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

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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 minimum capital requirements and reserve requirements. 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. Questionnaire was used to gather quantitative data. To examine data gathered, descriptive statistics was 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. 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. A reserve requirement is one of the major challenges that commercial banks face during the start-up process, thus negatively affecting the stability of the commercial banks. 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.

Keywords: *Minimum Capital Requirement, Reserve Requirement, Financial Performance*

INTRODUCTION

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 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. Changing the reserve requirement can indeed pose challenges, especially for banks with low excess reserves. 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.

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) 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) 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) 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) 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.

Objectives of the study

i. To determine the impact of the minimum capital requirement, a Kenyan central bank regulation, on monetary results of commercial banks in Embu Town.
ii. To evaluate the impact of reserve requirement, a Kenyan central bank regulation, on monetary results of commercial banks in Embu town.

LITERATURE REVIEW

Theoretical literature

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.

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. 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.

Empirical review

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. 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.

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.

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 and reserve requirement) are imposed by central banks.

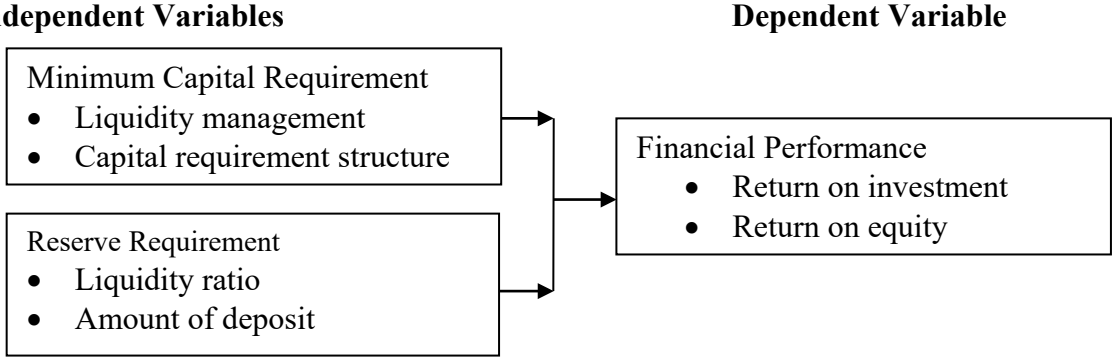


Figure 1: Conceptual Framework
Source; Researcher 2023

METHODOLOGY

The research design is a descriptive research design, which aims in obtaining information about current situation or phenomena and describe them without manipulating variables. The target respondents for the study are specific roles within the banks, namely branch managers, operation managers, credit supervision, debt recovery, and risk and compliance department employees.

Primary data is collected using a questionnaire. Stratified random sampling was 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. The study used descriptive statistics to summarize and present the data. The Statistical Package for Social Science (SPSS) was used for the analysis.

FINDINGS AND DISCUSSION

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, consequently, 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 1 below.

Table 1: Reserve requirements a major challenge faced by 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**	

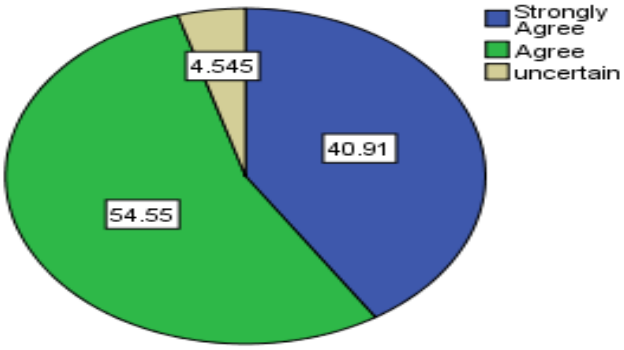
Researchers sought to find out if reserves requirement serve as a safeguard against a sudden inordinate demand for withdrawals. Forty five point five percent (45.5%) depicted strongly agree that reserve requirement serve as a safeguard against a sudden inordinate demand for withdrawals. Forty percent (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 1 below.

Table 1: 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 2 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 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).

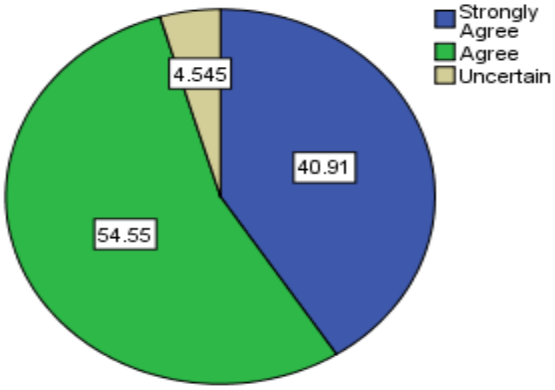
Figure 2: maintenance of minimum reserve requirements



Minimum Capital

Figure 3 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.

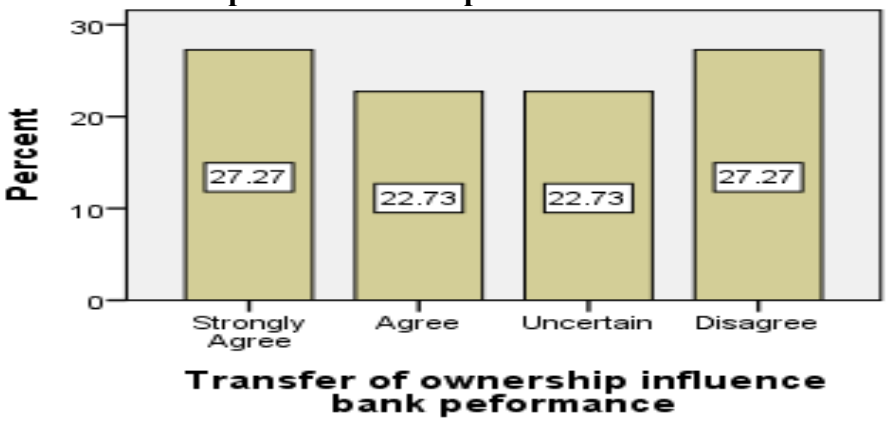
Figure 3: capital requirements is one effect of CBK regulatory



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.

Figure 4: Transfer of ownership influence bank performance



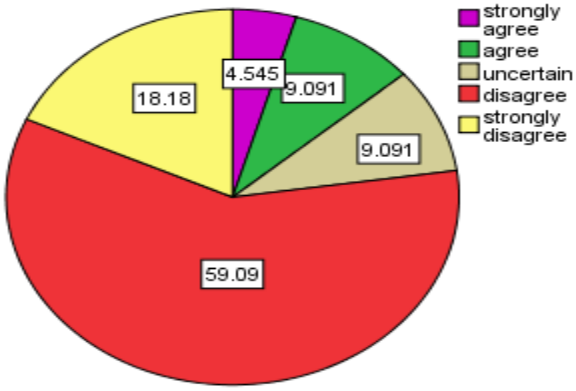
The researchers sought to find out if capital requirement structures of banks are highly regulated. Thirty one point eight percent (31.8%) of respondents, eighteen point two percent (18.2%) of respondents agree, while forty five point five percent (45.5%) of respondents were uncertain and four point five percent (4.5%) of respondents disagree that capital requirements structures of banks is highly regulated. As presented below in table 2.

Table 2: 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 5 below.

Figure 5: 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 6 below.

Figure 6: Bank is able to supervise and oversight their systems

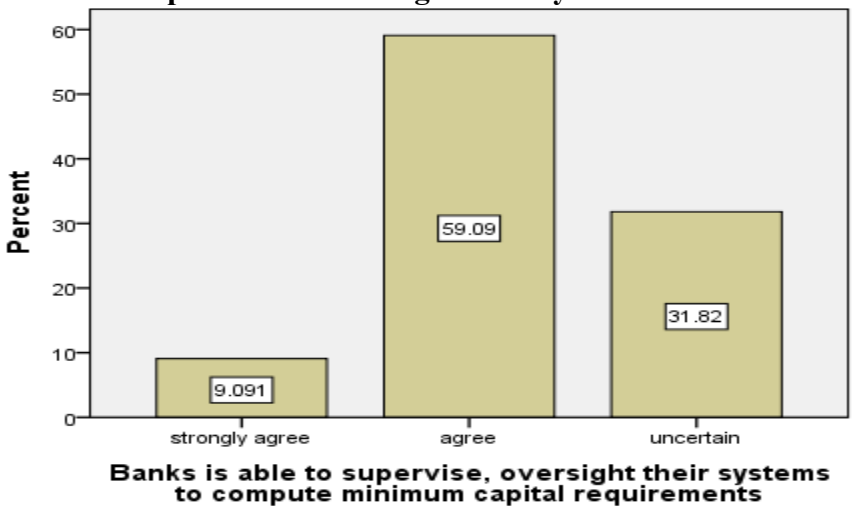


Table 3 below depicts If there is a policy in this bank regarding the definition of capital requirements that goes beyond cash or government security, it raises the question of whether regulatory and supervisory authorities verify the source of this capital or not, eighteen point two percent (18.2%) 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 3: 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**	

Performance

Table 4 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: 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**	

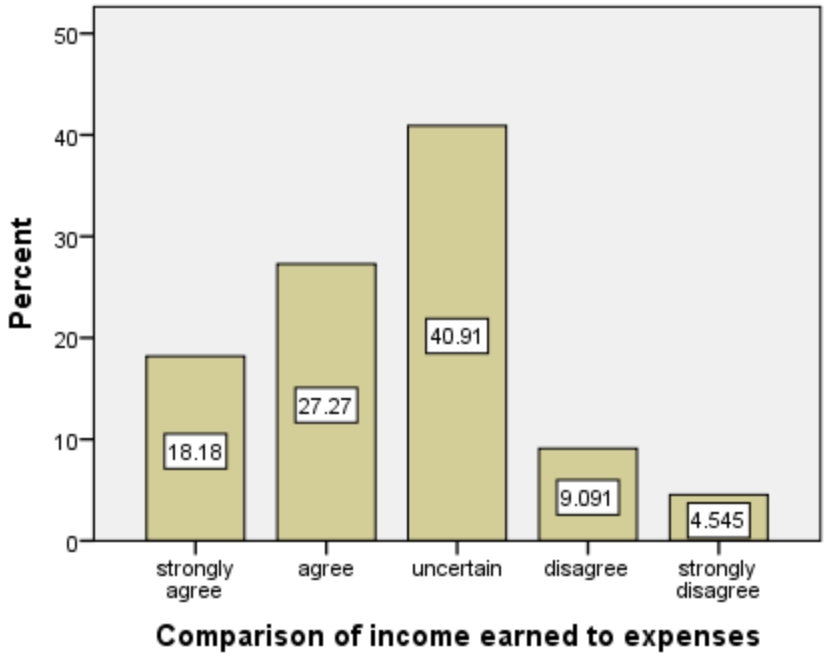
The researchers sought to find out if increased efficiency has helped to save costs, twenty two point seven percent (22.7%) of respondents strongly agree, forty point nine percent (40.9%) of respondents postulates that they agree while thirty six point four percent (36.4%) of respondents were uncertain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

Table 5: 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 6 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 6: 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 6 below.

Table 6: 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**	

CONCLUSIONS AND RECOMMENDATIONS

Conclusions

The study concludes that a reserve requirement 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.

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.

Recommendations

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.

The 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.

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