financial performance, focusing on the lending spread and the impact of higher interest rates on the present value of bank assets. The empirical relationship between interest rates and financial well-being of commercial banks is emphasized through the findings of previous studies.

2.8 Conceptual Framework

Independent Variables



Dependent Variables

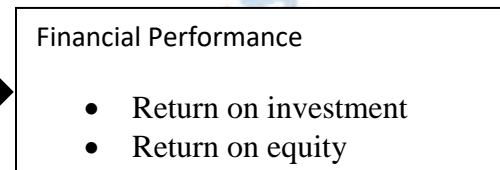


Figure 2.1 Conceptual Framework

The conceptual framework outlined above elucidates the relationship between the independent and dependent variables. In this research, the dependent variable, which signifies financial performance, is captured through proxies such as return on equity (ROE) and return on investment. These proxies align with indicators of bank profitability. The independent variables (minimum capital requirement, reserve requirement, corporate governance, and CBK quarterly publishing of commercial banks on loan charges) are imposed by central banks.

The conceptual framework presupposes a linear connection between the variables and was created from the literature study outlined above.

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Introduction

This chapter outlines the various approaches employed for conducting the study, encompassing aspects such as research design, population selection, sample design, data collection techniques, procedures, and data analysis.

3.2 Research Design

The research design is a descriptive research design, which aims in obtaining information about current situation or phenomena and describe them without manipulating variables. This type of research is suitable when you want to gather factual information and understand the existing conditions, practices, and relationships related to the research variables. (Kothari, 2014)

A survey is a common method used in descriptive research designs and is appropriate for this study (Mugenda Mugenda, 2003). Surveys involve collecting data from sample of participants using questionnaires or interviews to gather information about their attitudes, opinions, behaviors, or experiences related to the research topic. The data collected through surveys can then be analyzed using descriptive statistics to summarize and present the findings accurately. (Bryman, 2006)

3.3 The Target population

Population is defined as all cases or individuals who share common observable characteristics. In this case, the population consists of eight commercial banks in Embu town that are licensed and registered under the Banking Act.

The target respondents for the study are specific roles within these banks, namely branch managers, operation managers, credit supervision, debt recovery, and risk and compliance department employees. These individuals were chosen because they play crucial roles in the performance of their respective banks and have a deeper understanding of how regulatory

requirements set by the Central Bank of Kenya (CBK) influence financial performance of their banks.

By selecting these employees as respondents, the research aims to gain valuable insights into how CBK regulations have affected financial health of commercial banks in Embu town. This targeted approach ensures the study to captures perspectives from key stakeholders who possess relevant knowledge and expertise on the subject matter.

3.4 Data Collection Procedure

Primary data is collected using a questionnaire. Researcher will take questionnaires to respondents who will be branch managers in various banks. The respondents will be expected to respond to the questionnaire which will be collected by the researcher for analysis. The questionnaire will adopt a Likert scale ranging from 1-5.

3.5 Sampling and Sampling Procedures

Collecting data from the entire population is unfeasible due to its size and time constraints faced by the researcher. Therefore, it is necessary to choose sample that can effectively represent entire population. In this study, stratified random sampling is the preferred method for selecting departments to which questionnaires are distributed. This approach was well-suited because the population exhibited heterogeneity. Mugenda and Mugenda (2003) suggest that 30% representation of target population is considered adequate.

3.6 Data Validity and Reliability

Mugenda and Mugenda (2003) emphasize the importance of data collection instruments in ensuring the accuracy of collected data, specifically in terms of validity and reliability.

Validity is the extent to which results obtained from analyzing data truly represent the phenomenon being studied. In other words, it assesses whether the data collection instruments measure what they are intended to ascertain. To enhance validity, researcher used objective questions in questionnaire, which means the questions are clear and straightforward, leaving little room for misinterpretation by respondents. Additionally, seeking guidance from a supervisor and obtaining input from experts can further improve the validity of the research instruments. Their insights and

expertise can help ensure that the chosen questions and methods align with the research objectives and accurately capture the intended phenomenon.

Reliability, on other hand, refers to consistency and stability of results obtained from research instruments. When instruments are reliable, they should produce consistent results when applied repeatedly to same group or population under similar conditions. Achieving reliability involves using methods and instruments that minimize potential biases and errors, allowing for the repetition of the study to yield similar outcomes. While the passage does not explicitly mention the steps taken to ensure reliability, it is generally ensured through careful design, piloting, and consistency in administering the data collection instruments.

In summary, the accuracy of data collected in a research study is heavily dependent on validity and reliability of data collection instruments. Validity ensures that instruments accurately measure the intended phenomenon, while reliability ensures that the instruments yield consistent results upon repeated use. By incorporating objective questions and seeking guidance from supervisors and experts, the researcher increases the validity of the instruments, while careful design and administration processes enhance their reliability.

3.7 Data analysis and Data presentation

Data collection process using a structured questionnaire is a common and effective method for gathering information from respondents. Ensuring completeness, reliability, and accuracy of the data is crucial for validity and integrity of study's findings. Using descriptive statistics, such as pie charts, frequencies, tables, graphs, and percentages, is a standard approach to summarize and present the data. These visual aids can help readers and researchers quickly understand the patterns, distributions, and relationships within the data.

A popular and effective method for social science research is the use of Statistical Package for Social Science (SPSS) for quantitative data analysis. It enables researchers to do different statistical tests and analyses to learn more from the data. Investigating the link between dependent variable (commercial banks' financial well-being) and independent variable (bank regulations) is best done by using a linear regression model to look at how banking regulations affect financial performance. As a gauge of financial success, return on equity (ROE) is applied in this instance.

Regression analysis often use the Fischer distribution test (F-test) to evaluate the model's overall relevance. It aids in determining if the model as a whole fits the data well and whether independent variables have a substantial impact on dependent variable when taken together. The researcher may need to take into account additional variables that might affect financial performance, such as macroeconomic conditions, market competition, and bank-specific features, in order to properly comprehend result of banking rules on financial health.

The generally suggested technique is well-structured and acceptable for researching how regulatory requirements affect Kenyan commercial banks' financial performance. However, quality of data gathered and proper interpretation of findings in light of research question will also play a role in study's success. The regression model utilized was as follows:

$$Y = a + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \epsilon$$

Where:

Y = Return on equity (Dependent variable).

a = Constant

β_1 = Coefficient of capital regulation requirement

β_2 = Coefficient of liquidity requirement ratio

β_3 = Coefficient of

X1 = Capital requirement

X2 =

ϵ = Error

3.8 Ethical Considerations

Seeking research permit from National Commission for Science, Technology and Innovation (NACOSTI) is essential to ensure that research complies with national regulations and guidelines. Additionally, obtaining formal permission from the bank managers of Kenya Commercial Bank and Family Bank is crucial to access data from the target respondents, as it ensures transparency and cooperation with the banks involved. Obtaining informed consent from all participants is a fundamental ethical requirement in research involving human subjects. This ensures participants are fully aware of research's purpose, potential risks, and benefits, and voluntarily agree to take part. Excluding respondents who are unwilling to participate is also a necessary step in upholding the principles of voluntary participation and respecting individual autonomy.

Maintaining confidentiality and anonymity of respondents is vital in protecting their privacy and personal information. By not indicating the identity of respondents on data collection tools, the researcher ensures that the information gathered cannot be linked back to specific individuals, thereby preserving their confidentiality.

Lastly, using the information solely for academic purposes aligns with ethical research practices, as it ensures that the data collected is used only for the intended research study and not for any other purposes without the participants' consent.

The steps taken by the researcher demonstrate a commitment to conducting the research in an ethical and professional manner. These considerations are vital for academic research projects, ensuring the protection of participants' rights and the credibility of study's results.

CHAPTER FOUR

DATA ANALYSIS, PRESENTATION AND DISCUSSION

4.1 Background of Statistics

The gender of respondents is fifty nine point one percent (59.1%) of respondents are male and forty point nine percent (40.9%) of respondents are female. From these findings most of the respondents were males. Fifty nine point one percent (59.1%) of respondents are aged between 25 to 30 years, twenty two point seven percent (22.7%) are aged between 31-35 years, and four point five percent (4.5%) are aged between 36 to 40 years and thirteen point six percent (13.4%) of respondents are aged above 41 years. Most of the respondents are aged between 25 to 30 years in this commercial banks from this findings. From findings four point five percent (4.5%) of the respondents have done CIFA, sixty eight point two percent (68.2%) of the respondents have done degree and twenty seven point three percent (27.3%) of the respondents have masters level. Most of the respondents have degree level in their education. Twenty two point seven percent (22.7%) of the respondents have worked for less than one year; forty five point five percent (45.5%) of the respondents have worked for 2 to 5 years have worked as finance manager in this institution, twenty seven point three percent (27.3%) of respondents have worked for 6 to 10 years and four point five percent (4.5%) of the respondents have worked for 11 years and above. Most of respondents have worked for 2 to 5 years.

4.2 Reserve Requirement

The researchers sought to find out if reserve requirement is one of major challenges that commercial banks face during start-up process and it negatively affect the performance of commercial banks. Thirteen point six percent (13.6%) of respondents strongly agree, seventy two point seven percent (72.7%) of respondents agree with the statement, four point five percent (4.5%) of respondents were uncertain while another four point five percent (4.5%) of respondents disagree with the statement and four point five percent (4.5%) of respondents strongly disagree.

Most of the respondents depicted reserve requirements is one of major challenges that commercial banks face during the start-up process, onsequently, this has a detrimental impact on the performance of commercial banks. In alignment with this study, it asserts that an augmentation in the capital base of banks enhances performance by allowing them to broaden the scope of their activities within the industry, mitigate risks, ensure quality asset management, and establish a robust liquidity position (Aderinokun, 2004). The summarized findings are presented in Table 4.1 below.

Table 4.1 Reserve requirements is one of the major challenges that commercial banks

	Frequency	Percent	Valid Percent	Cumulative Percent
Strongly Agree	3	13.6	13.6	13.6
Agree	16	72.7	72.7	86.4
Uncertain	1	4.5	4.5	90.9
Disagree	1	4.5	4.5	95.5
Strongly Agree	1	4.5	4.5	100.0
Total	22	100.0	100.0	

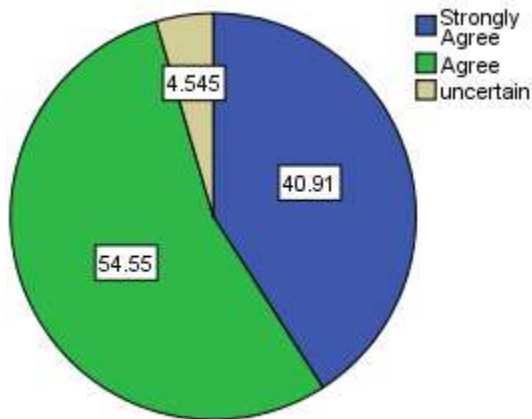
Researchers sought to find out if reserves requirement serve as a safeguard against a sudden inordinate demand for withdrawals. Forty five point five percent (45.5%) depicted strongly agree that reserve requirement serve as a safeguard against a sudden inordinate demand for withdrawals. Forty percent (50%) of respondents agree with the statement while four point five percent (4.5%) of respondents were uncertain about it. These findings indicate that reserve requirements act as a safeguard against a sudden and excessive demand for withdrawals. Building on these results, Whitehead (2005) contends that well-capitalized banks are more competitive. They can expand their product offerings both locally and offshore, thereby establishing a broader network coverage. Moreover, well-capitalized banks can competitively price their products and fund a diverse array of transactions across sectors. Finding summary are presented in Table 4.2 below.

Table 4.2 Reserve requirements serve as a safeguard against a sudden inordinate demand

	Frequency	Percent	Valid Percent	Cumulative Percent
Strongly Agree	10	45.5	45.5	45.5
Agree	11	50.0	50.0	95.5
Uncertain	1	4.5	4.5	100.0
Total	22	100.0	100.0	

Figure 4.1 below depicted if maintenance of minimum reserve requirements creates confidence to stakeholders which is crucial to overall financial well-being of commercial banks. forty point nine percent (40.9%) of respondents strongly agree, four point five four percent (4.54%) of respondents were uncertain and fifty four point five five percent (54.55%) of respondents agree that maintenance of minimum reserve requirements creates confidence to stakeholders in overall financial performance of commercial banks in contrast, Banks that are sufficiently capitalized will also have the capability to provide longer loan repayment periods and operate more efficiently in comparison to other banks, a benefit derived from enhanced information technology systems (Whitehead, 2005).

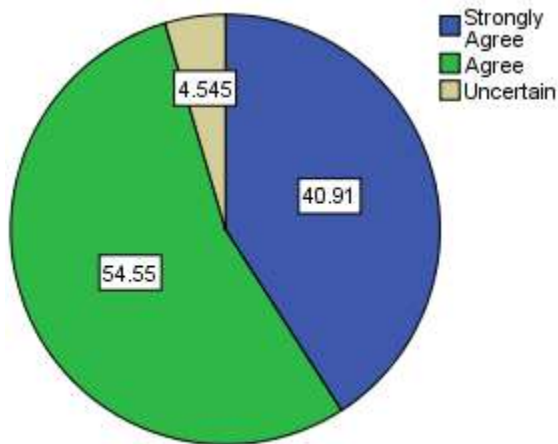
Figure 4.1 maintenance of minimum reserve requirements



4.3 Minimum Capital

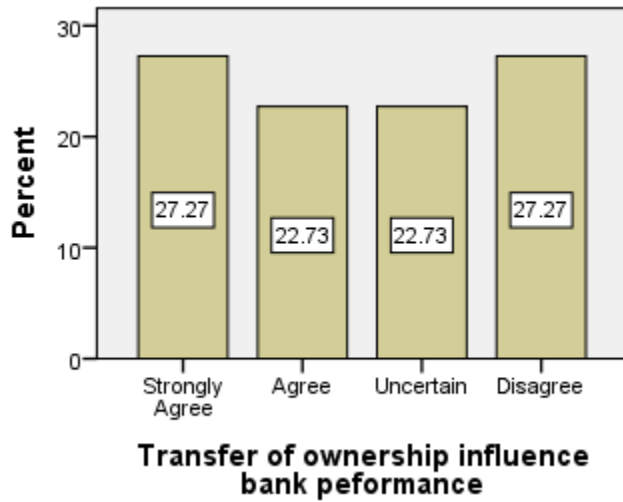
Figure 4.2 below postulates if capital requirement is one of effects of CBK regulatory requirements on financial performance. Forty point nine one percent (40.91%) strongly agree, fifty four point five five percent (54.55%) Certainly, the acknowledgment that capital requirements constitute an effect of Central Bank of Kenya (CBK) regulatory requirements on financial health is a notable observation. It aligns with the view that higher capital requirements, as suggested by Tieman (2004), can potentially limit competitive pressures on banks in terms of loans, deposits, and various sources of debt and equity investment. However, it's worth noting that 4.54% of respondents expressed uncertainty on this matter, indicating a diversity of perspectives or perhaps a need for further clarification among a subset of participants.

Figure 4.2 capital requirements is one effect of CBK regulatory



The researchers sought to find out if transfer of ownership influence bank performance, twenty seven point two seven percent (27.27%) of respondents depicted that they strongly agree. Twenty seven point seven three percent (27.73%) of respondents agree that transfer of ownership influence bank performance. Another twenty two point seven three (22.73%) were uncertain and twenty two point seven two percent (22.72%) of respondents disagree this study contrast with this, The statement Indicates a positive correlation between lending rates and the profitability of banks. In other words, an increase in lending rates is believed to contribute to higher profitability for banks. This aligns with the common understanding that, generally, higher interest rates on loans can potentially enhance a bank's profit margins, as it allows them to earn more from interest income on loans extended to borrowers. However, it's essential to consider various factors, including market conditions and the overall economic environment, as they can influence the dynamics between lending rates and bank profits. (Rao, 2006) summary presented below in figure 4.3

Figure 4.3 Transfer of ownership influence bank performance



The researchers sought to find out if capital requirement structures of banks are highly regulated. Thirty one point eight percent (31.8%) of respondents, eighteen point two percent (18.2%) of respondents agree, while forty five point five percent (45.5%) of respondents were uncertain and four point five percent (4.5%) of respondents disagree that capital requirements structures of banks is highly regulated. As presented below in table 4.3

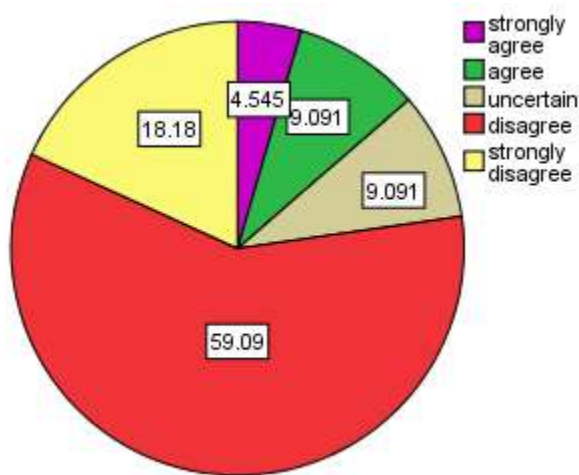
Table 4.3 Capital requirement structures of banks is highly regulated

	Frequency	Percent	Valid Percent	Cumulative Percent
Strongly agree	7	31.8	31.8	31.8
Agree	4	18.2	18.2	50.0
Uncertain	10	45.5	45.5	95.5
Disagree	1	4.5	4.5	100.0
Total	22	100.0	100.0	

The researchers sought to find out if high capital requirements in banks lead to low profits, four point five four (4.54%) of respondents strongly agree Posits that elevated capital requirements in banks result in reduced profitability, nine point zero nine percent (9.09%) of respondents agree, nine point zero nine percent (9.09%) of the respondents were uncertain, fifty nine point zero nine

percent (59.09%) of respondents disagree that The statement suggests a belief that high capital requirements in banks can lead to low profits. This perspective aligns with the idea that when banks are required to maintain higher levels of capital, it may limit their ability to leverage funds for lending or investment, potentially impacting their profit margins and eighteen-point one eight percent (18.18%) of respondents strongly disagree. From this finding elevated capital in banks does not leads to low profits (Rao, 2006). As illustrated in figure 4.4 below.

Figure 4.4 Elevated capital requirement in banks leads to low profits



The researchers aimed to determine whether a bank possesses the capability to supervise and oversee its systems for calculating minimum capital requirements, nine point zero nine percent (9.09%) of respondents strongly agree while fifty nine point zero nine percent (59.09%) of survey respondents agree and thirty one point eight two percent (31.82%) respondents were uncertain. From these findings it is depicted that exalted capital requirement in banks leads to reduced profitability, (K. Ravi Teja, 2013). Additionally, fluctuations in CRR exhibit an inverse relationship with domestic investor institutions and a direct relationship with foreign institutions. These findings are depicted in Figure 4.5 below.

Figure 4.5 bank is able to supervise and oversight their systems

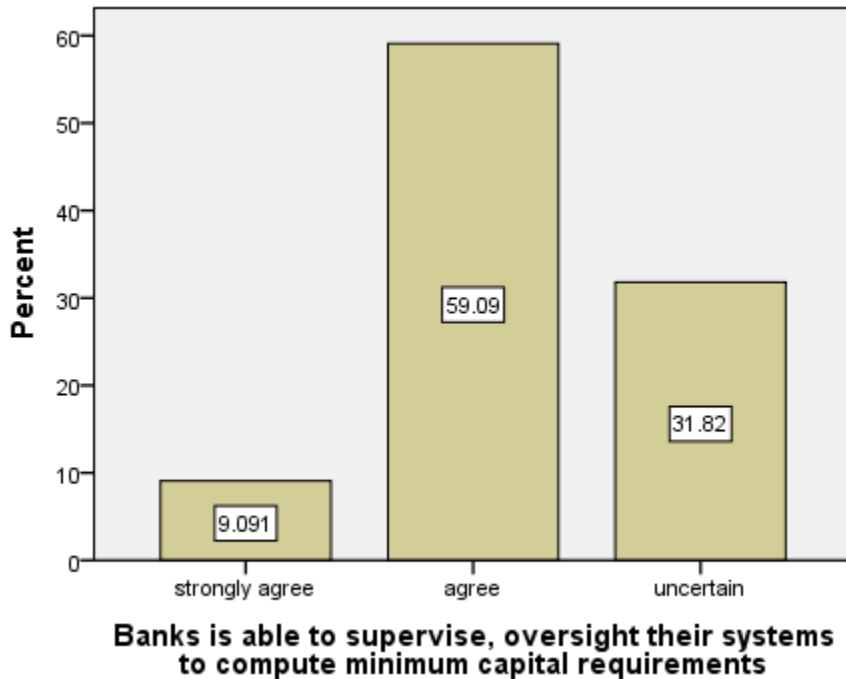


Table 4.4 below depicts If there is a policy in this bank regarding the definition of capital requirements that goes beyond cash or government security, it raises the question of whether regulatory and supervisory authorities verify the source of this capital or not, eighteen point two percent (18.2%) of the respondents postulated strongly agree, fifty four point five percent (54.5%) of respondents indicated they agree while twenty seven point three percent (27.3%) of respondents were uncertain. From these findings it is concluded that policy regarding definition of capital requirements extends beyond cash or government securities, encompassing a broader range of assets. Whether regulatory and supervisory authorities verify source of capital depends on specific regulations and practices in place.

Table 4.4 A policy addressing the definition of capital requirements that extends beyond cash or government security.

	Frequency	Percent	Valid Percent	Cumulative Percent
strongly agree	4	18.2	18.2	18.2
agree	12	54.5	54.5	72.7
uncertain	6	27.3	27.3	100.0
Total	22	100.0	100.0	



4.4 Corporate Governance

From table 4.5 below, fifty nine point one percent of the respondents depicted strongly agree that bank has clear list of share owned by members of the Board of Directors, thirteen point six percent (13.6%) of respondents agree while twenty two point seven percent (22.7%) of the respondents were uncertain and four point five percent (4.5%) of respondents disagree that is bank does not have clear list of share owned by members of Board of Directors From these findings, it is evident that the bank maintains a clear list of shares owned by members of the Board of Directors. This provides strong evidence that both internal and external factors exert a significant influence on the profitability of the banks (Sehrish Gul, 2011).

Table 4.5 The bank maintains a transparent record of shares owned by members of the Board of Directors

	Frequency	Percent	Valid Percent	Cumulative Percent
strongly agree	13	59.1	59.1	59.1
agree	3	13.6	13.6	72.7
uncertain	5	22.7	22.7	95.5
disagree	1	4.5	4.5	100.0
Total	22	100.0	100.0	

The researchers aimed to determine if the firm publishes and distributes its financial results and management analysis. Fifty percent (50%) of the respondents strongly agree that the firm indeed publishes and distributes its financial results and management analysis. Forty five point four five percent (45.45%) of respondents agree with the statement and four point five four percent (4.54%) of survey participants were uncertain about the statement. This findings means firm disseminates its financial results and management information through publication and distribution (SehrishGul, 2011). As below in table 4.6

Figure 4.6 The firm disseminates and circulates its financial results and management analysis.

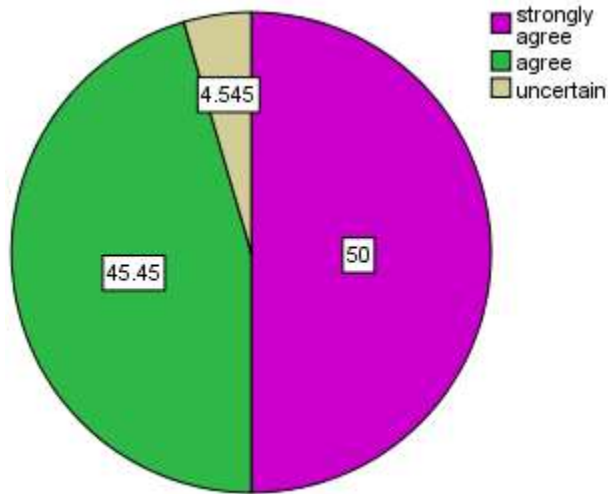


Table 4.6 below postulates if The audit section of the firm is fulfilling its duties as anticipated, seventy seven point three percent (77.3%) of respondents indicated that they strongly agree and twenty two point seven percent (22.7%) of respondents depicted they agree that audit section of the firm is fulfilling its responsibilities as anticipated. From this it is concluded audit section of the firm is executing its duties as anticipated.

Table 4.6 The audit section of the firm is carrying out its responsibilities as anticipated.

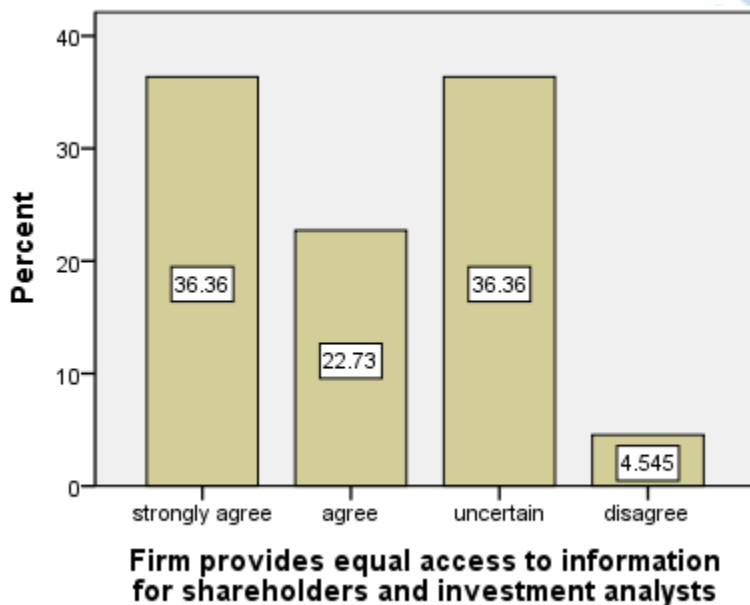
	Frequency	Percent	Valid Percent	Cumulative Percent
strongly agree	17	77.3	77.3	77.3
agree	5	22.7	22.7	100.0
Total	22	100.0	100.0	

The researcher sought to find out if a bank Engages in self-assessment with regard to good corporate governance.

thirty six point three six percent (36.36%) of the respondents strongly agree that The firm ensures equal access to information for both shareholders and investment analysts.

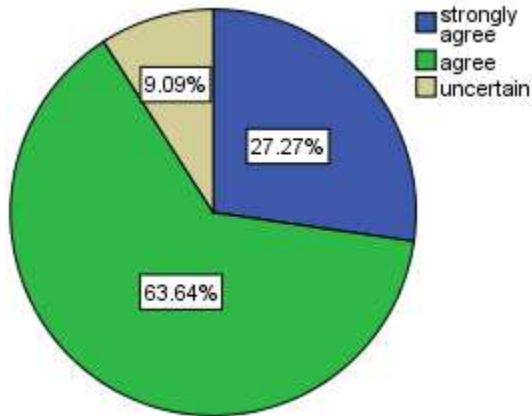
Twenty two point seven three percent (22.73%) of respondents agree with the statement while another thirty six point three six percent (36.36%) of respondents were uncertain and four point five four percent (4.54%) of respondents disagree firm ensures equitable access to information for both shareholders and investment analysts. From these findings it is found that The firm guarantees fair and equal Access to information is provided equally to both shareholders and investment analysts. (Haiying Pan, 2012) discovered that altering the reserve ratio does not have a direct impact on controlling surplus liquidity, preventing inflation, or regulating lending activity. The summarized findings are presented in Figure 4.7 below.

Figure 4.7 Banks holds self-assessment of good corporate governance



The researchers sought to find out Whether the bank conducts regular self-assessments of good corporate governance. , sixty three point six four percent (63.64%) of respondents agree with the statement, twenty seven point two seven percent (27.27%) of respondents strongly agree and nine point zero nine percent (9.09%) of respondents were uncertain. From these findings it is found that bank routinely conducts self-assessments of its adherence to good corporate governance practices. The findings are summarized in figure 4.8 below

Figure 4.8 The bank consistently conducts self-assessments of good corporate governance.



From table 4.7 below, four point five percent (4.5%) of respondents strongly agree that there are potential conflicts of interest between the bank and the member of its Board of Directors, thirteen point six percent (13.6%) of respondents agree with the statement, twenty two point seven percent (22.7%) of respondents were uncertain while forty point nine percent (40.9%) of respondents disagree while eighteen point two percent (18.2%) of respondents depicted strongly disagree. From these findings the researchers found out that anticipated conflicts of interest exist between the bank and its Board of Directors.

Table 4.7 potential conflicts of interest between the bank and Board of Directors

	Frequency	Percent	Valid Percent	Cumulative Percent
strongly agree	1	4.5	4.5	4.5
agree	3	13.6	13.6	18.2
uncertain	5	22.7	22.7	40.9
disagree	9	40.9	40.9	81.8
strongly disagree	4	18.2	18.2	100.0
Total	22	100.0	100.0	

The researchers aimed to determine if the bank has a well-written corporate governance framework, including policies specifying the duties of the Board of Directors (BODs), disclosure rules, and shareholders' rights. The findings indicated a clear code of conduct or ethics, fifty percent (50%) of the respondents strongly agree and another fifty percent (50%) of the respondents agree on the same statement. Summary of findings are below in 4.9

Figure 4.9 bank has well written corporate governance

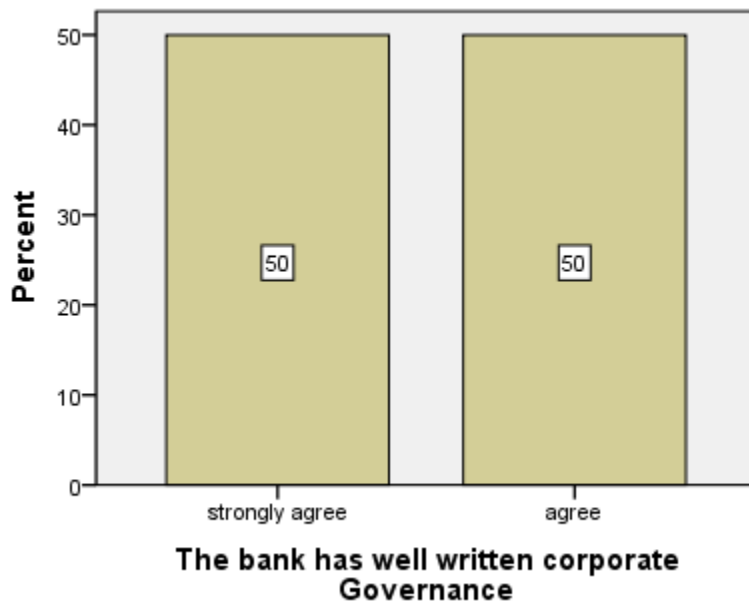


Table 4.8 illustrates if proper utilization of financial information has led to an increase in profit of commercial banks, twenty seven point three percent (27.3%) of respondents strongly agree, twenty two point seven percent (22.7%) of respondents agree that proper utilization of financial information influence profitability of the commercial banks. thirty one point eight percent (31.8%) of participants were uncertain about the statement and lastly eighteen point two percent (18.2%) of respondents strongly disagree. From this it is found that proper utilization of financial information influences profitability (Haiying Pan, 2012)

Table 4.8 Proper utilization of financial information on profitability

	Frequency	Percent	Valid Percent	Cumulative Percent
strongly agree	6	27.3	27.3	27.3
agree	5	22.7	22.7	50.0
uncertain	7	31.8	31.8	81.8
disagree	4	18.2	18.2	100.0
Total	22	100.0	100.0	

The researchers sought to find out if increased efficiency has helped to save costs, twenty two point seven percent (22.7%) of respondents strongly agree, forty point nine percent (40.9%) of respondents postulates that they agree while thirty six point four percent (36.4%) of respondents were uncertain on the question. From this study it is found that increased financial efficiency help to save cost.

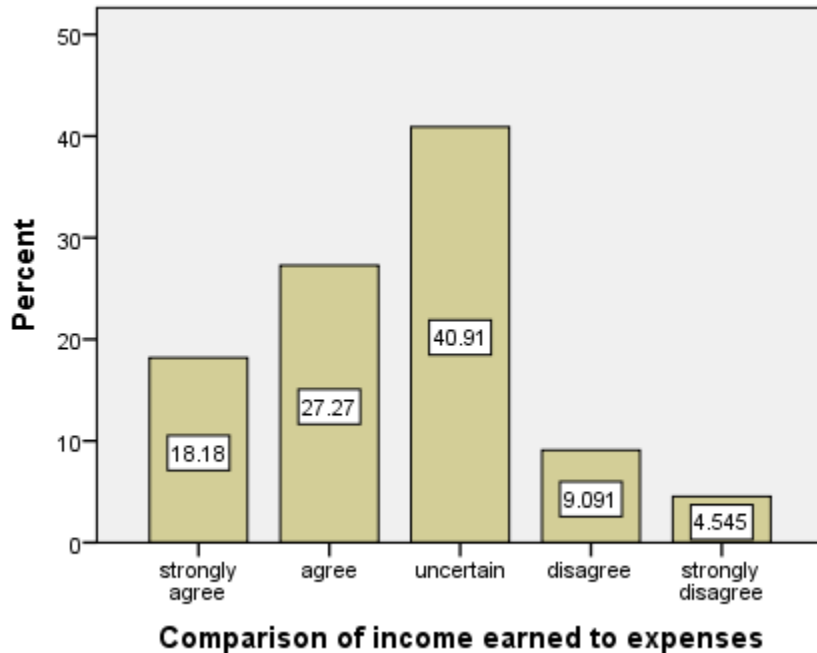
Table 4.9 Increased financial efficiency has helped to save cost

	Frequency	Percent	Valid Percent	Cumulative Percent
strongly agree	5	22.7	22.7	22.7
agree	9	40.9	40.9	63.6
uncertain	8	36.4	36.4	100.0
Total	22	100.0	100.0	

Figure 4.10 below depicts if comparison of income earned to expenses incurred positively affect financial performance of commercial, eighteen point one eight percent (18.18%) of respondents strongly agree, twenty seven point two seven percent (27.27%) of respondents agree, forty point nine one percent (40.91%) of respondents were uncertain. Nine point zero nine percent (9.09%) of the respondents disagreed with the statement and four point five four percent (4.54%) of respondents strongly agree on the question. From this findings it is depicted that comparison of

income earned to expenses incurred positively affect financial performance of commercial. (SehrishGul, 2011)

Figure 4.10 comparison of income earned to expenses



The researchers sought to find out if disclosure of financial information reduce information asymmetry and thereby will lower uncertainty which in turn will reduce the cost of capital. Nine point one percent (9.1%) of respondents postulated strongly agree on the question, thirty six point four percent (36.4%) of the respondents agree while fifty percent of respondents were uncertain and four point five percent (4.5%) of respondents disagree that disclosure of financial information reduce information asymmetry. From this it is found that respondents are not aware if disclosure of financial information asymmetry will lower uncertainty and reduce cost of capital which in line with this .A rise in interest rates is good for MFIs due to higher returns on new investments, increased profit margins on loans (study (Were and Wambua, 2013).The findings are summarized in table 4.10 below

Table 4.10 Disclosure of financial information reduce information asymmetry

	Frequency	Percent	Valid Percent	Cumulative Percent
strongly agree	2	9.1	9.1	9.1
agree	8	36.4	36.4	45.5
uncertain	11	50.0	50.0	95.5
disagree	1	4.5	4.5	100.0
Total	22	100.0	100.0	



CHAPTER FIVE

SUMMARY OF FINDINGS, CONCLUSIONS AND RECOMMENDATIONS

5.1 Summary of Findings

This study examined effects of regulatory requirements by central bank of Kenya on financial performance of commercial banks in Embu town. The general objectives of this study were to determine **central bank of Kenya regulatory requirement and financial performance of commercial banks in Kenya, Case of Embu Town**. The specific objectives were; to find out the effects of corporate governance as a central bank of Kenya regulatory requirement on financial performance of commercial banks in Embu town; to establish the effects of minimum capital as central bank of Kenya regulatory requirement on financial health of commercial banks in Embu town; to assess the effects of reserve requirement as a central bank of Kenya regulatory requirement on financial performance of commercial banks in Embu town; to determine the effects of quarterly publication of commercial bank charges on loans as a central bank of Kenya regulatory requirement on financial performance of commercial banks in Embu town; To explore the comprehensive impacts of regulatory requirements set by the Central Bank of Kenya on the financial performance of commercial banks in Embu town.. Fifty nine point one percent of respondents were male and forty point nine percent of the respondents were female. Also fifty nine point one percent of respondents are aged between 25 to 30 years thus most of respondents are aged between 25 to 30 years in commercial banks. Sixty eight point two percent of the respondents have done degree and twenty seven point three percent of the respondents have masters level. Therefore most of respondents have degree level in their education. Forty five point five percent of respondents have worked for 2 to 5 years as credit manager in this institution, twenty seven point three percent of respondents have worked for 6 to 10 years and four point five percent of respondents have worked for 11 years and above thus most of the respondents have worked for 2 to 5 years.

According to objective one which depicts to find out the effects of corporate governance as a central bank of Kenya regulatory requirement on financial performance, seventy two point seven percent of respondents agree that reserve requirement is one of the major challenges that

commercial bank face during the start-up process, four point five percent of the respondents were uncertain while another four point five percent of survey respondents disagree. Researchers sought to find out if reserves requirement serve as a safeguard against a sudden inordinate demand for withdrawals. Forty five point five percent depicted strongly agree that reserve requirement serve as a safeguard against a sudden inordinate demand for withdrawals and forty percent of the respondents also agree that reserves requirement serve as a safeguard against a sudden inordinate demand for withdrawals.

Fifty four point five percent of respondents agree that maintenance of minimum reserve requirements creates confidence to stakeholders in overall financial performance of commercial banks.

Derived from objective two, this aims to ascertain the impact of the minimum capital requirement, a regulatory mandate by the Central Bank of Kenya, on financial performance. Fifty-four point five percent of respondents affirm that capital requirements are indeed one of the effects of CBK regulatory measures on financial well-being, while four point five four percent express uncertainty. Additionally, twenty-seven point seven three percent of respondents acknowledge that the transfer of ownership has an influence on bank performance. Another twenty two point seven three of the respondents were uncertain and twenty two point seven two percent of the participants disagree. Four point five four of survey respondents strongly agree that abundant capital requirements in banks leads to low profits, fifty nine point zero nine percent of respondents disagree that high capital requirement in banks leads to low profits and eighteen point one eight percent of the respondents strongly disagree on the same. Fifty nine point zero nine percent of respondents agree and thirty one point eight two percent respondents were uncertain. From these findings it is depicted that high capital requirement in banks leads to low profitability. From these findings it is concluded that policy concerning definition of capital requirement beyond cash or government security.

Based on objectives three this depicts to assess the effects of reserve requirement as a central bank of Kenya regulatory requirement on financial performance, fifty nine point one percent of survey

respondents depicted strongly agree bank has clear list of share owned by members of the Board of Directors, thirteen point six percent of survey participants agree while twenty two point seven percent of the respondents were uncertain and four point five percent of respondents disagree that bank does not have clear list of share owned by members of Board of Directors. Fifty percent of respondents strongly agree that firm disseminates its financial results and managerial analysis through publication and distribution. Seventy seven point three percent of respondents indicated that they strongly agree and twenty two point seven percent of the respondents depicted they agree that audit section of the firm is executing its responsibilities as anticipated, thirty six point three six percent of respondents strongly agree firm ensures impartial access to information for both shareholders and investment analysts.

, twenty two point seven three percent of the respondents agree with the statement while another thirty six point three six percent of respondents were uncertain and four point five four percent of the respondents disagree that firm ensures equal access to information for both shareholders and investment analysts. four point five percent of respondents strongly agree that there are conflicts of interest exist between the bank and certain members of its Board of Directors., thirteen point six percent of the respondents agree with the statement, twenty two point seven percent of participants were uncertain while forty point nine percent of the respondents disagree while eighteen point two percent of survey respondents depicted strongly disagree. From these findings the researchers found out that there are potential conflicts of interest between the bank and Board of Directors.

According to objective four which states to determine the effects of quarterly publication of commercial bank charges on loans as a central bank of Kenya regulatory requirement on financial performance, twenty two point seven percent of respondents agree that proper utilization of financial information influence profitability of the commercial banks, thirty one point eight percent of respondent were uncertain about the statement and lastly eighteen point two percent of respondents strongly disagree that proper utilization of financial information influence profitability of the commercial banks. Forty point nine percent of respondents postulate that they agree while thirty six point four percent of respondents were uncertain on the question. From this study it is

found that increased financial efficiency help to save cost, thirty six point four percent of respondents agree while fifty percent of the respondents were uncertain and four point five percent of the respondents disagree that disclosure of financial information reduce information asymmetry.

5.3 Conclusions

From the research findings presented in chapter four and above summary of findings, the study concludes that reserve requirements is one of the major challenges that commercial banks face during the start-up process, thus negatively affecting the stability of the commercial banks. Banks depicts that minimum cash reserve of 1 billion is very high especially for banks with minimum capital base. The researchers also concluded that reserve requirements serve as a safeguard against a sudden inordinate demand for withdrawals. Forty point nine percent of respondents strongly agree, four point five four percent of respondents were uncertain and fifty four point five percent of respondents agree that maintenance of minimum reserve requirements creates confidence to stakeholders in overall financial performance of commercial banks.

With respective to objective two which states to determine the impacts of minimum capital requirements as central bank of Kenya regulatory requirement on financial performance, the study concludes that capital requirement is one effect of CBK's regulatory standards concerning financial well-being.

Thirty one point eight percent of respondents depicted capital requirement structures of banks are highly regulated, eighteen point two percent of the respondents agree, while forty five point five percent of the respondents were uncertain. Researchers concluded that high capital requirement in banks does not leads to low profits. Also the study concludes high capital requirement in banks leads to low profitability. From these findings it is concluded that policy concerning definition of capital requirement beyond cash or government security whether regulator and supervisory authorities verify source or not.

Based on objective three which depicts to assess the effects of reserve requirement as a central bank of Kenya regulatory requirement on financial performance researchers concluded bank has clear list of share owned by members of the Board of Directors. The banks have a clear list of board of directors. It is also concluded commercial banks Regularly releases and disseminates its financial results and management analyses. From this study it is concluded that audit section of the firm is fulfilling its duties as anticipated., the firms also provide equitable access to information for both shareholders and investment analysts. The study further asserts that the bank consistently conducts self-assessments of good corporate governance. Additionally, there are no identified potential conflicts of interest between the bank and its Board of Directors.

Fourth objective sought to determine the effects of quarterly publication of commercial bank charges on loans as a central bank of Kenya regulatory requirement on financial performance, the researchers concluded that proper utilization of financial information influences profitability of the commercial banks. The study also concluded comparison of income earned to expenses incurred positively affect financial performance of commercial. From this study the researchers concluded disclosure of financial information asymmetry will lower uncertainty and reduce cost of capital. Lastly the fifth objective which states to investigate overall effects of selected central bank of Kenya regulatory requirements on financial performance the researchers concluded that all this variables of the study affects the profitability of the commercial banks.

5.4 Recommendations

Based on the research findings of this study, the researchers recommended that commercial banks should train their employees on how to form teamwork so that they have adequate knowledge on how to handle their customers. The commercial banks should also have the new blood in their stream of management by bringing in new employees to the top management.

The study also based on objective one recommends that bank should publish and distributes its financial results. This will ensure stakeholders of the bank assess the financial liquidity and when the bank has good and appealing financial records then the borrowers will have confidence in investing in that bank. This will ensure high profitability in the banks since there will be huge deposits. The bank should also have well written policies of corporate governance.

With respect to objective two which states to establish the effects of minimum capital as central bank of Kenya regulatory requirement on financial stability, the study recommends that central bank should have a policy which ensures commercial bank should have adequate capital requirement. This policy will ensure banks are well regulated thus protecting the welfare of all the stakeholders. The bank should also supervise and oversight their systems which enables them to compute minimum capital requirements adequately.

Based on objective three the researchers recommended that banks should ensure they have adequate reserve requirement which will ensure bank have cushion which acts as a safeguard against sudden shock in huge demand for withdrawals. This minimum reserve requirements will also creates confidence of stakeholders because it will ensure that the bank will not collapse because it has shock absorber with the central bank.

With respective objectives four which depicts to determine the effects of quarterly publication of commercial bank charges on loans as a central bank of Kenya regulatory requirement on financial performance, the study concludes the commercial banks should have proper utilization of financial

information which will lead to increase in profits, also the banks should compare income earned and expenses which well comparison is done then the financial performance will increase. Banks should adequately disclose financial information which ensures reduction of information asymmetry between the shareholders and Board of Directors.

5.5 Suggestions for further research

This study examined effects of regulatory requirements by the central bank of Kenya on financial performance of commercial banks in Embu town. The following research area is recommended for further research; to assess the effects of reserve requirement as a central bank of Kenya regulatory requirement on financial direction. This will bring in more conclusions and recommendations on financial requirements.

REFERENCES

- Barth, J. R., Caprio Jr, G., & Levine, R. (2001). Banking systems around the globe: Do regulation and ownership affect performance and stability?. In *Prudential supervision: What works and what doesn't* (pp. 31-96). University of Chicago Press.
- Barth, J. R., Caprio, G., & Levine, R. (1998). Financial regulation and performance: cross-country evidence. *World Bank Policy Research Working Paper*, (2037).
- Barth, J. R., Caprio, G., & Levine, R. (2004). Bank regulation and supervision: what works best? *Journal of Financial intermediation*, 13(2), 205-248.
- Barth, J. R., Caprio, G., & Levine, R. (2005). *Rethinking bank regulation: Till angels govern*. Cambridge: Cambridge University Press.
- Biggar, D., & Heimler, A. (2005). An increasing role for competition in the regulation of banks. *Antitrust Enforcement in Regulated sectors—Subgroup 1, ICN (International Competition Network)*. Bonn, 586.
- Dang, U. (2011). The CAMEL rating system in banking supervision. A case study. Study of Arcada University of Applied Sciences, International Business.
- Demirguc-Kunt, A., Laeven, L., & Levine, R. (2003). *Regulations, market structure, institutions, and the cost of financial intermediation* (No. w9890). National Bureau of Economic Research.
- Diamond, D. and Dybvig, P. (1983). Bank runs, deposit insurance and liquidity. *Journal of Political Economy*,
- Diamond, D., W., and R., G. Rajan (2001). Liquidity risk, liquidity creation, and financial fragility: A theory of banking. *Journal of Political Economy* 109: 287–327.
- Hantke-Domas, M. (2003). The public interest theory of regulation: non-existence or misinterpretation?. *European Journal of Law and Economics*, 15(2), 165-194.
- Kamau, A. (2009). *Efficiency and Productivity of the Banking Sector in Kenya: An Empirical Investigation*. Unpublished PhD dissertation, University of Nairobi
- Kamau, A. W. (2011). Intermediation efficiency and productivity of the banking sector in Kenya. *Interdisciplinary Journal of Research in Business*, 1(9), 12-26.

- Kamau, A., & Were, M. (2013). What drives banking sector performance in Kenya?. *Global Business and Economics Research Journal*, 2(4), 45-59.
- Mugenda, O. M and Mugenda, A.G.(2003). *Research methods: Qualitative and qualitative approaches*. African Centre for Technology Studies, Nairobi, Kenya.
- Ndung'u, N. (2011, February). Strengthening regulatory frameworks in the finance industry—a key enabler for private sector development. In *speech by the Governor of the Central Bank of Kenya at the Africa Banking and Finance Conference, Nairobi* (Vol. 21).
- Odunga R.M. Nyangweso P.M. and Nkobe D.(2013). Liquidity, capital adequacy and operating Efficiency of Commercial Banks in Kenya Research. *Journal of Finance and Accounting*, 4(8), 76-80
- Ongore, V. O., &Kusa, G. B. (2013).Determinants of Financial Performance of Commercial Banks in Kenya. *International Journal of Economics & Financial Issues (IJEFI)*, 3(1), 237-252
- Ongore, V.O. (2011). The relationship between ownership structure and firm performance: An empirical analysis of listed companies in Kenya. *African Journal of Business Management*, 5(6), 2120-2128
- Salah, N. B. and Fedhila, H. (2012). Effects of Securitization on Credit Risk and Banking Stability: Empirical evidence from American commercial banks, *International Journal of Economics and Finance* 4(5); 194
- Sentero, D. R. (2013). *The Effect of Capital Adequacy Requirements on the Efficiency of Commercial Banks in Kenya*, Unpublished Thesis, University of Nairobi
- Stigler, G.J. 1972. "The Theory of Economic Regulation". *Bell Journal of Economics and Management Science* 11: 3-21.

MKU RESEARCH PERMIT



DIRECTORATE OF GRADUATE STUDIES

MBA/2021/40186

9th November, 2023

*National Commission for Science Technology & Innovation (NACOSTI)
Off Waiyaki Way, Upper Kabete,
P.O Box 30623- 00100
NAIROBI, KENYA*

Dear Sir/ Madam,

RE: WARIO ABDUBA HASSAN - REGISTRATION NO. MBA/2021/40186

The purpose of this letter is to introduce the above named student who is pursuing **Master of Business Administration** in the department of **Accounting and Finance** in the school of **Business and Economics** ...

The title of the research is "**Central Bank of Kenya Regulatory Requirement and Financial Performance of Commercial Banks in Kenya. Case of County Government of Embu.**" It has been cleared by the University's Ethics Review Committee (Certificate attached) and now has to proceed to the field to collect data between **November, 2023 and January, 2024.**

Any assistance accorded to the student will be highly appreciated.

Thank you.


Dr. Samuel M. Karega, **Off. of the Director,
Director, Graduate Studies**
Enc.

NACOSTI RESEARCH PERMIT



REPUBLIC OF KENYA

Ref No: 865402



NATIONAL COMMISSION FOR SCIENCE, TECHNOLOGY & INNOVATION

Date of Issue: 15/November/2023

RESEARCH LICENSE



This is to Certify that Mr. WARIO HASSAN ABDUBA of Mount Kenya University, has been licensed to conduct research as per the provision of the Science, Technology and Innovation Act, 2013 (Rev.2014) in Embu on the topic: CENTRAL BANK OF KENYA REGULATORY REQUIREMENT AND FINANCIAL PERFORMANCE OF COMMERCIAL BANKS IN KENYA, CASE OF COUNTY GOVERNMENT OF EMBU for the period ending : 15/November/2024.

License No: NACOSTI/P/23/31531

865402

Applicant Identification Number

Handwritten signature

Director General NATIONAL COMMISSION FOR SCIENCE, TECHNOLOGY & INNOVATION

Verification QR Code



NOTE: This is a computer generated License. To verify the authenticity of this document, Scan the QR Code using QR scanner application.

See overleaf for conditions

APPENDIX TWO: RESEARCH QUESTIONNAIRE

Instruction

Kindly tick [] appropriately in the boxes provided

SECTION A. Basic information

1. Name of your bank
2. Gender of the respondent.
 Male [] Female []
3. The age of the respondent.
 25-30years [] 31-35years [] 36-40years [] Above 41years []
4. Highest level of education of the respondent.
 CPA [] CIFA [] Diploma [] Degree [] Masters []
 Others, specify.....
5. Length of time you have been working as a finance manager.
 Below 1 year [] 2-5 years [] 6-10 years [] over 11years []

Section B: Reserve Requirement

Kindly respond to the following statement by indicating the extent to which you agree or disagree as per the given choices. Use a scale of 1-5 where 1=strongly agree, 2=agree, 3=uncertain, 4=disagree, 5=strongly disagree.

		Strongly Agree	Agree	Uncertain	Disagree	Strongly Disagree
6.	Reserve requirement is one of the major challenges that commercial banks face during the start-up process, thus negatively affecting the performance of commercial banks					
7.	Reserve requirements serve as a safeguard against a sudden and inordinate demand for withdrawals					

8.	Maintenance of minimum reserve requirements creates confidence to stakeholders which is crucial to the overall financial performance of commercial banks					
----	--	--	--	--	--	--

Section C: Minimum capital

Kindly respond to the following statement by indicating the extent to which you agree or disagree as per the given choices. Use a scale of 1-5 where 1=strongly agree, 2=agree, 3=uncertain, 4=disagree, 5=strongly disagree.

		Strongly Agree	Agree	Uncertain	Disagree	Disagree Strongly
9.	Capital requirement is one of effects of CBK regulatory requirement on financial performance					
10.	Transfer of ownership influences bank performance					
11.	Capital requirement structure of banks is highly regulated					
12.	High capital requirement in banks leads to low profits					
13.	Bank is able to supervise, oversight their system to compute minimum capital requirements.					

14.	In this bank there is policy concerning definition of capital requirement beyond cash or government security whether regulator and supervisory authorities verify source capital or not					
-----	---	--	--	--	--	--



Section D: Corporate Governance

Kindly respond to the following statement by indicating the extent to which you agree or disagree as per the given choices. Use a scale of 1-5 where 1=strongly agree, 2=agree, 3=uncertain, 4=disagree, 5=strongly disagree.

		Strongly Agree	Agree	Uncertain	Disagree	Disagree Strongly
15.	The bank has a clear list of the share owned by members of the Board of directors					
16.	The firm publishes and distributes its financial results and management analysis					
17.	The audit section of the firm is performing its duties as expected					
18.	The firm provides equal access to information for shareholders and investment analysts					
19.	The bank regularly holds self-assessment of good corporate governance					
20.	There are any potential conflicts of interest between the bank and the member of its Board of Directors					
21.	The bank has well written Corporate Governance (Policies; e.g. which covers specification on BODs duties, disclosure rules,					

shareholders rights etc. Revealed code of conduct/ethics clearly)						
---	--	--	--	--	--	--

Section E: Quarterly Publication

Kindly respond to the following statement by indicating the extent to which you agree or disagree as per the given choices. Use a scale of 1-5 where 1=strongly agree, 2=agree, 3=uncertain, 4=disagree, 5=strongly disagree.

		Strongly Agree	Agree	Uncertain	Disagree	Strongly Disagree
22.	Proper utilization of financial information has led to an increase in profit of commercial banks					
23.	Increased financial efficiency has helped to save on cost					
24.	Comparison of income earned to expenses incurred positively affect financial performance of commercial					
25.	Disclosure of financial information reduce information asymmetry and thereby lowering uncertainty and reducing the cost of capital					

THANK YOU FOR YOUR TIME AND PATIENCE

APPENDIX THREE: RESEARCH BUDGET

Activities	Quantity	Unit Cost (Ksh)	Total Cost (Ksh)
Flash Disk	3	3000	9000
Stationeries			65000
Printing	1500	100	150000
Photocopying	2000	10	20000
Internet		28000	28000
Transport/Accomodation	5000	6	30000
Total			302,000



