INFLUENCE OF CENTRAL BANK PRUDENTIAL GUIDELINES ON PERFORMANCE OF COMMERCIAL BANKS IN KENYA

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DECLARATION

This research project is my original work and has not been presented for any award in any other university.

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DEDICATION

This work is dedicated to my husband Dr. Khalwale and our children for the support they have given me.

AKNOWLEDGEMENT

I would like to express my special thanks of gratitude to my supervisor who gave me much needed guidelines in every step of this project. My colleagues at Co-operative Bank Langata Road Branch, my friends in KCA University and all for the support they gave me during my research work. God bless you all.

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ABBREVIATIONS AND ACRONYMS

AQ	Asset Quality
CA	Capital Adequacy
CAR	Capital Adequacy Ratio
CBK	Central Bank Kenya
FDI	Foreign Direct Investment
GDP	Gross Domestic Product
INF	Inflation rate
KCB	Kenya Commercial Bank
LS	Liquidity Ratio
MFCs	Mortgage Finance Companies
MO	Management Oversight
PCA	Prompt Corrective Action
ROA	Return on Asset
ROE	Return on Earnings

DEFINATION OF TERMS

Compliance	Conforming to a rule, such as a specification, policy, standard or law (Olweny&Shipho, 2011).
Corporate governance	Most often viewed as both the structure and the relationships which determine corporate direction and performance (Oluyemi, 2006).
Financial performance	Measuring the results of a firm's policies and operations in monetary terms (Hult, *et al*., 2008).
Prudential Guidelines	this are policies provided by CBK to safeguard consumer against risk that can arise due to un-coordinated banks supervisory activities (Macit, 2011).

ABSTRACT

The Central Bank plays a dominant role in both the decision making and managerial process taking place in the economy while other banks do provide the essential financial services needed for effective operation of the economy. Prudential guidelines are issued by CBK to safeguard consumer against risk that can arise due to un-coordinated banks supervisory activities. These regulations comprise adherence and enforcement of the rules and policies sets and also compliance of the critical banks asset management policies, financial capacity of the banks and its managements. Despite introduction of CBK prudential regulations 2006 governing commercial banks in Kenya, there are very few systematic studies that critically assess how regulations have affected the financial performance of commercial banks. The study aimed to investigate influence of central bank prudential guideline on financial performance of Commercial Bank in Kenya. The investigated effect of risk management guidelines, corporate governance and loss prudential on financial performance of Commercial Bank in Kenya. Public interest theory, capture theory of regulation and public choice theory were adopted to support on the research literature relating to CBK prudential regulations. The study aimed at analyzing the influence of central bank prudential guideline on financial performance with focus to Commercial Bank in Kenya. The target population of the study was 43 commercial banks regulated by CBK 2017. The study used a census since the number of the banks is manageable. Primary data was collected through the use of questionnaires, data was analyzed by use of SPSS software and presentation of descriptive and inferential statistics done in table and charts. Theregression coefficient showed that loan loss prudential guidelines, risk management guidelines and corporate governance guidelines have impact on the financial performance of commercial banks in Kenya. Loan loss prudential guidelines increases financial performance of commercial banks by 0.605. Corporate governance guidelines increase financial performance of commercial banks by 0.576 and risk management guidelines increases commercial banks financial performance by 0.638 units. The study recommends CBK needs to promote their prudential regulations guidelines to the commercial banks by formulating supportive financial policies to bring value to the commercial banks by not only restricting them but also involving banks in their shared vision.

CHAPTER ONE

1.1 Introduction

The chapter gives a generalized and concise introduction of the study by providing a background of on the impact of central bank prudential guideline on financial performance of commercial banks in Kenya. The chapter presented on the overview of banking sector in Kenya by presenting on various studies that have been done in past research studies under problem statement. The chapter gave specific objective, research question, significance and scope of the study. The chapter also highlights the scope of the study that the researcher foresees in the undertaking of this research as well as time scope.

1.1.1 Background to the Study

The banking sector plays a pivotal role when it comes to financial and non-financial factors of productivity in an economy in every nation's development (FSB, 2014). The central bank is said to be the bankers of bankers whereby any mater relating to regulating and overseeing on the commercial banks is impacted at management and operational level. Over the year's different nations regulation and banks operations have been scrutinized (CBK, 2013). Kenya too has had a challenging time in the banking sector with the cases of collapsed banks like Imperial Bank, Dubai Bank and Chase Bank.

According to the micro prudential regulation, banks finance themselves using government insured deposits which while it helps to reduce bank runs, it creates a moral hazard problem because it leads to the management of banks taking too many risks because they know that the government will cover any losses they make. Micro prudential regulation requires banks to take prompt steps to restore their capital ratio if losses occur. This is referred to as Prompt Corrective Action, (Hanson, Kashyap& Stein 2011). Central banks enforce capital regulations. The macro prudential theory aims at reducing as much as possible the financial impact that is felt in the economy when many commercial banks decide to sell their assets at the same time in order to cover their losses especially when the assets are similar for example real estate (Hanson *et al*., 2011).

Thatcher (2002) posited that establishment of a regulation can enhance business operation or completely make a business close down. Thus, key prudential regulation measure meant to improve banks supervisory approach and to post a good impact on the performances. The prudential guidelines present a generalized overview of the study findings to present on how the banks can restrict unsupportive activities and invest in profit streams (Pasiouras, 2009). The Prudential Guideline has drawn to attention the level of disclosure of material information in corporate reports as published by commercial banks. Reports from banks would be subjected to more scrutiny owing to the state of health of some banks arising from the management of their risk assets portfolio (a, 2011). The prudential guidelines assist in ensuring the ability to repay loans through the utilization of prudent credit management (Odimgbe, 2012) practice. These guidelines specify actions the banks should take to ensure they fully provide for their non-performing assets. The prudential guidelines are meant to address various aspects relating to banks operations like corporate management, risk management and consumer protection through Know Your Customer principle and loan loss prudential (Oladele, 2012).

1.1.2 Central Bank of Kenya Prudential Guidelines

The prudential guidelines and regulations put in place by the CBK is meant to safeguard consumer against risk that can arise due to un-coordinated banks supervisory activities (Ndung'u*et al*., 2014). These regulations comprise adherence and enforcement of the rules and policies sets and also compliance of the critical banks asset management policies, financial capacity of the banks and its managements (CBK, 2013). It is perceived that effective supervision of banking sector can lead to economic growth resulting from the efficient and effective banks performance (Soludo, 2007).

The Prudential Guideline has drawn to attention the level of disclosure of material information in corporate reports as published by commercial banks. Reports from banks would be subjected to more scrutiny owing to the state of health of some banks arising from the management of their risk assets portfolio (Macit, 2011). The prudential guidelines assist in ensuring the ability to repay loans through the utilization of prudent credit management (Odimgbe, 2012) practice. These guidelines specify actions the banks

should take to ensure they fully provide for their nonperforming assets. The prudential guidelines in the banking sector is meant to reassess on the various models of banks operations like corporate governance and consumer protection through Know Your Customer principle and loan loss prudential (Oladele, 2012).

According to (Ganiolu, 2007) stated that the commercial banks prudential guidelines involves a corporate body tasked to develop specific rules and concepts to be imposed on by the government or external agency to the involved banking institutions. Through the policy framework and industry stakeholder's involvement, the Central Bank of Kenya continuously evaluate on the prudential polices in place and its impact on the performance of the commercial banks. This is aimed at achieving a mutual understanding and creating a win situation to the financial institutions in their scope of operations. (Olweny & Shipho, 2011). The prudential guidelines aim to highlight on the peculiarities of the types of credit financing to various sectors in the economy. The regulatory approach also embeds on the banking sector is aimed at establishing a stable financial model and attaining general confidence from the public when it comes the overall management of the systemic risk in the banking institutions and customer protection rights.

Commercial banks in Kenya are guided by the Banking Act (Cap 488, Laws of Kenya) and the CBK Act of 2013. The establishment of the Central Bank of Kenya came in through the Act of Parliament in 1966. The Act stipulated on the key objectives, roles and functions of the Central Bank of Kenya which gives it an absolute and solemn role in regulating all the financial institutions established and operating within the Kenyan landscape. The body is mandated in licensing of new financial institutions under the conduct of banking regulation mode. The CBK (2013) Act contained key prudential guidelines and risk management in which financial institutions and mortgage finance companies were required to adhere on the various managerial and financial requirements. The commercial banks are required to submit the day to day reports on the current liquidity level, capital adequacy records, foreign exchange risk management measures, money fraud and ant laundering reports, promoting of the current banking law in place and agency banking report.

The CBK issued a new set of Prudential Guidelines and Risk Management Guidelines which came into force on 1st January, 2013.Banks, financial institutions and mortgage finance companies need to adhere to these Prudential Guidelines (CBK, 2013). The Prudential Guidelines deal with a wide range of issues including licensing requirements, corporate governance, capital adequacy requirements, liquidity management, stress testing, foreign exchange exposure limits, prohibited business, anti-money laundering, consumer protection, enforcement of banking laws and regulations, agent banking, and representative offices (Sonal*et al*. 2013).

The Central Bank of Kenya do provide a consolidated report on the operational performance of financial institutions and this forms part of the initiatives that avails on the resources being consolidated to reduce on the aspects of bank complexity and enhance on efficient resolution of the commercial banks risks (CBK, 2013). The presentation of corporate governance in the banking sector is intended to provide criteria standards on the management and the board of financial institutions in promoting sound and appropriate banking practices and ensuring good practices and clear specification of the laid down duties and the responsibilities.

Capital adequacy in the banks prudential governance management is aimed at maintaining an optimal level of which capital issued is available (Leonard & Maws (2014). Risk classification of assets and provisioning intends to encourage and promote financial institutions in developing proper work out plans in asset managements (Odimgbe, 2012). The aim of liquidity management guidelines in the banking sector is to ensure the organization are able to fulfil on the minimum liquidity level required as well as provide clear guidelines on the planning and management of available current assets and current liabilities.

The foreign exchange exposure limits on the intends to reaffirm on the potential risk losses that might arise from the forex fluctuations of banks capital base within the defined asset base by the central bank (Leonard & Maws, 2014). Prohibited business guideline applies to all transactions conducted by an institution and reflected on the balance sheet or reflected as off-balance sheet items. Proceeds of crime and money laundering

prevention guideline apply to all institutions licensed to transact business under the Banking Act (Macit, 2011).

The selection of the CBK external auditors in charge of daily running of the businesses and oversight of the management roles and responsibilities in Appointment, duties and responsibilities of external auditors need CBK's approval of the registered public accounting firm arises out of the desire to ensure that the registered public accounting firm appointed by the institutions has achieved acceptable standards of both competence and independence to enhance the supervisory role of the CBK.

The introduction of the new Prudential Guidelines reflects Kenya's continued efforts towards strengthening its banking environment so that she can achieve its goal under Vision 2030 to be an international financial Centre. Recent experience in emerging markets has demonstrated that financial crises can be highly damaging for economies, government budgets and living standards. This realization has reinforced interest in improving financial sector regulation and supervision. The objective of prudential regulation is to protect the stability of the financial system and protect deposits so its main focus is on the safety and soundness of the banking system and on non-bank financial institutions that take deposits (Martin, Colin & Samuel, 2002).

1.1.3 Financial Performance of Commercial Banks in Kenya

According to Richard (2009) points out that firm performance represents a multidimensional aspect such as operational effectiveness, organization survival, corporate reputation and the management. To measure on the financial performance of different firms, various models are adopted such as return on equity, return on capital, return on sales, return on investment or market-based measure of Tobin's Q and market return for profitability (Combs, 2005).

Company's financial performance can be defined as a subjective measure of how well a firm can use assets from its primary mode of business and generate revenues (Padachi, 2011). Key useful measures of financial performance have been developed and the model is widely referred to as the CAMEL. The acronym stands for capital adequacy, asset quality, management, earning and liquidity. Capital adequacy is the determination of the

minimum capital amount required to satisfy a specified economic capital constraint (Chien, 2014). Ultimately, it is used to determine how the commercial bank is using current assets in the balance sheet.

The solvency of the commercial banks involves the risks attached on the assets when it becomes impaired. Thus, to assess the financial performance, researchers generally use either accounting-based measures of profitability such as return on assets (ROA), return on sales (ROS), and return on equity (ROE), or stock market-based measures such as Tobin's Q and market return (Combs *et al.*, 2005; Hult*et al.*, 2008). Both accounting-based and market-based measures of financial performance are generally accepted as suitable indicators of firm financial performance even though their relationship in is not well-defined Keats (1988). The variety of measures, which represent different perspectives of how to evaluate a firm's financial performance, have different theoretical implications (Oloo, 2010). On average the performance of commercial banks in the country has been increasing. Compared to the financial performances of banks in developing countries, the overall financial performance of commercial banks in the country is good (Flamini et al., 2009.) This shows that investments in commercial banking in Kenya are profitable and it is an avenue to attract foreign direct investment (FDI) in the sector.

Market measures on the other hand are forward looking and focus on market performance. They are less susceptible to different accounting procedures and represent the investor's evaluation of the ability of a firm to generate future economic earnings (McGuire, *et al.*, 2008). But the stock-market-based measures of performance also yield obstacles. According to Ullmann (2005) the use of market measures suggests that an investor's valuation of firm's performance is a proper performance measure which may not be the case (McGuire *et al.*, 1988). Even if the assumption of market efficiency holds, Bettis (1983) argues that a firm's Stock price does not necessarily reflect its fundamental value because it is influenced by the information managers choose to disclose to investors (Gale, 2010).

The study by Oladele*et al.* (2012) also found that the operating expense, relationship between cost and income, and equity to total assets significantly affects the performance

of banks, which clearly what the present found. Ani*et al*. (2012) established that capital and asset composition positively affect bank profitability, while bank size has negative effect on bank profitability. This was complimented by Babalola (2012) study, which found that in the short run, capital adequacy ratio is the determining factor for bank profitability, where consistency of some of the internal factors like capital, size and credit risks in determining bank profitability across different economies of the world. Karagu and Okibo (2014) carried a study to establish effect of fund misappropriation, investment decisions, loan defaulting and membership withdrawal on financial performance. Thus, they concluded that membership retention and growth is an important component of financial performance.

1.1.4 Commercial Banks in Kenya

The banking sector in any economy serves as a catalyst for growth and development. Banks are able to perform this role through their crucial functions of financial intermediation, provision of an efficient payments system and at the same time facilitating the implementation of monetary policies (CBK, 2013). It is not surprising therefore, that governments the world over attempt to evolve an efficient banking system, not only for the promotion of efficient intermediation, but also for the protection of depositors, encouragement of efficient competition, maintenance of public confidence in the system, stability of the system and protection against systemic risk and collapse (Iyade, 2006).

The CBK has issued a new set of Prudential Guidelines and Risk Management Guidelines which came into force on 1st January, 2013 (the “Prudential Guidelines”). Banks, financial institutions and mortgage finance companies need to adhere to these Prudential Guidelines (CBK, 2013). The Prudential Guidelines deal with a wide range of issues including licensing requirements, corporate governance, capital adequacy requirements, liquidity management, stress testing, foreign exchange exposure limits, prohibited business, anti-money laundering, consumer protection, enforcement of banking laws and regulations, agent banking, and representative offices (Sonal, et al. 2013).

According to Sonal*et al*. (2013) the reason behind these new Prudential Guidelines is best summarized by reference to the circular issued by the CBK which states that: "Pursuant to its mandate of fostering the liquidity, solvency and proper functioning of a stable market-based financial system, the Central Bank of Kenya has conducted a comprehensive review of the Prudential Guidelines and Risk Management Guidelines currently in use. The review has been necessitated by developments in the national, regional and global arenas and the need to proactively strengthen the regulatory framework for banks and other institutions licensed pursuant to the Banking Act."

Kenya is not a member of the Basel Committee on Banking Supervision, but the CBK does adopt and incorporate Basel standards when possible. The introduction of the new Prudential Guidelines reflects Kenya's continued efforts towards strengthening its banking environment so that she can achieve its goal under Vision 2030 to be an international financial Centre. Recent experience in emerging markets has demonstrated that financial crises can be highly damaging for economies, government budgets and living standards. This realization has reinforced interest in improving financial sector regulation and supervision. The objective of prudential regulation is to protect the stability of the financial system and protect deposits so its main focus is on the safety and soundness of the banking system and on non-bank financial institutions that take deposits (Martin, Colin & Samuel, 2002).

There are 43 licensed commercial banks in Kenya according to the CBK. There is only one mortgage finance company namely Housing Finance Company of Kenya. The CBK has enforced strict regulations on financial institutions. However unlike in the American market, Kenya's banks seem to be growing very fast over the past few years in spite of strict regulations. According to the Monthly Economic Review of November 2015 by the CBK, the balance sheet saw an increase in terms of total assets from Ksh 3,168.7 billion in November 2014 to Ksh 3,626.9 billion in November 2015. This is a 14.5 percent increase.

1.2 Statement of the Problem

Most countries, Kenya included, have experienced banking problems requiring major reforms of the banking systems. The problems are largely due to domestic causes, such as

weak banking supervision and inadequate capital. A key part of bank regulation is to make sure that firms operating in the industry are prudently managed (Berg, 2010). CBK 2006 regulation spelt out the guidelines and regulations to ensure that there is prudential management in the banking industry. Some of these guidelines relate to licensing of new institutions, corporate governance, capital adequacy requirements, liquidity management, risk classification and asset provisioning, foreign exchange exposure limits, publication of financial statements among others. Without sound measures of banking policies across countries and over time, researchers are constrained in assessing which policies work best to promote well-functioning banking systems and in proposing socially beneficial reforms to banking policies in need of improvement. This helps in explaining why the study of effect of Central Bank regulatory requirements in bank financial performance in Kenya is needed.

Brunnermeir (2009) stated that increase in unsafe lending and risky investments led to financial turmoil in the world and was particularly severe in the US and European Union countries in 2007 and 2008, views shared by Knell and Stix (2009) and Guiso (2010). To avoid similar experiences in Kenya, credit management had to be addressed. The prudential guidelines assist in ensuring the ability to repay loans through the utilization of prudent credit management (Odimgbe, 2012) practice. These guidelines specify actions the banks should take to ensure they fully provide for their nonperforming assets. Prudential Guidelines aims to address various aspects of banks' operations such as; risk management, corporate governance, consumer protection through Know Your Customer principle and loan loss prudential (Oladele, 2012). According to Gallardo et al (2005), designing the regulatory framework for MFIs requires that the goals and range of the regulation should be properly delineated. This is aimed at issue of whether regulation should focus on microfinance lending as an activity or on the institutions that are engaged in the microfinance business.

Despite introduction of CBK prudential regulations 2006 governing commercial banks in Kenya, the banking sector in Kenya has in the recent past come under beefed scrutiny by stakeholders after some banks ran into financial crisis and were consequently placed on receivership. This happens despite the regulations set aside in supervising banks. There

are very few systematic studies that critically assess how regulations have affected the financial performance of commercial banks; Kamau and Were (2013) sought to understand what drives bank performance in Kenya by analyzing the structural performance relationship existing in the banking sector using SCP literature. The results of the regressions analysis had provided statistically significant evidence that the main source of superior performance in the Kenyan banking sector is as a result of structure/collusive power and not efficiency. Aduda*et al*., (2013) studied the Relationship between Agency Banking and Financial Performance of Commercial Banks in Kenya. Since financial institution operate in unpredictable environment which is full of uncertainty. The closure of Dubai, Imperial and Chase Banks left many depositors uncertain of the stability of some of the facilities in the industry. The cases of these banks were majorly due to failure of banks to have risk management guidelines, poor governance and poor policies on loan insurance. There is need to investigate how prudential guideline safeguards the banks future as well as the saving of the clients. However, no study has focused on central bank prudential guideline on performance of commercial bank. Thus, the current study aims to bridge this knowledge gap by investigating influence of central bank prudential guideline on performance of Commercial Bank in Kenya.

1.3 Objectives of the study

1.3.1 Main objective

The main objective of this study was to investigate influence of central bank prudential guideline on financial performance of Commercial Bank in Kenya.

1.3.2 Specific Research Objectives

i. To determine the effect of risk management guidelines on financial performance of Commercial Bank in Kenya.
ii. To establish the effect of corporate governance guidelines on financial performance of Commercial Bank in Kenya.
iii. To establish the effect of loan loss prudential guidelines on financial performance of Commercial Bank in Kenya.

1.4 Research Questions

The research aimed to answer the questions below:

i. How do risk management guidelines affect financial performance of Commercial Bank in Kenya?
ii. Do corporate governance guidelines influence financial performance of Commercial Bank in Kenya?
iii. Do loan loss prudential guidelines influence financial performance of Commercial Bank in Kenya?

1.5 Justification of the Study

It has become evident that one of the very completing requirements for the success of any business in any economy is the existence of favorable regulatory environment. For the industry to be efficient, it must be regulated and supervised in view of the failure of the market system to recognize social rationality and the tendency for market participants to take undue risks which could impair the stability and solvency of their institutions (Alao, 2010). The recent development in the Kenyan financial institutions has become subject of concern for Accountants and other practitioners as far as performance measurement and predictions for investment decisions are concerned. It is against this background that the current study aims to investigate influence of central bank prudential guideline on performance of Commercial Bank in Kenya.

1.6 Significant of the Study

1.6.1 Central Bank

This research study would especially be of great importance to Central Bank of Kenya as it will provide a platform for CBK to appreciate the impact of their activities on the banking industry, and underscores areas for improvement. It is also imperative to state that a study of this nature provides an independent platform via which CBK can appraise fundamental tools of supervision in a bid to make reasonable adjustments where necessary.

1.6.2 Bank Managers

This research is also of great significant to the Bank's Chief Executives, Bank Managers and Risk managers. They would use the information gathered through this research to be able to know how these regulations and guidelines have influenced their operations and even look at areas which require remedial actions to be taken and there by eventually improve on their financial performance. Central Banks in Africa can learn from this Kenyan study and thus evaluate these regulations and guidelines that they can replicate in their country in order to improve on their performance. The study findings inform them on which regulations and guidelines have better link to financial performance and hence save on the costs of conducting cost benefit research in their institutions.

1.6.3 Banking Sector

The findings of this study are of immense benefit not only to the Kenyan banking industry and its related institutions, but also to those interested in understanding the inter-relationship between the actions of the CBK on one hand and the banking institutions on the other as well as providing a platform for promoting an efficient and effective banking practice. Finally, the study will be of academic interest and it would also definitely help researchers and academicians who may have an interest in this area to conduct further studies.

1.7 Scope of the Study

The research seeks to investigate influence of central bank prudential guideline on performance of Commercial Bank in Kenya. The study targeted 43 commercial banks Licensed by CBK by the end of year 2017.

1.8 Limitations of the Study

According to Mugenda and Mugenda (2012), limitation is an aspect that may influence the results negatively but over which the researcher has no control. Some of the limitations of this study are; the required sources of data are not available on the account of non-documentation, postulation of unsupportive respondents from the commercial banks interviewed in filling the questionnaires provided.

CHAPTER TWO
LITERATURE REVIEW

2.1 Introduction

This chapter presents key concepts and theories used in are of CBK prudential guidelines, the study will present on the reflective study objectives under the empirical review and also use a conceptual framework for predictor and response variable relationship.

2.2 Theoretical Framework

Theoretical framework is defined as an edge of reference that forms the foundation for observations, meanings of ideas, research plans, presentation, and analysis, much as the casing that lays on an establishment characterizes the general outline of a house (Mugenda, 2012).

2.2.1 Public Interest Theory of Regulation

The public interest theory is skewed on the economic concepts with a view that the regulation is supplied to cater for the demand that is penned by the public in the market as a result of lack of efficient and supportive policy in the area of operation. The theory was first developed by Cecil Pigou in 1932. The need for regulation in the public interest theory is linked to the wellbeing of the society (Jaya, Septiarini & Arafat, 2016).

The theory of public interest is practical in the essence that it is the Central Bank of Kenya that sets policies and guidelines on the operation of the commercial banks. The recent evidence is depicted from the Finance Bill 2016 which was enacted by the Parliament and enforced by CBK on the interest rate capping. Over the years, CBK has developed a number of regulations plus having set out base lending points. The aim of capping was meant to lower on the cost of borrowing and also unleash other hidden costs associated with the credit services provided by the lenders to the borrowers.

In this study review, the concept of prudential guidelines is attached to financial performance of the commercial banks. The provision of existing on new policy is meant to have a direct or indirect impact on the involved industry stakeholders. The analysis thus presents a critical review of how the regulation with the first consideration to the

general public is meant to shed light and consider publics as the beneficiary. The moderation on the applicability of the public interest theory is meant to yield a win-win scenario to the public as well as the financial institutions. The regulation that is imposed by the CBK shouldn't be an opaque to the involved financial institutions and embrace public but that which is at the middle point to the all involved parties in the financial institutions.

2.2.2 Capture Theory of Regulation

The capture theory of regulation was developed by a political scientist (Hertog, 1999) postulating on how governing bodies do develop regulations in the interest of those majority who may be manipulated or being sidelined in the system. The theory presents a review on how the policy makers consider the interests of the involved or concerned parties in the course of regulation by involving the designated bodies towards policy adjustment in the favor of the infringed institutions. The capture theory of regulation works on the willing intentions of the financial institutions or the commercial banks by presenting on the negative externalities like the need to consider liquidity level of the banks, negative profit records or loss, poor performance, employee retrenchment among many other factors.

The capture theory is ideal in the scenario in that for long time the borrowers have been complaining of high cost of borrowing and other hidden costs that were in place. This necessitated the legislators and in coordination with the Central Bank of Kenya they drafted a 14% interest capping law. This was meant to reduce on the cost of borrowing, increases on the SMEs access to credit services that was opted to be cheap and affordable and increase on the banks transparency. The law being in operation under the watch of the Central Bank of Kenya posted a negative reaction in the market. First, the commercial banks were against the law citing of high credit risk and non-performing loans in the market, diversion of the investment portfolio by sidelining on the potential borrowers and investing to the government securities due to risk free attached on it. The other side of the public in the market cited being dished out by the banks saying that access to the credit has become bureaucratic with the requirement of security and guarantor.

The failure of the interest rate capping under the Finance Bill 2016 has led to paradigm shift and currently the industry is considering on amending the changes to reflect to the interest of the banks. The aspect of capture theory of regulation plays a pivotal role and gives a clear picture on how the central bank prudential guidelines do impact on the financial performance of the commercial banks (CBK, 2017).

2.2.3 Public Choice Theory

The public choice theory of regulation argues that the involved parties in a regulatory agency are not an exceptional to the rule that most of the involved parties are driven by the self-interest. The theory suggests that the regulatory agencies come into place to widen on the scope of bureaucratic model and have self-centered interest in serving the other bureaucratic interest in their choice. The government institutions are the one that regulates and enforces certain aspects to economic mic regulation by developing policies that are meant to safeguard certain interest in the choice chain.

The aspect of public choice of regulation is meant to serve on the interests of the consumers through market restriction, notification or withdrawal of certain practices or quotes that are or poses challenge to the business firms (Viscusi, 2002). This brings in the advocacy scenario where the infringed parties in a regulation will have to appeal at all levels if or when their interest is filed out without consideration to the general wellbeing of others but based on the personal interest that supersedes other deeds. The commercial banks are trying to control on the decisions of the economy by selfishly fishing out on the best investment that is impactful to them and the one that will bring a public outcry to be reconsidered in what is good for their personal interest. Lack of strong will by the government and the central bank may pose a challenge to the public in that the commercial banks may exploit the general public on certain rights. The policy makers may also miss out the point on understanding challenges associated with the operation of commercial banks and support the interest of the majority that may be based on undefined foundations. This intrigues to acting with bear acratic eye and sidelined out the commercial banks in the policy making process hence impacting on their financial performances.

Commercial banks have been giving out low returns on deposit and charging high interest rate on lending. This is linked to exploitation in the market while expanding on their prestige returns. The general intend of the public choice regulation theory is to predict on the efficiency by eliminating on the bureaucratic practices and personal interest that exist in the financial institutions sectors and its allied agencies in the market.

2.3 Empirical Review

This section reviews the existing empirical studies on central bank prudential guideline and its impact on the financial performance of commercial banks in Kenya.

2.3.1 Risk Management Guidelines and Financial Performance

The risk management guidelines give a general guide on the risks levels and the management design strategies to implement when such risks occur in the financial sector. Normally, the financial institutions are faced with lots of business risks and operating risks in their normal way of operations. Throughout the policy guidelines and regulations, the central bank has developed a number of potential risks and mitigation strategies to the banks when such instance occurs (CBK Risk Management Guidelines, 2005).

The bank supervision wing from the central bank is mandated on overseeing the operations of commercial banks and carrying out on the possibilities of risk occurrences in the assessed financial institutions. This is in line with the CBK prudential guidelines report of 2006. The guidelines are intended to give banks on the clear specification on safeguarding their assets through regular evaluation and onsite supervision programme. The CBK puts in place a realistic valuation of assets and appropriate prudent recognition of all transactions. This is aimed at ensuring there is good risk management and the liability on risk transfer falls in the right direction.

In a report assessment done by (CBK, 2013), most of the central bank prudential policies for both developing and developed economies are aimed at understanding on the risk threat likelihood and informing the relevant authorities for appropriate actions in the management of stated risks. The model of risk management in the commercial banks must ensure there is a proper provisions and asset management. Given that the main objective of the bank is to ensure there is safe custody of wealth of general publics and

that honesty with prevail in the management of such resources without any subject to the risk that may impact on the bank shareholders.

2.3.2 Corporate Governance Guidelines and Financial Performance

Corporate governance has been of a great concern not only to the financial sector but also to the management decisions of the central bank authorities. Corporate governance is built on pillars that necessitate on the need to have accountability, transparency and ethic in the management of firms in a day to day basis. In today's economic development and wealth management, corporate governance is considered as a new concept that looks in to the management affairs of the commercial banks. This is sided on the aspect of an important correlation between the management and the practice of good governance principles in all areas of the organization.

Corporate governance in the commercial banks is stipulated by the Central Bank of Kenya under the (CBK prudential Guidelines Report, 2006). The report gives an emphasis on the minimum standards required to be a director in the bank, the qualification for the Chief Executive Officer, the board of the financial institutions and the management of the institutions that is well versed to promoted appropriate standards of conduct and banking practices. In review to the guidelines, the shareholders have the responsibility in making and adhering to prudential banking practices in place. The guideline stipulates that the commercial banks must be corporate entities. It outlines the structure of bank management and requires them to have a constitution or articles of association (CBK Prudential Guidelines, 2006).

The Central Bank of Kenya review and scrutinizes on the auditors and accounting firms involved in the financial and non-financial assessment of the commercial banks to ensure they meet on the acceptable standards of reporting competency and independence that enhances on the approach and practice of corporate governance in the banking sector. According to (Oluyemi, 2006) cooperate governance in the banking sector is meant to instill discipline and efficient management of the financial resources. The banks areknown to be the custodian of the public funds and they have to operate in ethical standards where credibility and accountability is a top-notch rank. This makes it credible

to financial institutions in having a prudent management of the resources endowed to the by the public. The CBK has an absolute role to play when it comes to instilling and reassessing on the corporate governance practiced by the commercial banks. A study presented by Thorsten, Jared and Peter (2009) on the management efficiency of commercial banks presented on the efficiency and financial service outreach by the Kenya banking system seems to be improved after being faced with many challenges in corporate governance, non-performing loans and weakness in corporate governance.

2.3.3 Loss Prudential Guidelines and Financial Performance

According to the micro prudential regulation, banks finance themselves using government insured deposits which while it helps to reduce bank runs, it creates a moral hazard problem because it leads to the management of banks taking too many risks because they know that the government will cover any losses they make. Micro prudential regulation requires banks to take prompt steps to restore their capital ratio if losses occur. This is referred to as Prompt Corrective Action, (Hanson, Kashyap & Stein 2011). Central banks enforce capital regulations. The macro prudential theory aims at reducing as much as possible the financial impact that is felt in the economy when many commercial banks decide to sell their assets at the same time in order to cover their losses especially when the assets are similar for example real estate (Hanson *et al*., 2011).

The result would be a significant reduction in the market price of the assets. This was experienced in the United States of America during the global financial crisis of 2007 and 2008. Commercial banks will also cut back on lending which will increase the cost of borrowing. This theory is presumed to be applicable to all deposit takers, insured or not. Regulators are therefore required to monitor the activities of all financial institutions in order to eliminate any activities that can cause damage to the economy. An important element of capital regulation is the principle of Prompt Corrective Action (PCA). This requires banks to take remedial measures immediately in order to restore their capital ratio when losses occur. Capital regulation is therefore carried out by central banks with the aim of protecting the deposit insurance fund and forcing banks to internalize their losses. It is mitigation against moral hazard. This they do by either seeking fresh capital from the stock market or by shrinking their assets in order to absorb the losses.

A bank’s capital enables it to have liquidity because customer deposits tend to be prone to bank runs. Capital adequacy protects a bank against credit, market and operational risks so that it can absorb any losses that may arise and protects debtors (Akintoye & Somoye, 2008). They go on to explain that the adequacy of capital is judged on the basis of capital adequacy ratio (CAR). CAR is directly proportional to the resilience of the bank to crisis situations. It also has a direct effect on the profitability of banks by determining its expansion to risky but profitable ventures. Loans, in most cases, generate the most amount of income for a bank. As a result, losses from non-performing loans pose the biggest risk to any bank. Banks must strive to keep non-performing loans as low as possible. This means that the smaller the ratio of non-performing loans to total loans, the healthier the portfolio of the bank.

2.4 Summary and Gap in Literature

The review of a report presented on central bank prudential regulations (CBK, 2006) on regulatory and management framework and how they impact on the banks performance are imminent. The review of the articles exemplifies that banks development is key to increasing on the financial services in the society. From the foregoing review of relevant literature, it is evident that research has been done in areas relating to central bank prudential guideline on financial performance of Commercial Bank in Kenya. Special emphasis to risk management guidelines, corporate governance and loan loss prudential guidelines.

Empirical evidence in Kenya showing the effects of prudential regulations on financial performance of commercial banks in Kenya aren’t explicitly researched and related studies are not explicitly documented, and a gap exists which can be filled through more research on the area. Thus, there is need to carry out an empirical investigation to establish the extent to which the CBK 2006 banks guidelines and regulations have affected or influenced financial performance of commercial banks in Kenya for the research gap.

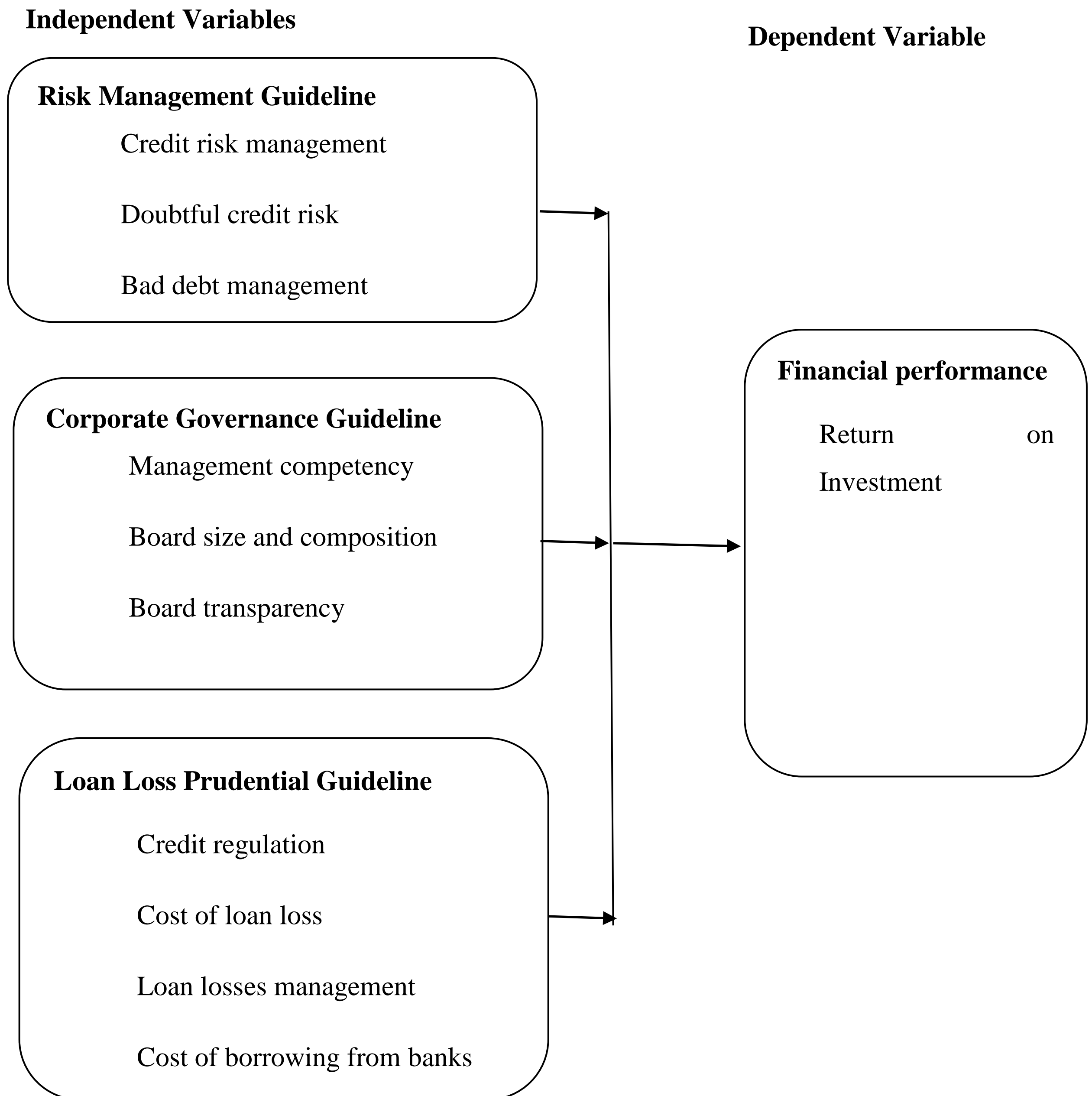
2.5 Summary of Literature Review

From the analysis of the presented literature in the banking sector shows that the skewness tends to be on the banking business regulation all over the world. According to Iyade (2006) points out that the regulation in the banking sector is very pivotal not only to the central bank concerns but also to the majority of the financial institutions and investors. Having an efficient banking system in the economy is one of the milestone towards national development and competences in the production.

It is clear that quality banking services that is sound and profitable is able to withstand harsh conditions in all the business cycles. This links to key important roles that commercial banks play in the economic growth. Banks are known to be the bridge between those who have money resources and those who lacks money resources and have potential investments to work on. Proper CBK prudential guidelines promotes the interest of commercial banks and that of the investors and industry stakeholders (Alao, 2010).

2.6 Conceptual Framework

According to Mugenda (2008) defines conceptual framework as a system of variables operationalized by the researcher in an attempt to realize the set objectives. The independent variables in this research are risk management guideline, corporate governance guideline and loan loss prudential guideline while the dependent variable is financial performance as shown.



Source: (Author, 2018)

Figure 2.1 Conceptual Framework

2.7 Operationalization of the Variables

The study operationalizes the influence of central bank prudential guideline on financial performance of commercial bank in Kenya. The study independent variables were to determine the effect of risk management on financial performance of commercial banks, to establish the effect of corporate governance guidelines on financial performance of commercial banks and to establish the effect of loan loss prudential guidelines on financial performance of commercial banks. Shown below is the table that was used to present on the operationalization of the study variables.

Table 2. 1Operationalization of the Study Variables

Objective	Variable	Indicators	Measurement scale
To determine the effect of risk management on financial performance of commercial banks	**Independent** Risk Management Guideline	• Substandard credit facilities management • Doubtful credit facilities management • Lost credit facilities management • Bad debt management	Ordinal
To establish the effect of corporate governance guidelines on financial performance of commercial banks	**Independent** Corporate governance guideline	• Board competence • Role and responsibility • Accountability • Fairness on expectations of all stakeholders • Transparency in disclosing information	Ordinal
To establish the effect of loan loss prudential guidelines on financial performance of commercial banks	**Independent** Loan loss prudential guideline	• Perfection of securities • Valuation of securities • Discounting of securities • Write off of loan/advances • Evaluation of potentials loan losses and adequacy of the provision for loan losses	Ordinal
	Financial performance	**Profitability ratio** • Gross margin • Operating margin • Return on Investment • Return on Assets	Ordinal

CHAPTER THREE
RESEARCH METHODOLOGY

3.1 Introduction

The chapter on the methodology is based on the fieldwork procedure and data administration. The chapter covers on the following areas; research design, target population, sample population, sampling procedures, research instruments, study validity and analysis of the collected data (Mugenda, 2012).

3.2 Research Design

Research design is defined as the guide to the process of data collection, analysis, interpretation of the study finding via dialect and inference on the data relations (Mugenda, 2008). The study adopted a descriptive research in order to explain on the relationship that exists between the independent variables and the dependent variables (Gay & Airasian, 2003). Descriptive research design defines the phenomenon in their natural context in description terms like when, how why, where and who (Mugenda, 2008). Descriptive design showed the correlation between risk management guideline, corporate governance guideline, loan loss prudential guideline with financial performance of commercial bank.

3.3 Target Population

Mugenda (2008) defines target population as that total composition of people, sets, element, group of things and event that is under the investigation. The target population of the study will consist of all the 43 commercial banks operating in Kenya as at 31 December 2016 and are listed by the CBK.

3.4 Sample Technique

The study adopted a census sampling procedure to point out and present on the final respondents for the study. According to Mugenda (2008), a census approach should be used when the target population isn't very large and data could be collected from all the subjects in it. A census of 43 commercial banks in Kenya were considered under the current study and conducted at the head office.

3.5 Data Collection

The study used questionnaires as a primary data source which was obtained from the banks' senior management selected. The guide when developing questionnaires came from some published information about banks prudential regulation and financial performance.

3.6 Validity of the Instrument

Validity is defined as the ability of the research instrument to provide accurate information and valid solutions (Kothari, 2004). To ensure there is validity of the research instrument, the researcher selectively took in to account the opinions of the bankers and coordinated with the KCA university research supervisor. Validity was further assured by the fact that the research variables were chosen in such a manner that the explanatory variables which were deemed to have the largest impact on the response variable are the ones which were investigated.

3.7 Reliability of the Research Instrument

The term study reliability is used to explain on the assessments that are consistent under similar circumstances of research study in the same business environment Kothari, (2004). In the study developed, questionnaires were used for data collection. They were shared to the selected respondents randomly and the information given was evaluated for the reliability. Co-operative Bank was selected for a pilot study. The pilot study data was analyzed, interpreted and the instrument reviewed in readiness to the main data collection study. The Cronbach's alpha test was used to test on the reliability where all the recorded variables were above 0.7 in the test. In addition, when the value of Cronbach's alpha coefficient exceeds 0.7, the instrument is deemed reliable.

3.8 Data Analysis

The study sought to analyze on the influence of CBK prudential regulations on the financial performance of commercial banks. The study used questionnaires to collect primary data. A five scale Likert measurement was used to profile respondent's opinion on the stated topic with special attention to reflect on risk management guidelines and financial performance of commercial banks, corporate governance guidelines and

financial performance of commercial banks and loan loss prudential guidelines on financial performance of commercial bank. The use of the research questionnaires was practically based on low cost involved, gives adequate time to respondents to fill and uniformity in response (Mugenda, 2008).

3.9 Diagnostic Tests

The data that was collected was analyzed using demographic, descriptive and inferential statistics in SPSS version 23, the researcher performed the following diagnostic tests on the regression model;

3.9.1 Multicollinearity

The study had three independent variables and a multicollinearity was established in the regression of coefficients on the relationship between the independent and dependent variables. The Cronbach's test, the F Test and coefficient of determination. A one-way ANOVA and F test were used to test on the significance of the overall regression model. The study results were presented using tables, frequencies and percentages. The empirical model will be used in this study in the multiple linear regression model is specified below:

The regression equation; $Y = \beta 0+\beta 1X1+\beta 2X2+\beta 3X+\epsilon$: Whereby

Y = Financial performance of commercial banks

$\beta 0$ = Constant term, $\beta 1$, $\beta 2$ and $\beta 3$ = Beta coefficients

$\beta 0$ = Constant term

$\beta 1$, $\beta 2$ and $\beta 3$= Beta coefficients,

X1 = Risk management guidelines

X2 = Corporate governance guidelines

X3 = Loan loss prudential guidelines

ϵ= Error term

CHAPTER FOUR

DATA ANALYSIS PRESENTATION AND INTERPRETATION

4.1 Introduction

The chapter presents an in-depth analysis of the study methodology findings based on the influence of Central Bank prudential guidelines on financial performance of the commercial bank in Kenya. The study specific objectives involved determining the effect of risk management guidelines on financial performance of commercial banks, establishing on the effect of corporate governance guidelines on financial performance of commercial banks and assessing on the impact of loan loss prudential guidelines on financial performance of the commercial banks in Kenya. Throughout the review and analysis, primary data was collected via the use of questionnaire and presented as shown below.

4.1.1 Response Rate.

Table 4. 2 Sample Response Rate

Response rate	Tally	Percentage
Correctly filled and returned	32	74.42%
Not returned	11	25.58%
Total	43	100%

From the table above 74.42% of the questionnaires sent to the respondents were returned fully filled, while 25.58% of them were not returned. This showed a good response rate though some were not able to return questionnaires due to busy schedules, non-interest and other inconveniences. According to Mugenda (2012) points out that response rate of 50% is very good and adequate for analysis and presentation, a response rate of 60% and above gives exemplary reporting while a response rate of 70% and above is a distinction that gives an excellent assessment of the study results.

4.1.2 Gender of the Respondents

Table 4.3Gender of the respondents

	Frequency	Percentage	Valid Percentage	Cumulative Percentage
Female	14	43.75	43.75	43.75
Male	18	56.25	56.25	100.0
Total	32	100.0	100.0	

The respondents included both males and females. The figure above shows that 43.75% of the respondents were recorded to be female in number whereas 56.25% were reported to be male. The study findings indicated that the banking sector had more males than the female in the departments involved in the study during that time.

4.1.3 Level of Education

Table 4.4Level of Education

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	College	1	3.1	3.1	3.1
	University	7	21.9	21.9	25.0
	Masters	14	43.8	43.8	68.8
	PHD and Others	10	31.3	31.3	100.0
	Total	32	100.0	100.0	

Referring to the above table, the targeted respondents in the study were asked to post on their level of education. From the analysis, 43.75% had Master's Degree, 31.25% had PHD, and 21.88% had Degree while 3.13% had Diploma qualification. This shows that the respondents provide skilled labor and have professional experience in the banking sector.

4.1.4 Position in the organization

Table 4. 5Position organization

	Tally	Percent	Valid Percent	Cumulative Percent
Senior Management	9	28.1	28.1	28.1
Middle Level Management	23	71.9	71.9	100.0
Total	**32**	**100.0**	**100.0**	

From the above figure on the respondent's feedback on their position in the banking sector. The analysis indicated that 71.9% of the respondents were from the middle management while 28.1% were from the top or senior management.

4.1.5Number of years working in the bank

Table 4. 6Number of years working in the bank

		Frequency	Percent	Valid Percent	Cumulative percent
Valid	1 to 5 years	5	15.6	15.6	15.6
	6 to 10 years	8	25	25	40.6
	11- 19 years	12	37.5	37.5	78.1
	Over 20 years	7	21.9	21.9	100.0
	Total	**32**	**100.0**	**100.0**	

Referring to the above table, the researcher wanted to access the number of the years that the respondents have been in the banking sector. From the analysis majority have been in the banking sector within 11- 19 years with a total response of 37.5%, this was followed by 6-10 years with 25%, 15.6% had been in banking sector for less than 5 years while 21.9% had been in the sector for over 20 years.

4.1.6 Age groups of the respondents

Table 4.7Age group of the respondents

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	25 Years and less	4	12.5	12.5	12.5
	26-35 years	9	28.1	28.1	40.6
	36 - 49 years	11	34.4	34.4	75.0
	Over 50 years	8	25	25	100
	Total	32	100.0	100.0	

From the above table, 50% of the respondents were aged 46 – 60 years, 26 -45 years were 37.5% while those below 25 years were 12.5%. This shows that most of the respondents in the medical facilities are above 45 years representing economic active category therefore increasing on the frequency of the response rate.

4.1.7 Impact of Central Bank prudential guideline on the financial performance of commercial banks

Table 4.8Impact of CBK prudential guidelines on financial performance of commercial banks

	Frequency	Percent	Valid Percent	Cumulative Percent
Strongly Disagree	3	9.40	9.4	9.4
Disagree	6	18.8	18.8	28.1
Neutral	6	18.8	18.8	46.9
Agree	3	9.4	9.4	56.3
Strongly Agree	14	43.8	43.8	100.0
Total	32	100.0	100.0	

Referring to the above table, most of the respondents were in agreement that Central Bank prudential guidelines greatly impacts on the financial performance of commercial banks in Kenya. This was supported 43.75% strongly agreed, 9.4% agreed, 18.75% were neutral while a total of 28.125 disagreed.

4.2 Risk Management Guidelines and Financial Performance

The researcher requested the respondents to indicate on the risk management guidelines as an aspect of Central Bank prudential guidelines that impact on the financial performance. The decision was based on the key points that were ranked as per the mean. From the observation, statement relating to banks have risk management policy in place was the highest ranked with a mean score of 3.81 and a standard deviation of 1.2.30. contrary, the extreme of the variable scale measure showed that CBK caries onsite and

offsite inspection to the commercial banks was ranked lowest with a mean of 2.28 and standard deviation of 1.198 as indicated in the table

Table 4. 9 Risk Management Guidelines and Financial Performance

	N	Min	Max	Mean	Std. Deviation
CBK carries onsite and off-site inspection to banks compliance to risk management	32	1	5	2.28	1.198
Sometimes bank fails to identify problem assets in the balance sheet	32	1	5	2.75	1.164
CBK provides clear guidelines to the financial institutions on the development of risk management systems and frameworks.	32	1	5	2.84	1.347
My banks have a positive portfolio analysis system for credit policy evaluation	32	1	5	2.84	1.110
Risk Management Guidelines involve developing strong internal control in the financial institutions	32	1	5	2.94	1.162
Risk Management is spearheaded by risk managers in the banks	32	1	5	3.19	1.030
Banks have risk management policy in place	32	1	5	3.81	1.230
Valid N (listwise)	32				

4.3 Corporate Governance Guidelines and Financial Performance

The author wanted to analyze the respondent's decision on statement relating to corporate governance guidelines and how it impact on the financial performance of commercial banks in Kenya under prudential guidelines. The statement of analysis was based on the aspect of CBK guidelines being considered as one of the policies that doesn't consider proper judgement from the management. Corporate governance seems to be a challenge to the banking sector, Corporate governance guidelines are intended to safeguard integrity and credibility of banks, CBK provides in details key guidelines on proper standards of conduct and sound banking policies. CBK requires banks to have a competitive management, banks have been marred by corporate management challenges and bank's shareholders do appoint managers who are competent and dedicated in the board of management in line with CBK Prudential Guidelines Report, 2006). The result of the finding indicated that bank's shareholders do appoint a very competitive and dedicated board of directors in the management in line with CBK Prudential Guidelines Report, 2006), this had a highest post with a mean score of 3.63 and a standard deviation of 1.476. The lowest response rate came from the statement that CBK guidelines do not restrict on the proper judgement of the management and employees when conducting day to day business which had a mean of 2.81 and a standard deviation of 1.401

Table 4. 10 Corporate Governance Guidelines and Financial Performance

	N	Minimum	Maximum	Mean	Std. Deviation
CBK Guideline do not restrict on the proper judgement of the management and employee when conducting day to day business	32	1	5	2.81	1.401
Corporate governance is a challenge in the banking sector	32	1	5	2.84	1.417
Corporate governance guidelines are intended to safeguard integrity and credibility of banks	32	1	5	3.03	1.379
CBK provides in details key guidelines on the proper standards of conduct and sound banking practices.	32	1	5	3.12	1.601
CBK requires banks to have competitive management	32	1	5	3.22	1.362
Banks have been marred by corporate management challenges	32	1	5	3.53	1.218
Bank's shareholders do appoint competent and dedicated board of directors and management in line with CBK Prudential Guidelines Report, 2006).	32	1	5	3.63	1.476
Valid N (listwise)	32				

4.4 Loan Loss Prudential Guidelines and Financial Performance

The respondents were asked to indicate their support level on support or non-support level on statement relating to loan loss prudential guidelines and how they impact on financial performance of commercial banks in Kenya.

The analysis of the study showed that most respondents agreed that capital regulation by central banks is meant to protect the deposit insurance fund and force banks to internalize on their losses with a highest mean score of 3.84 and standard deviation of 0.987. the respondents also agreed to a very little extent that CBK credit regulation has increased on the cost of borrowing with a mean score of 2.78 and standard deviation of 1.313 as shown in the table below.

Table 4. 11 Loan Loss Prudential Guidelines and Financial Performance

	N	Min	Max	Mean	Std. Deviation
CBK credit regulation has increased on the cost of borrowing	32	1	5	2.78	1.313
Commercial banks cut back on lending which to increase the cost of borrowing	32	1	5	2.84	1.417
Credit loan loss is main financial challenge facing banks	32	1	5	3.00	1.344
Micro prudential regulation is meant to restore prompt corrective action	32	1	5	3.16	1.322
Different banks differ on their cost of borrowing on loan	32	1	5	3.16	1.194
Government cover losses made by banks	32	1	5	3.19	1.378
Capital regulation by central banks is meant to protect the deposit insurance fund and force banks to internalize on their losses.	32	1	5	3.84	.987
Valid N (listwise)	32				

4.5 Financial Performance of commercial banks

The respondents in the study were asked to rank their support or non-support level on the statement relating to financial performance of commercial banks in Kenya. The represented below shows the response rank in that most of the respondents do support the point relating to. Their views were ranked based on the indicated level of support. From the analysis, majority of the respondents did support the fact that the bank's interest expense has reduced over the last five years with a mean of 3.13 and standard deviation of 1.338. the statement relating to the firm posted a reduction in operational costs had a mean of 2.34 and standard deviation of 1.335 as shown below.

Table 4. 12 Financial Performance of Commercial Banks.

	N	Min	Max	Mean	Std. Deviation
The bank posted a reduction in operational costs	32	1	5	2.34	1.335
The bank has posted and increase in total assets in the last five years	32	1	5	2.41	1.241
The firm Return on Investment increased	32	1	5	2.63	1.289
The bank has recorded an increase in net income in the last five years	32	1	5	3.03	1.231
The bank's interest expense has reduced over the last five years	32	1	5	3.13	1.338
Valid N (listwise)	32				

4.6Validity and Reliability

The construct validity can be inferred from the fact that all regressors were significant and the overall regression model, as indicated in the ANOVA table was also significant. To measure on the reliability and validity of the data collected, an internal consistency

model of Cronbach's Alpha was computed using the SPSS and the results presented as shown. All the test variables registered an alpha value of above 0.7 showing that the data had a high level of internal consistency.

Table 4. 13 Reliability Analysis

Independent Variable	Cronbach's Alpha	Comments
Risk Management Guidelines	0.816	Acceptable
Corporate Governance Guidelines	0.866	Acceptable
Loan Loss Prudential Guidelines	0.897	Acceptable

4.7 Inferential Analysis

The study used inferential statistical analysis to compute on the strength that exists among the variables in the study. The study incorporated coefficient of determination, analysis of variance (ANOVA) and multilinear regression equation for analysis

4.7.0 Correlation Matrix

Table 4. 14 Correlation Matrix

Correlations					
		Financial performance	Risk Management Guidelines	Corporate Governance Guidelines	Loan Loss Prudential Guidelines
Pearson Correlation	Financial performance	1.000			
	Risk Management Guidelines	.190	1.000		
	Corporate Governance Guidelines	.311	.724	1.000	
	Loan Loss Prudential Guidelines	.524	.197	.197	1.000

Results in the table shows that there was a positive and significant relationship between financial performance and risk managementguidelines (r =.190, p value <0.05).

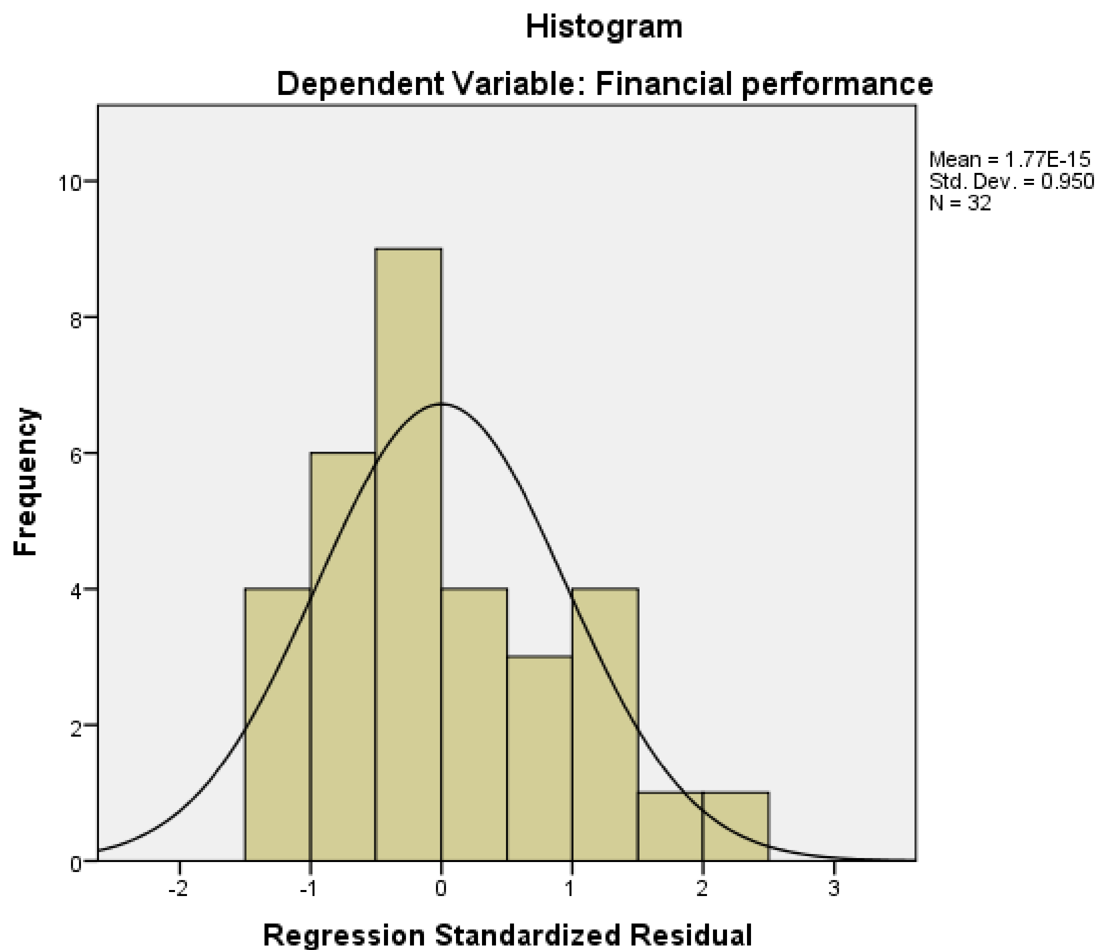
Secondly, there was a positive and significant relationship between Success of financial performance and corporate governance (r = .311, p value < 0.05).

Thirdly, there was a positive and significant relationship between financial performance and loan loss prudential guidelines (r = .524, p value < 0.05).

4.7.1 Normality Test

The figure below shows that financial performance of commercial banks was normally distributed the mean was 0 and standard deviation was 1.

Table 4. 15 Histogram



4.7.2 Coefficient of Determination

Coefficient of determination was computed to measure how well the study's data was suited for the statistical model that was used for main analysis. The table below shows that the coefficient of determination (R) was 0.506. This R^2 suggests a relatively goodness of fit of the study data to the OLS regression model. 50.6% of variability in the level of financial performance can be explained by variations in Loan Loss Prudential Guidelines, Risk Management Guidelines and Corporate Governance Guidelines. The remaining 49.4% of variability can be attributed to other factors not explained and included in the model.

Table 4. 16 Coefficient of Determination

Model Summary[b]

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Change Statistics					Durbin-Watson
					R Square Change	F Change	Df1	Df2	Sig. F Change	
1	.712[a]	.506	.453	.71952	.506	9.570	3	28	.000	1.583

a. Predictors: (Constant), Loan Loss Prudential Guidelines, Risk Management Guidelines, Corporate Governance Guidelines

b. Dependent Variable: Financial performance

4.7.3 Analysis of Variance

In testing the significance of the overall model, the study used the ANOVA F –Test. From the given figure below the p-value is 0.000 and F 9.570. The analysis implies that the model is statistically significant in estimating on the effect of Loan Loss Prudential Guidelines, Risk Management Guidelines and Corporate Governance Guidelines on financial performance.

Table 4. 17 Analysis of Variance

ANOVA[a]

Model		Sum of Squares	Df	Mean Square	F	Sig
1	Regression	14.863	3	4.954	9.570	.000[b]
	Residual	14.496	28	.518		
	Total	29.359	31			

a. Dependent Variable: Financial performance

b. Predictors: (Constant), Loan Loss Prudential Guidelines, Risk Management Guidelines, Corporate Governance Guidelines

4.7.4 Regression Analysis

The multiple regression analysis was tested to assess on the relationship between the financial performance and the three independent variables shown below.

Table 4.18 The regression Analysis

Coefficients

Model		Unstandardized Coefficients		Standardized Coefficients	T	Sig
		B	Std. Error	Beta		
1	(Constant)	1.329	0.473		2.825	0.0105
	Risk Management Guidelines	0.638	0.172	0.205	3.709	0.0139
	Corporate Governance Guidelines	0.576	0.155	0.693	3.716	0.0136
	Loan Loss Prudential Guidelines	0.605	0.187	0.222	3.235	0.005

a. Dependent Variable: Financial performance

b. Predictors: (Constant), Loan Loss Prudential Guidelines, Risk Management Guidelines, Corporate Governance Guidelines

The regression coefficients in the above table established that taking all the independent variables (Loan Loss Prudential Guidelines, Risk Management Guidelines and Corporate Governance Guidelines) to be constant, the level of absorption of financial performance will be at 1.329.

The analysis of the study findings shows that there was a positive and significant relationship between risk management guidelines and financial performance of (β=0.638 and P value of >0.05). this shows that a unit increase in risk management guidelines will lead to an increase in financial performance of commercial banks by 0.638.

The second objective of the study findings showed that there was a positive and significant relationship between corporate governance guidelines and financial performance commercial banks of (β=0.576 and P value of >0.05). this shows that a unit increase in corporate governance guidelines will lead to an increase in financial performance of commercial banks by 0.576.

The third variable findings showed that there was a positive and significant relationship between loan loss prudential guidelines and financial performance of commercial banks (β=0.605 and P value of >0.05). this shows that a unit increase in loan loss prudential guidelines will lead to an increase in financial performance of commercial banks by 0.605.

The general regression equation can be written as:

$$Y = \beta 0 + \beta 1X1 + \beta 2X2 + \beta 3X3 + \varepsilon$$:

Whereby:

$$Y = 1.329 + 0.638X1 + 0.576X2 + 0.605X3 + \varepsilon$$

Y = Financial Performance

0.575 = Financial Performance in absence of the explanatory factors.

β_0 = Constant term

X_1 = Risk Management Guidelines

0.638 = Coefficient of X_1

X_2 = Corporate Governance Guidelines

0.576= Coefficient of X_2

X_3= Loan Loss Prudential Guidelines

0.605= Coefficient of X_3

The study sought to investigate influence of central bank prudential guideline on financial performance of commercial banks in Kenya. This was based on analyzing the financial performance as dependent variable and its relationship to risk management guidelines corporate governance guidelines and loan loss prudential guidelines as predictor factors. The independent variables showed a statistically significant relationship given the P value of less than 0.05 on all the variables.

The study findings thus concur with the findings from Obiero (2002) who analyzed about the banking regulatory framework in Kenya and its adequacy in reducing the banks failure. He identified ineffective board and management malpractices as the most dominant reason for bank failure further noted that although the legal provisions of the banking regulatory framework are fairly comprehensive in coverage and adequate in content to reduce probability of failure, timely intervention by CBK is important if they are to be effective. According to Stiglitz (2001) on his study about principles of financial regulation noted that all the arguments that support the application of regulation to banks are naturally extended to other institutions with a varying model of regulation.

CHAPTER FIVE
SUMMARY CONCLUSIONS AND STUDY RECOMMENDATIONS

5.1 Introduction

The study chapter presents a summary of the findings from the statistical analysis of the reflective study objectives. The study general objective was to analyze the influence of central bank prudential guidelines on the financial performance of commercial banks in Kenya.

5.2 Summary of the Study Findings

5.2.1 Risk Management Guidelines and Financial Performance

The study objective was to assess the impact of risk management guidelines as an element of Central Bank prudential guideline and its impact on the financial performance. From the data analysis, it was clear that banks have risk management policy in place that had a highest record of mean score of 3.81 and a standard deviation of 1.230. The inferential study analysis indicated that risk management guidelines had a positive significant impact on the financial performance of the commercial banks in Kenya holding other factors constant.

5.2.2 Corporate Governance Guidelines and Financial Performance

From the analysis, corporate governance guidelines had a positive impact on the financial performance of commercial banks. From the descriptive statistics analysis, it was evident that majority of the bank's shareholders do appoint competent and dedicated board of directors in line with the CBK Prudential Guidelines Report, (2006), this had a highest mean score of 3.63 and a standard deviation of 1.476. The analysis of the multiple linear regression showed that holding other factors constant, a unit increase in account receivables will lead to 0.576 increase in financial performance. This implied that banks should have competitive management structure.

5.2.3 Loan Loss Prudential Guidelines and Financial Performance

Loan Loss Prudential Guidelines do impact on the financial performance of the organizations, from the analysis in chapter four. It was observed that banks in relation to capital regulation by central banks is meant to protect the deposit insurance fund and

force banks to internalize on their losses with a highest mean score of 3.84 and a standard deviation of 0.98. The respondents agreed to a very little extent that CBK credit regulation has increased on the cost of borrowing with a least mean of 2.78 and standard deviation of 1.313. The respondents also showed that the loan loss prudential guidelines will lead to a 0.605 increase in financial performance of commercial banks.

5.3 Conclusions s of the study

Referring to the study computation and findings, it was clearly evident that financial performance of commercial banks depends on the effective prudential regulations. From the analysis, the regression coefficientsloan loss prudential guidelines, risk management guidelines and corporate governance guidelines have impact on the financial performance of the commercial banks in Kenya. Loan loss prudential guidelines increases on the financial performance of commercial banks by 0.605. Corporate governance guidelines increase in the financial performance of commercial banks by0.576and risk management guidelines will have an increase in financial performance by 0.638 units.

5.4 Recommendations.

The study clearly heighted on the influence of central bank prudential guidelines on the financial performance of commercial banks in Kenya. The study objectives were emphasized on loan loss prudential guidelines, corporate governance guidelines and risk management guidelines. The analysis recommends that the managers, bankers and regulatory bodies in the banking sector should revise different aspects of Central Bank prudential guidelines to maintain a tradeoff between the current financial environment in the banking sector and the risk involved.

5.5 Research Limitations.

Despite the research study being successful, there were some challenges as a result of reluctances among the respondents, time constraint and financial constraint that limited the scope of the study to only commercial banks.

5.6 Suggestions for Further Studies

From the general overview of the research study and in-depth investigation, the research would like to point out the following areas for future studies to consider:

1. Similar study should be conducted on the same topic of central bank prudential guidelines with a special focus on microfinance institutions.
2. A study should be undertaken to analyze the effect of human resource capitalization on financial performance of commercial banks in Kenya.
3. Impact of Finance Bill 2016 by the Central Bank of Kenya on competitiveness of credit services by commercial banks.

5.7 Limitations of the study

Study limitation is defined as a potential weakness in the research area that hinders on the effectiveness of the study by the researcher and limit on the scope of study work (Leedy, 2010). Some of the key limitation that the researcher encountered when collecting data were based on unsupportive respondents, non-documentation of some important prudential reports. Though the research commitment and unsupportive respondents was able to link up with potential respondents in answering to the questionnaires.

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APPENDICES

LETTER OF INTRODUCTION

DIANA MORAGWA OKENO

P.O. BOX70643-00400

NAIROBI, KENYA

TO THE RESPONDENTS

<u>RE: RESEARCH ASSISTANCE.</u>

I am a final year student at KCA University persuing Masters of Science and am carrying out a research study on the influence of central bank prudential guideline on financial performance of Commercial Bank in Kenya.

I kindly request for your generous participation in filling the attached questionnaires. The information obtained will be strictly used for purpose of academic research. The respondents are guaranteed that the information provided will be treated as private and confidential.

Yours Sincerely

Diana MoragwaOkeno

Sign…………….

Research Questionnaires

This research is intended to find out the influence of central bank prudential guideline on financial performance of Commercial Bank in Kenya. The results are expected to assist the government, policy makers, industry stakeholders and academicians in understanding deeply about central bank prudential guideline and financial performance of Commercial Banks in Kenya. This questionnaire consists of four sections (Sections A to D). Kindly respond to all questions by putting a tick (✓) in the box matching your answer or write your answer in the space provided if it is not included in the choices. The information given here will only be used for the purposes of academic study and will be treated with utmost confidentiality. You are not required to indicate your names on the questionnaire to ensure anonymity. Your cooperation will be highly appreciated.

Section A: Background Information

Questionnaire No…………………….

Date……………………………..

Name of the bank ---------------

1. Please indicate your gender

   Male [ ] Female [ ]

2. Level of education

College Diploma & Professional [ ] University Degree [ ]

Masters and Others [ ] PHD and Others [ ]

3. Position in the organization

Senior Management [ ] Middle Level Management [ ]

4. How long have you been in the banking sector?

1 – 5 years [ ] 6 - 10 years [ ]

11- 19 years [ ] Over 20 years [ ]

5. Which of the following age groups do you belong to?

Less than 25 years [ ] 26-35 years [ ]

36 – 49 years [ ] Over 50 years [ ]

6. To what extent does central bank prudential guideline impact on the financial performance of Commercial Bank in Kenya?

Very great extent [ ] Great extent [ ]

Moderate extent [ ] Little extent [ ]

Not at all [ ]

Section B:Risk Management Guidelines

7. To what extent do you agree with the following statements with regard to risk management guidelines as an element of central bank prudential guideline and its impact on financial performance of Commercial Banks in Kenya.

Use the following Likert scale: Strongly Disagree (1); Disagree (2); Neither Agree nor Disagree (3); Agree (4); strongly agree (5).

Please tick (✓) the numeric value corresponding to your personal opinion for each statement.

Statement relating to risk management guidelines and financial performance of banks	**SD1**	**D2**	**N3**	**A4**	**SA5**
1. Banks have risk management policy in place					
2. CBK provides guidance to financial institutions on the development of risk management systems and frameworks					
3. Risk Management Guidelines involve developing strong internal control in the financial institutions					
4. Risk Management is spearheaded by risk managers in the banks					
5. CBK carries onsite and off-site inspection to banks compliance to risk management					
6. Sometimes bank fails to identify problem assets in the balance sheet					
7. My banks has a portfolio review system for evaluation of credit policies and problem loans					
Other (specify……………………….……………………….………………….)					

Section C: Corporate Governance Guidelines

8. To what extent does institutional support impact on the level of accessing higher education loans by students?

To what extent do you agree with the following statements with regard to corporate governance guidelines as an element of central bank prudential guideline and its impact on financial performance of Commercial Banks in Kenya.

Use the following Likert scale: Strongly Disagree (1); Disagree (2); Neither Agree nor Disagree (3); Agree (4); strongly agree (5).

Statements relating to Corporate Governance Guidelines and financial performance of banks.	**SD1**	**D2**	**N3**	**A4**	**SA5**
1. CBK provides in details key guidelines on proper standards of conduct and sound banking practices.					
2. Bank's shareholders do appoint competent and dedicated board of directors and management in line with CBK Prudential Guidelines Report, 2006).					
3. CBK requires banks to have competitive management					
4. Banks have been marred by corporate management challenges					
5. Corporate governance is a challenge to the banking sector					
6. CBK Guideline do not restrict proper judgment of the management and employees when conducting day-to-day business					
7. Corporate governance guidelines are intended to safeguard integrity and credibility of banks					
Other (specify……………………………….….………….)					

Section C: Loan Loss Prudential Guidelines

9. Indicate your level of agreement with the following statements relating to loan loss prudential guidelines and how they impact on financial performance of Commercial Banks in Kenya.

Use the following scale: Strongly Disagree (1); Disagree (2); Neither Agree nor Disagree (3); Agree (4); strongly agree (5)

Statements relating to loan loss prudential guidelines and financial performance of banks.	**SD1**	**D2**	**N3**	**A4**	**SA5**
1. Government cover losses made by banks					
2. Micro prudential regulation is meant to restore prompt corrective action					
3. Different banks differs on their cost of borrowing on loan					
4. Credit loan loss is main financial challenge facing banks					
5. CBK credit regulation has increased on the cost of borrowing					
6. Commercial banks cut back on lending which to increase the cost of borrowing					
7. Capital regulation by central banks is meant to protect the deposit insurance fund and force banks to internalize on their losses.					
Other (specify……………………………….…….………….)					

Section F: Financial performance

For the following questions you are requested to indicate whether you agree (A),Disagree (D), strongly agree (SA), Strongly Disagree (SD) or Neutral (N) aboutfinancial performance based on ROA of your bank.

	Statement Response	SA5	A4	N3	D2	SD1
1	The bank has recorded an increase in net income in the last five years					
2	The bank has posted and increase in total assets in the last five years					
3	The bank's interest expense has reduced over the last five years					
4	The firm Return on Investment increased					
5	The firm posted a reduction in operational costs					

Thank you

Project Budget.

NO	ACTIVITY	BUDGET (IN KSHS)
1	Purchase of Stationery	3,500
2	Preparation of the project	3,500
2	Transport to banks head office	5,000
3	Payment of five data collectors	5,000
4	Analysis of the Report	5,500
5	Printing of three copies of the report	5,000
6	Binding of the project copies	4,500
7	Miscellaneous/contingency	5,000
TOTAL		**36,000**

List of Commercial Banks
1-Equity Bank
2-Family Bank
3-Fidelity Commercial Bank Limited
4-First Community Bank
5-Giro Commercial Bank
6-Guaranty Trust Bank Kenya
7-Guardian Bank
8-ABC Bank (Kenya)
9-Bank of Africa
10-Bank of Baroda
11-Bank of India
12-Barclays Bank of Kenya
13-CfC Stanbic Holdings
14-Chase Bank Kenya (In receivership)
15-Citibank
16-Commercial Bank of Africa
17-Consolidated Bank of Kenya
18-Cooperative Bank of Kenya
19-Credit Bank
20-Development Bank of Kenya
21-Diamond Trust Bank
22-Ecobank Kenya
23-Gulf African Bank
24-Habib Bank
25-Habib Bank AG Zurich
26-Housing Finance Company of Kenya
27-I&M Bank
28-Imperial Bank Kenya (In receivership)
29-Jamii Bora Bank
30-Kenya Commercial Bank
31-Middle East Bank Kenya
32-National Bank of Kenya

33-NIC Bank

34-Oriental Commercial Bank

35-Paramount Universal Bank

36-Prime Bank (Kenya)

37-Sidian Bank

37-Spire Bank

39-Standard Chartered Kenya

40-Trans National Bank Kenya

41-United Bank for Africa

42-Victoria Commercial Bank

43- Dubai Bank (In receivership)

Project Schedule 2017

Activity	Time Frame						
	May	June	July	August	September	October	November
Formulation of the Problem							
Writing Project							
Data Collection							
Data Analysis							
Presentation							