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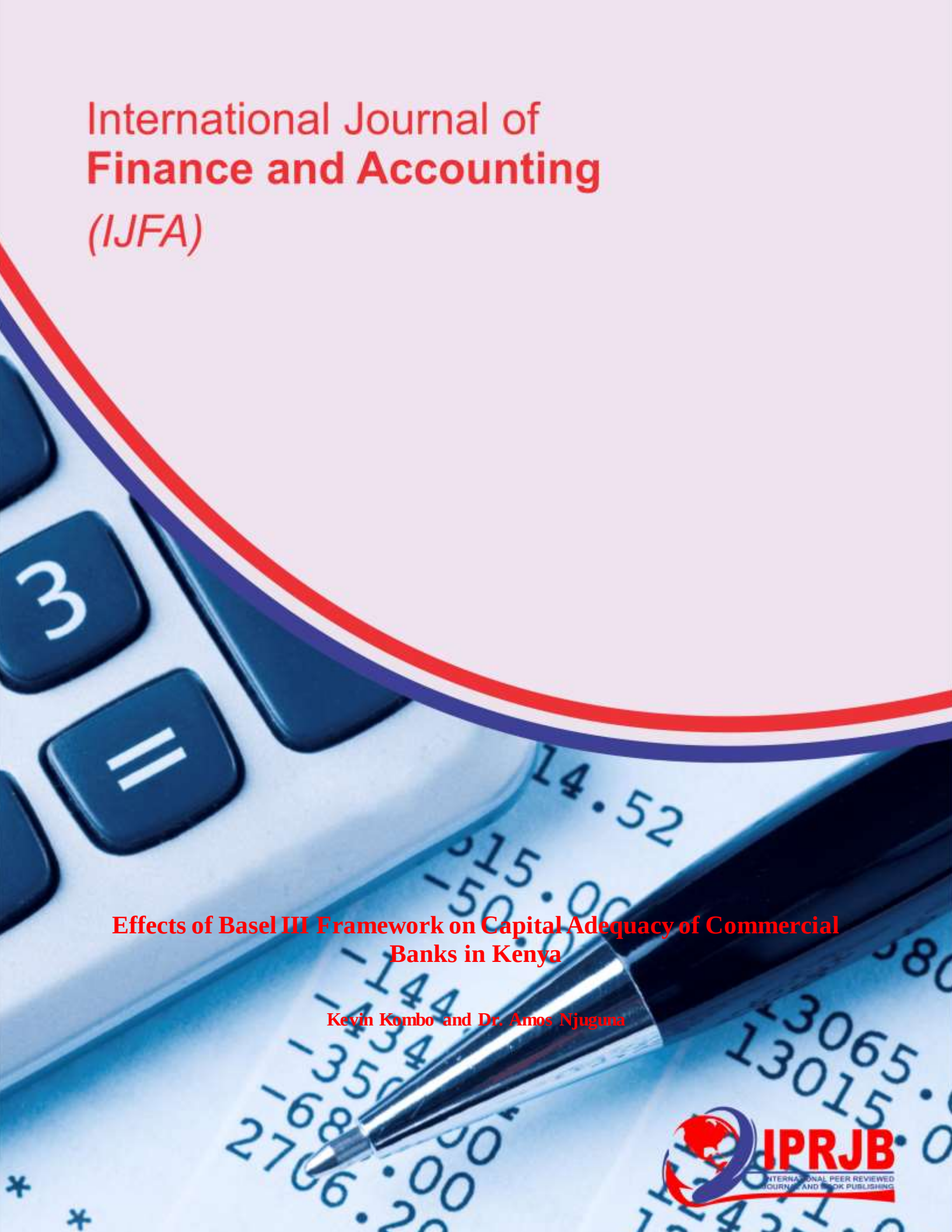

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ABSTRACT

Purpose: The purpose of the study was toassess the effects of Basel III framework on capital adequacy requirement in commercial banks in Kenya. The study sought to address the following research questions: why are capital adequacy regulations important in commercial banks in Kenya? What challenges are commercial banks facing in the implementation of capital adequacy requirement? What measures have commercial banks taken to ensure compliance with the capital adequacy requirement?

Methodology: A descriptive survey design was applied to a population of 43 commercial banks operating in Kenya. The target population composed of the 159 management staff currently employed at the head offices of the various commercial banks in Kenya. The population was composed of Senior, Middle and Junior or Entry level Management staff. A sample of 30% was selected from within each group. Primary data was gathered using questionnaires which were dropped off at the bank's head offices and picked up later when the respondents had filled the questionnaires. Descriptive analysis was used to analyze quantitative data while content analysis was used to analyze qualitative data.

Results: The findings show that capital adequacy requirement is important in commercial banks because it leads financial stability in the Kenyan economy, improves credit risk management techniques as poor credit risk management requires more capital and leads to reduced vulnerability to liquidity shocks due to the sound capitalization policies being implemented under the Basel III framework. Findings also revealed that capital adequacy affected the balance sheet structure of the commercial banks in Kenya.

Unique contribution to theory, practice and policy: The study recommends that banks should continue the pursuit of various strategies to ensure that they are in compliance with Basel III requirements and the Central Bank of Kenya's Prudential Guidelines. The staff of this committee should be drawn from mainly the finance, legal, compliance and treasury departments. Compliance with the capital requirements will lead to a safety net for all commercial banks as the additional capital will act as a cushion that absorbs losses in case of distress in the commercial banking sector.

***Keywords**: capital adequacy, challenges, measures, Basel III framework*

1.0 INTRODUCTION

The global financial crisis of 2009-2010 spurred the need to review the regulatory framework of banks across the globe. As a result, reforms were necessary to rectify flaws in the regulatory framework. The Basel Committee on Banking Supervision (BCBS) is leading efforts to reform the global banking regulatory framework (BCBS, 2010a). In December 2010, BCBS announced Basel III proposals which national regulators and regional supervisory organizations are reviewing to evaluate its suitability to conditions in their own financial systems. According to Bean (2009), the banks were undercapitalized which is one of the reasons behind the 2007-2010 financial crises. The financial crisis 2007-2009 still has effects on international financial markets and the real economy.

Key lessons from the global financial crisis revolve around leverage, capital and liquidity. According to BCBS (2010b) the existence of the credit bubble, alongside with the constant innovation in financial products and techniques and fair value accounting have to be cited in this context as additional causes of the crisis. In addition, inadequate bank regulation is viewed as one of the main causes of the financial crisis (BCBS, 2010a; Calice, 2010).

According to Financial Stability Board (2011) global crises had a huge impact on banks across the world. The crisis resulted from too much leverage, little capital and inadequate liquidity by many banks. They were thus unable to absorb their large trading and credit losses that had occurred since 2007 and many banks failed (International Monetary Fund, 2010). The weaknesses in the banking sector were rapidly transmitted to the rest of the financial system and the economy resulting in a massive contraction of liquidity and credit availability (Moreno, 2011).

Basel III is the third installment of the Basel accords and is a global regulatory standard set by the BCBS on capital adequacy (including a new leverage ratio and capital buffers), market liquidity risk (with new short-term and long-term liquidity ratios) and stress testing focusing on stability. The Basel III reforms to global regulatory standards were agreed by the G-20 in November 2010 and were then issued by the Basel Committee on Banking Supervision in December 2010 (BCBS, 2010a). The key aim of these reforms is to strengthen the capital adequacy requirements with regard to quality and quantity of capital which banks must hold in order to absorb losses. The Basel III framework, whose main thrust has been enhancing the banking sector's safety and stability, emphasises the need to improve the quality and quantity of capital components, leverage ratio, liquidity standards, and enhanced disclosures. Basel III is therefore an effort to control the causes of the most recent crisis. Regulation of this sort has been effective in the past (BCBS, 2010).

Basel III introduces new and enhanced rules, these includes the introduction of a new and stricter definition of capital – designed to increase consistency, transparency and quality of the capital base – and the introduction of a global liquidity standard (BCBS, 2010). The two new liquidity ratios – the longer-term Net Stable Funding Ratio (NSFR) and the short-term Liquidity Coverage Ratio (LCR)–call on banks to raise high-quality liquid assets and acquire more stable sources of funding, ensuring that they are in agreement with the principles of liquidity risk management. In addition, Basel III introduces a new leverage ratio, a substitute to the risk-based Basel II framework. By setting 3 percent as the ratio of Tier 1 Capital to total exposure, the new leverage ratio may limit banks' scope of action (BCBS, 2010c).

Moreover, Basel III increases capital requirements for securities financing activities, repurchase agreements andcounterparty credit risk arising from derivatives. Additionally, the new framework

has formulated ways of reducing systemic risk and the cyclical effects of Basel II. For instance, it introduces a countercyclical capital buffer and capital conservation, and discusses "through the-cycle" provisioning. The bursting of the credit bubble led to a rapid decline in asset prices, combined with a reduction in what Wilmot,Sweeney, Klein & Lantz (2009) dubbed, the stock of shadow money, liquid assets which take up the role of money to finance the expansion during an economic boom.

1.2 Statement of the Problem

The aggregate effects of the requirements vary from one bank to another. Among large banks almost all of them have had to deal with its far reaching implications. Several studies have been carried out with regard to such bank regulations across the globe. In Egypt for the period 1989-2004, using a bank scope data base for 28 banks Naceur and Kandil, (2009) analysed the effects of capital regulations on the stability and performance of banks. The study analysed two measures of performance: cost of intermediation and banks' profitability- measured by return on assets. Result revealed that banks raise the cost of intermediation as the capital adequacy ratio internalizes the risk for shareholders. This results to higher return on assets and equity revealing the need for capital regulation to the performance of banks and financial stability in Egypt. Their study suggested that the use of structural reforms aiming at establishing more competition in the banking industry can help ensure that performance indicators are corresponding with the best practices of the intermediation function that assures financial stability over time.

According to the quantitative impact study conducted by the Basel Committee (2010c), on average the newly defined capital ratio (Common Equity Tier I ratio) of large banks decreases from 11.1 percent to 5.7 percent, due to the change of definition of capital and the changes in risk-weighted assets. Furthermore, Basel III increased the required minimum capital level percent to more than 7 percent. Kamau *et.al* (2004) used the simultaneous equations approach to model the regulatory effect of minimum capital requirements on bank risk behaviour and capital levels in Kenya for the period 2000-2002. This study established that the Kenya's banking sector has an oligopolistic market structure.

To the best of the researcher's knowledge, no study had ever concentrated on assessing the effects of Basel III framework on capital adequacy of commercial banking industry in Kenya hence the research gap that the current study sought to fill. This study was built on the premise that the passage of time and the very numerous and significant changes in the commercial banks operating environment have led to totally different operating environment after the Basel III framework requirements.

1.3 Objectives of the Study

i. Why are capital adequacy requirements in Basel III framework important for commercial banks in Kenya?
ii. What challenges are commercial banks facing in the implementation of capital adequacy requirement in Basel III framework?
iii. What measures have commercial banks taken to ensure compliance with the capital adequacy requirement in Basel III framework?

2.0 LITERATURE REVIEW

2.1 Empirical Review

Mutesi (2011) sought to investigate the relationship between risk management, information and financial performance of commercial banks. The research objectives that guided the study were, to examine the relationship between information sharing and risk management, to examine the relationship between information sharing and financial performance, to investigate the relationship between information sharing, risk management and financial performance. A sample of 104 commercial banks branches were selected from a total of all the branches of commercial banks in Kampala. The respondents were purposively selected from each branch. Across-sectional research design was used in this study. Questionnaires were used collect primary data. SPSS package was used to analyze data. Descriptive regression and correlation analysis were carried out. The findings revealed that there was a significant positive relationship between all the study variables information sharing, risk management, and financial performance. The study recommended that banks should put up strong information sharing premises like credit bureaus, enrich their risk management committee, credit committee and audit function so as to minimize risks. The study also recommended that banks should recruit qualified staff and embrace training as a common practice in the banking industry in order to improve risk management policies and hence improved financial performance.

Mwangi (2012) examined the effect of credit risk management on the financial performance of commercial banks. The study used a descriptive research design. The study used secondary data which was obtained from the commercial banks' annual reports (2007-2011). Of the 43 commercial banks in Kenya, complete data was obtained from only 26 banks and thus the study concentrated on the 26 banks. The data obtained from the annual reports of the banks was analyzed using multiple regression analysis. Statistical Package for Social Sciences (SPSS version 18) was used to obtain the regression output. In the model return on equity (ROE) was used as the profitability indicator while non-performing loans ratio (NPLR) and capital adequacy ratio (CAR) as credit risk management indicators. Results revealed that there is a significant relationship between financial performance (in terms of profitability) and credit risk management (in terms of loan performance and capital adequacy). The results of the analysis revealed that both non-performing loans ratio (NPLR) and capital adequacy ratio (CAR) have negative and relatively significant effect on return on equity (ROE), with NPLR having higher significant effect on ROE in comparison to CAR. The study recommended that all banks should take on a credit risk grading system. The system should define the risk profile of borrower's to ensure that account management, structure and pricing are proportionate with the risk involved. Risk grading is a key measurement of a Bank's asset quality, and as such, it is essential that grading is a robust process. All facilities should be assigned a risk grade. Where deterioration in risk is noted, the risk grade assigned to a borrower and its facilities should be immediately changed. Borrower Risk Grades should be clearly stated on Credit Applications.

Gudmundsson, Ngoka-Kisinguh and Odongo (2013) sought to find out the role of capital requirements on bank competition and stability in Kenya for the period 2000-2011. The study adopted the Lerner index and the Panzar and Rosse H-statistic to measure competition in Kenya's banking industry. Approximations of both the Lerner index and the H statistic showed that competition in the Kenyan banking sector had reduced over the study period. The study

approximated the fixed effects of capital requirements on bank competition and stability for the 36 commercial banks using a panel regression model. The panel estimates indicated that there was a significant non-linear effect of core capital on competition. The log of core capital was positive and significant while squared log of core capital was negative and significant which is an implication that an increase in core capital reduces competition up to a point and then increases competition. Therefore, the advantages of raising capital requirements on competitiveness are achieved after consolidation in the banking sector. Return on equity was used to capture bank performance and stability which showed a positive relationship in support of the evidence that capital regulation improves the performance of banks and financial stability.

Waithaka (2013) sought to investigate the effect of Basel II requirement on Kenyan commercial banks' lending. A descriptive research design was adopted for this study. The populations for this research are the 43 listed Commercial Banks in Kenya analyzed for a period from 2009-2012. The study findings revealed that commercial banks risk weighted asset had increased by 79% over the years indicating a similar growth in bank's assets. To meet the asset growth, core capital had also increased by 88% with bank's undertaking rights issue between 2011 and 2012 in order to meet the new capital requirements with Basel II. Total loans and advances with a risk weight of 100% also increased by 77% from the year 2009 to 2012. The CAMEL rating also showed continuous growth in all the main ratios over the years under review. The study concluded that Basel II requirement has an impact on banks' capital requirement and asset growth with growth in core capital and risk weighted assets clearly seen over the years. The study also concluded that Basel II requirement has an impact on banks' lending. None of the commercial banks so far was in breach of the minimum capital requirements of 8% as additional capital has being raised through rights issues.

Owino (2013) investigated lending policies and their impact on the levels of non-performing loans among commercial banks in Kenya. A descriptive survey was employed in this study with the population of interest of being the forty three (43) commercial banks in Kenya. The study used primary data which was collected using questionnaires. Self-administration of the questionnaires was done through drop-and-pick later method. Descriptive statistics was used to summarize the data and findings presented using tables and other graphical presentations as appropriate for ease of understanding and analysis. The study found that there is a relationship between lending policies and non-performing loans, leading the banks to lend prudently. This lowers the risk level to the banks.

Ada (2013) carried out a study seeking to establish the relationship between corporate governance practices on the dividend payout of commercial banks in Kenya. The study used a functional form relationship between corporate governance practices and dividend payout using a regression model that showed the relationship between board size, insider holding, board composition, CEO duality, leverage as well as ownership and control to dividend payout. A total of 17 commercial banks in Kenya that paid dividends in the year 2008 - 2012 were used to determine the relationship. Results revealed that 72.7% of dividend payout in Kenyan commercial banks could be explained by corporate governance practices. The study recommended that the government should ensure that the corporate governance practices as outlined by the CMA are followed by companies which in turn will certify that the dividend payout to investors is most favourable.

3.0 RESEARCH METHODOLOGY

This study used a descriptive research design. The study selected 43commercial banks were to investigate the effects of Basel III framework on capital adequacy requirement. The target population composed of the management 159 management staffs currently employed at the head offices of the commercial banks in Kenya. The study used stratified random sampling. The study used a sample of 30% of the entire population which was 48 respondents. The study used questionnaires to collect primary data. The study generated both quantitative and qualitative data. The qualitative data was analyzed using content analysis and presented in prose form. Quantitative data was analyzed using descriptive statistics.

4.0 RESULTS AND DISCUSSIONS

4.1 Response Rate

The study sampled 48 respondents from the target population to collect data with regard to the effects of Basel III framework on capital adequacy requirement in commercial banks in Kenya. Out of 48 questionnaires distributed 37 respondents completely filled in and returned the questionnaires which accounted for 77.1% response rate. The good response rate was reached due to the adoption of the data collection method of constant follow up with the respondents by the researcher. The response rate demonstrates a willingness of the respondents to participate in the study on the effects of Basel III framework on capital adequacy requirement in commercial banks in Kenya.

4.2 Demographic Characteristics

4.2.1 Distribution of the Respondents by Gender

The respondents sampled comprised male and female staff of the commercial banks in Kenya. They were to indicate their gender by ticking on the spaces provided in the questionnaire. Table1 shows the distribution of the respondents by gender.

Table 1: Gender of the Respondents

Gender	Frequency	Percent
Male	23	62
Female	14	38
Total	**37**	**100**

Accordingly, 62% of the respondents were males while 38% of them were females. The findings show that the institution studied has both male and female members; however the majority of them are males. The findings imply that the views expressed in this findings are gender sensitive and can be taken as representative of the opinions of both genders as regards to the effects of Basel III framework on capital adequacy requirement in commercial banks in Kenya.

4.2.2 Response Rate Based on the Respondents' Departments

Capital requirements and implementation of Basel III decisions affect the various aspects of performance of the organizations across various departments. It was therefore important to ensure

that questionnaires were distributed and returned from various departments within the selected commercial banks. This was to ensure that the all areas influenced by Basel III are captured in the study. The results are as shown in table 2.

Table 2: Respondents' Departments

Department	Frequency	Percentage
Human resource	7	19.0
Finance	16	42.9
Procurement	7	19.0
Operations	5	14.3
Marketing	2	4.8
Total	**37**	**100.0**

From the results shown in table 2 and figure 4.1, 42.9% of the respondents were working in the finance departments, 19.0% of them were working in the human resource departments, 19.0% worked in procurement department, and 14.3% worked in the operations department, while 4.8% worked in marketing departments. This implies that all departments that were targeted by the study were involved and that the findings are not biased hence representative of the various departments' views on effects of Basel III framework on capital adequacy requirement in commercial banks in Kenya.

4.2.3 Respondents Managerial Positions

The study targeted to collect data from the management staffs. As such the respondents were likely to include managers, assistant managers, supervisors and general staffs. This was relevant to assess the distribution of the respondents across the management levels since they are part and parcel in the process of determining the effects of Basel III framework on capital adequacy requirement in commercial banks in Kenya.

Table 3: Respondents Designations

Designations	Frequency	Percentage
Heads of department	4	10.3
Assistant heads of department	13	34.5
Supervisors	13	34.5
General staffs	8	20.7
Total	**37**	**100.0**

The study findings in table 3 show that all the respondents occupy positions concerned with implementation of decisions like Basel III therefore they are aware of the effects of Basel III framework on capital adequacy requirement in commercial banks in Kenya. As such, 34.5% of the respondents indicated that they were assistant heads of department (assistant managers), another 34.5% of them were supervisors, 20.7% of them indicated that they were general staffs, while 10.3% of the respondents comprised of heads of departments (managers). These findings show

that the respondents that participated in the study were mainly those involved in the implementation of Basel III requirements that affect the capital adequacy requirement in commercial banks in Kenya.

4.2.4 Distribution of Respondents by Working Experience in the Banking Industry

The respondents were required to indicate the length of time they had worked in commercial banks in Kenya. The length of service/working in an organization determines the extent to which one is aware of the issues sought by the study. The results are as depicted in Table 4.

Table 4: Respondents' Duration of Work in the Commercial Banks in Kenya

Duration	Frequency	Percentage
0-5 yrs	7	19.0
5-10 yrs	11	31.0
10-15	19	50.0
Over 15 yrs	0	0.0
Total	**37**	**100.0**

From the respondents' duration of work in the commercial banks demonstrated in Table 4, 50.0% of them indicated that they had worked in the commercial banks for 10 to 15 years, 31.0% of them had been working in the commercial banks for 5 to 10 years, while 19.0% had worked in the commercial banks for 0 to 5 years. For that reason, majority of the respondents had enough experience on the effects of Basel III framework on capital adequacy requirement in commercial banks in Kenya.

4.2.5 Highest Formal Qualification

The respondents were asked to indicate their level of education. The target population comprised of people in different responsibilities and qualification requirements hence different academic qualifications. This difference might contribute to differences in the responses given by the respondents.

Table 5: Level of Education

Level of Education	Frequency	Percent
Undergraduate	15	40.5
Post graduate level	19	50.0
Certificate/Diploma	4	9.5
Total	**37**	**100.0**

The outcome depicted in table 5 show that majority of the respondents had at least an undergraduate degree and hence understood the information sought by this study, that is, 40.5% of the respondents had acquired a undergraduate degrees level of education, 50.0% of the respondents indicated that they had acquired a post graduate level of education, while 9.5% of the respondents indicated that they had acquired other levels of education such as ICPAK and Higher

Diplomas. These outcomes mean that majority of the respondents had at least an undergraduate degree and hence understood the information sought by this study.

4.3 Descriptive Statistics

4.3.1 Importance of Capital Adequacy Requirement

The first objective the study was to establish the importance of capital adequacy requirement. In this regard the respondents were required to indicate the extent to which capital adequacy requirement is perceived to be important in commercial banks in Kenya.

Table 6: Extent to which Capital Adequacy Requirement is Important to Banks

Extent	Frequency	Percent
To a very great extent	11	30.1
To a great extent	20	53.2
To a moderate extent	5	13
To a little extent	1	3.7
Total	**37**	**100**

From table 6, 53.2% of the respondents indicated that capital adequacy requirement is perceived to be important in commercial banks to a great extent, 30.1% of them indicated that capital adequacy requirement is perceived to be important in commercial banks to a very great extent, 13.0% of the respondents indicated to a moderate extent, while 3.7% of the respondents indicated that capital adequacy requirement is perceived to be important in commercial banks to a little extent.

In addition the respondents were required to indicate the extent to which various aspects of Basel III regulations affect the capital requirement of the commercial banks in Kenya.The results are as depicted in Table 7.

Table 7: Extent to which Basel III Regulations affect Banks' Capital Requirement

Aspects of Basel III regulations	No extent	Little extent	Moderate Extent	Great extent	Very great extent	Mean	Std. Dev.
Credit Risk Management	2.1	16.7	10.4	60.4	8.3	3.6250	1.0022
Balance Sheet Structure	4.1	26.3	18.1	19.2	32.3	3.4612	1.2633
Deposit Insurance	27.1	37.5	6.3	14.6	14.6	3.2083	1.1842
Financial Stability	2.1	27.1	16.7	10.4	43.8	3.6667	1.3421
Reduced Vulnerability to Liquidity Shocks	29.2	43.8	8.3	8.3	10.4	3.5428	1.5152

From the study majority of the respondents indicated that financial stability affects the capital requirement of the commercial banks in Kenya to a great extent as shown by a mean score of 3.6667, credit risk management affects the capital requirement of the commercial banks in Kenya to a great extent as shown by a mean score of 3.6250 and reduced vulnerability to liquidity shocks affects the capital requirement of the commercial banks in Kenya to a great extent as shown by a mean score of 3.5428 while balance sheet structure and deposit insurance affect the capital requirement of the commercial banks in Kenya to moderate extents as shown by mean scores of 3.4612 and 3.2083 respectively.

4.3.2Challenges Faced in Implementation of Capital Adequacy Requirement

The second objective of the study was to seek to investigate the challenges commercial banks are facing in the implementation of capital adequacy requirement. Accordingly, the respondents were required to indicate the extent their banks experience various challenges in the implementation of capital adequacy requirement.

Table 8: Challenges Faced in the Implementation of Capital Adequacy Requirement

Challenges	No extent	Little extent	Moderate extent	Large extent	Very large extent	Mean	Stddev
Regulatory constraints	29.2	43.8	8.3	8.3	10.4	3.5428	1.5152
Additional capital	18.8	10.4	35.4	35.4	33.3	3.2972	1.6102
Risk and finance management culture	0	12.5	14.6	25	29.2	3.3322	1.4923
Growth barrier	0	4.2	45.8	37.5	12.5	3.5845	0.77251

Results in table 8 reveal that majority of the respondents reiterated that their banks experienced growth barrier and regulatory constraints to great extents as shown by mean scores of 3.5845 and 3.5428 respectively, while they indicated that, in the implementation of capital adequacy requirement, commercial banks experience risk and finance management culture and additional capital challenges to moderate extents as shown by mean scores of 3.3322 and 3.2972respectively.

4.3.3Measures taken to Ensure Compliance with Capital Adequacy Requirement

The third objective of the study was to establish the measures that commercial banks have taken to ensure compliance with the capital adequacy requirement. As such the study sought to ascertain the extent to which commercial banks have taken some measures to ensure compliance with the capital adequacy requirement.

Table 9: Measures taken for Compliance with Capital Requirement

Extent	Frequency	Percentage

Very great extent	12	33
Great extent	14	39
Moderate extent	9	23
Little extent	2	5
Total	**37**	**100.0**

Results in Table 9 reveal that a majority (39%) of the respondents stated that commercial banks have taken measures to ensure compliance with the capital adequacy requirement to a great extent and 33% to a very great extent while 23% said commercial banks have taken some measures to ensure compliance with the capital adequacy requirement to a moderate extent. According to 4.5% of the respondents, commercial banks have taken some measures to ensure compliance with the capital adequacy requirement to a little extent. These results indicate that commercial banks have taken some measures to ensure compliance with the capital adequacy requirement to a great extent as shown by majority of the respondents, 72%.

The study further required the respondents to rate the extent to which the banks have taken various measures to ensure compliance with the capital adequacy requirement. A scale of 1 to 5 where 1= no extent, 2= little extent, 3= moderate extent, 4= large extent and 5 is to a very large extent was provided as in table 10.

Table 10: Measures to Ensure Compliance with the Capital Adequacy Requirement

Measures to ensure compliance	**No Extent**	**Little Extent**	**Moderate Extent**	**Great Extent**	**Very Great Extent**	**Mean**	**Std. Dev**
Cutting back on lending	2.1	27.1	16.7	10.4	43.8	3.6667	1.342
Market rights issue/bonds	11.9	7.4	22.6	21.2	24.3	3.0071	1.695
Increasing revenue growth/cutting costs	16.2	7.1	21.7	21.2	26.0	3.1000	1.634
Withholding dividend payment	0	27	7	41	23	3.5528	1.1843

Majority of the respondents recapped that their banks have practiced cutting back on lending and withholding dividend payment to great extents as shown by mean scores of3.6667 and 3.5528to ensure compliance with the capital adequacy requirement while their banks have been increasing revenue growth/cutting costs as well as market rights issue/bondsto a moderate extents shown by mean scores of 3.1000 and 3.0071 respectively.

4.4 Content Analysis

With regard to the open ended questions, the residents felt that Basel III raises the capital requirements for counterparty credit risk arising from repurchase agreements, derivatives and

securities financing activities. As such, the capital conversion buffer enables banks to take up losses without negating the minimum capital requirement, and is able to continue in business even in a downturn without deleveraging.

Similarly, the respondents said that other challenges faced by commercial banks and financial institutions is deciding how best to implement a solution that will allow them to comply with Basel III included; how to operate the systems and processes for improved operational effectiveness and how to understand and ultimately reduce their capital requirements. The weaknesses in applying consistent, robust risk asset definitions globally have led to distortions of true capital adequacy positions. Further, the respondents felt that commercial banks should adopt policies that reduce the capital adequacy gap with a steadfast secured liquidity facility after it has done what it can to reduce its liquid asset requirement by other means.

5.0 DISCUSSION CONCLUSIONS AND RECOMMENDATIONS

5.1 Findings

The first objective of the study was to assess the importance of capital adequacy regulations in commercial banks in Kenya. The study found that capital adequacy requirement is perceived to be important in commercial banks to a great extent, where financial stability, credit risk management and reduced vulnerability to liquidity shocks were found to affect the capital requirement of the commercial banks in Kenya to great extents while balance sheet structure and deposit insurance affect the capital requirement of the commercial banks in Kenya to moderate extents.

The second objective of the study was to determine the challenges faced by commercial banks facing in the implementation of capital adequacy requirement. Results revealed that commercial banks experienced growth barrier and regulatory constraints to great extents, while in the implementation of capital adequacy requirement, commercial banks experience risk and finance management culture and additional capital challenges to moderate extents.

The third objective of the study was to establish the measures that commercial banks have taken to ensure compliance with the capital adequacy requirement. Results revealed that the banks have practiced cutting back on lending and withholding dividend payment to great extents, while the banks have been increasing revenue growth/cutting costs as well as market rights issue/bonds to a moderate extents to ensure compliance with the capital adequacy requirement.

5.2 Conclusions

The study concludes that capital adequacy requirement is perceived to be important in commercial banks. In this regard, capital adequacy requirement is perceived to be important in commercial banks.

The study further concludes that, the implementation of Basel III requirement has been faced by various challenges like growth barrier, regulatory constraints, risk and finance management culture and additional capital challenges.

The study also concluded that the commercial banks in Kenya have taken various measures to ensure compliance with capital adequacy requirement such as cutting back on lending, market rights issue/bonds, increasing revenue growth/cutting costs and withholding dividend payment.

5.3 Recommendations

The study recommends that banks should ensure a flexible Basel III management expertise that delivers speed, accuracy, and performance to deliver competitive advantage. And those banks that implement the optimal solution will not only have an ideal platform for delivering Basel III, they will also have a solid platform for their future commercial development.

The study also recommends that Banks should manage their risks more closely and avoid a build-up of unintended risk, reducing the opportunities for regulatory capital arbitrage. The study further recommends that it is vital to understand the forces behind the increasing sophistication and efficiency of risk management systems, before adopting them more widely for regulatory purposes.

5.4Suggestions for Further Studies

Further research can be done on the impact of liquidity requirements on the performance of commercial banks in Kenya since Basel III also introduced two essential liquidity ratios. The liquidity Coverage Ratio is guarantee that a bank holds sufficient high-quality liquid assets to cover up for total net cash outflows for over 30 days. Similarly, the Net Stable Funding Ratio necessitate that the available amount of stable funding should be more than the requisite amount of stable funding for more than one-year of pro-longed stress.

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