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ABSTRACT

The increase of bank's financial performances can be achieved through forming good and relevant rules for banking activities. The main objective of this study was to find out the effect of CBK prudential guidelines on financial performance of commercial banks. The study was guided by three independent variables which were: to find out the effect of rate cap law on financial performance of commercial banks in Nairobi CBD, to examine the effect of capital adequacy on financial performance of commercial banks in Nairobi CBD, and to find out the effect of liquidity management on financial performance of commercial banks in Nairobi CBD. The scope of the study was based on commercial banks in Nairobi CBD. Descriptive research design was used in the study. The study population was 43 managers of all licensed commercial banks in Nairobi CBD. Questionnaires were self-administered for data collection. Statistical package for social sciences (SPSS) was used to analyze data. The study found that the Rate Capping Law was not achieving its primary objective of making credit accessible to the low income earners at an affordable prize. The study further found that capital adequacy and liquidity management are important regulations that positively affect financial performance of commercial banks. Therefore, the study recommended the review of rate capping law by the relevant authority because it had failed to achieve its main objective to ease the access of credit to low income earners. The study also recommended that both capital adequacy and liquidity management are very important regulations that positively affect financial performance of commercial banks in Nairobi CBD hence Central Bank of Kenya should ensure they are strictly complied with by all banks.

Keywords: *rate cap law, capital adequacy, liquidity management, financial performance, commercial banks in Nairobi*

INTRODUCTION

Globally, western countries governments either reduced or removed state regulations that were governing financial institutions since 1980s meaning that their financial sector has been going through the process of deregulation (Kumbhakar, Lozano-Vivas, KnoxLovell & Hassan 2005). Policy makers in these countries believed that the only way to increase performance and efficiency in financial institutions was through deregulation. Such policies objective is to increase banks competition on territorial rivalry, products and prices. However, this deregulation process has led to mixed consequences for they tend to be good for some countries and bad for other countries. For instance, the results have been favorable for Norwegian banks for they gave them the permission to set the amount of money they could lend out as well as their own lending rates but the case has not been the same in USA and India.

In 2005, Nigerian banking sector went through a dramatic post consolidation growth and this occurrence brought a lot of issues to both regulators and the finance industry. Initially, people believed that Nigerian banking system was sound and insulated from the global financial crisis but this kind of believe was highly misplaced. critical gaps in prudential guidelines, inadequate disclosures and transparency about the financial position of banks, uneven supervision and enforcement, lack of investor and consumer sophistication and major failures in banks' corporate governance were the major factors that led to the creation of an extremely fragile financial system that was tipped into crisis by the global financial meltdown (Aburime and Uche, 2008). To address such predicaments, Central Bank of Nigeria (CBN) did a review of the prudential guidelines in accordance with the Basel Accord Framework. anti-money laundering, corporate governance and risk management are the bank's operation aspects that the revised prudential guidelines aimed to address. The guidelines also aimed at addressing the peculiarities of financing different sectors and different loan types.

The economic growth in Kenya is contributed by the good management of commercial banks. Prudential regulations are made by the central bank of Kenya which guide the commercial banks in carrying out their businesses hence creating stability in the industry. Protecting the deposits of the public, channeling activities that would promote monetary and credit facilities, maintaining a competitive an efficient system and preservation of the soundness and stability of financial system are the main functions for financial regulation (Kevin Greenidge 2000). Provision of incentives to financial firms that induce them to align their private goals to social goals and the imposition of constraints to supervisees to deter them from engaging in certain activities that entail excessive risk are the two main approaches to financial regulation (Naceur and Kandil 2009). Without constituting a barrier for the natural development of financial industry, regulations are meant to define incentives and rules by which market participants must behave. The needed constraints, appropriate incentives, openness and innovation in the financial sector while maintaining sound prudential oversight and competition enhancement are the main challenges to financial regulation (Stieglitz, 2001).

Prudential guidelines are normally agreed upon by the Kenyan Banker Association (MPC) and the Central Bank of Kenya (CBK). In order to establish the gaps that the banking sector and the economy has an MPC meeting is held to look over the issue. The banking Act unit 33(4) provide these prudential guidelines. Such guidelines cover all the banking activities done by financial institutions, improve transparency amongst customers and banks and safeguard the operation of financial institutions (Central Bank of Kenya 2013). It is important to the economy to warrant their continuous existence that many actions have been taken to protect these institutions from fiscal volatility and this is the main reason as to why such guidelines are implemented. A great damage to the banking sector and on the economy can be caused if such guidelines are not followed accordingly.

There is a correlation between regulations and financial performance in financial institutions according to the micro prudential and the macro prudential theories (Martin, Colin & Samuel, 2002). Even though regulations may cause a bank to seek fresh capital from the stock market or shrink its assets, macro and micro prudential theories states that they must be put in place and enforced. Since such regulations aim at protecting tax payers' interests and achieving economic stability, they may lead to slowing down commercial banks' financial performance (Hanson et al., 2011). According to Sherman (2009), the global economic recession of 2008 has taught us the importance of regulating financial institutions. The relationship between financial regulation and financial performance is brought forward by the USA case.

The world bank report of 2014 indicates that at least 76 countries around the world have adopted interest rate caps as their main method of controlling interest rates in their economies. They include developed economies like Germany, United States, United Kingdom and Japan and less developed economies like turkey, brazil, India etc.

The most recent and exiting prudential guideline on financial industry specifically on banking sector is the introduction of rate cap law by the Kenyan parliament. On August 24th, the president of republic of kenya Uhuru Mwigai Kenyatta signed a law that capped lending interest rates. He defended his move by arguing that Kenyan borrowers have been frustrated for long by high cost of borrowing that dominated in the Kenyan economy. His stand was that lenders should take an extra mile to ensure creditors benefit from their borrowing by reducing the cost of lending. The rate capping law was operationalized officially on 14th September. It capped bank lending rates at 4% above the central bank standard rate which was at 10%. This meant that legally, no lending bank in the Kenyan economy could surpass a capped 14% lending rate. Besides, the law capped deposit rates at 70% of the central bank's rate.

The Central Bank of Kenya is pushing for removal of interest rate cap law which its governor Dr Patrick Njoroge argues is posing a negative impact on economic growth. Addressing media in Nairobi, Dr Njoroge said the law has led to a credit crunch since the banks credit rationing is pulling back the economic growth. 'So far the rate cap law has been acting as a break to the economy' Dr Njoroge said. He pointed out that preliminary findings of a joint study with the treasury on impacts of the rate capping on growth of credit had confirmed a negative impact. He also said that the private sector credit grew by 2.4% in December 2017 with a slight deference on 2% of October 2017. This clearly shows that the economy is being retracted by the law. We rather bring it out and find lasting solution so as to foster our economic growth instead of a silence that will curtail the economic dynamism. There was a 5 percent economic growth in the first half of year 2017 which was below the revised government prediction of 5.5%. Some parties have blamed the banking sector of blackmail and economic sabotage to compel the government to amend the law. However, Dr Njoroge said there is need to lift the credit crunch to pave way for economic growth in 2018. Otherwise, the 2018 economic growth projections of 6.2% will be a fantasy.

Problem Statement

Improvement in the macroeconomic as a result of stability in the banking system is caused by prudential guidelines mitigation effects of economic crises.

Several countries around the globe including Kenya have undergone serious banking problems in recent past that has called for a major banking system reforms. For instance, in the year 2016 the Kenyan government introduced interest rate capping law that capped lenders interest rate at no more than four per cents above the base rate set and published by the Central Bank of Kenya and the minimum interest rate granted on a deposit held in interest earning in Kenya to at least seventy per cent the base rate set and published by the Central Bank of Kenya. However, this regulation has been criticized by almost all financial sectors including the CBK and there are clear indications that it will be revised in the near future. Banks normally responds to prudential regulations related to lending rates by reducing their lending to 'risky' borrowers (small and medium enterprises) who are the primary target of the regulating body. On capital regulation requirements, banks respond by reducing their lending and there is lack of enough information to show that capital regulation has made banks to keep a higher capital to asset ratio than they would do if unregulated. Researchers are constrained in proposing socially beneficial reforms to banking policies in need of changes and in assessing which policies work best to promote well-functioning banking system due to lack of sound measures of banking policies across countries and over time. This shows that determining the effect of central bank regulatory guidelines on bank's financial performance is a very important area of study. There are other studies that have been done on corporate regulations and financial performance. For instance, a study done in the year 2013 by Njeule show that there exists a variation on bank's financial performance as a result of changes in corporate governance, foreign exchange risk exposure, liquidity management and risk classification of assets and provisioning. A study done in the year 2012 by Otieno show that corporate governance factors account for 22.4% of commercial bank's financial performance. This study sought to find out the impact of CBK prudential guidelines on financial performance of commercial banks guided by the following independent variables; to find out the effect of rate cap law on financial performance of commercial banks in Nairobi CBD, to examine the impact of capital adequacy on financial performance of commercial banks in Nairobi CBD, and to find out the effect of liquidity management on financial performance of commercial banks in Nairobi CBD.

Research Objectives

The main objective was to find out the effect of CBK prudential guidelines on financial performance of commercial banks. A case study of commercial banks in CBD Nairobi. The specific objectives were:-

- To find out the effect of rate cap law on financial performance of commercial banks in Nairobi CBD
- To examine the impact of capital adequacy on financial performance of commercial banks in Nairobi CBD
- To find out the effect of liquidity management on financial performance of commercial banks in Nairobi CBD

Research Hypothesis

H_{o1}: There is no significant relationship between rate cap law and financial performance of commercial banks in Nairobi CBD.

H_{o2}: There is no significant relationship between capital adequacy and financial performance of commercial banks in Nairobi CBD.

H_{o3}: There is no significant relationship between liquidity management and financial performance of commercial banks in Nairobi CBD.

LITERATURE REVIEW

Theoretical review

Rent-seeking theory

Economic studies show that rent-seeking situation occurs when there is controlling of prices that results to unequal allocation of goods and services (Bulow and Klemperer, 2012). According to Adam Smith, rent seeking means organizations that are out to make gains at the expense of clients by manipulating trade environment. Adam Smith argued that it's a bad move for the economy to place laws and policies to shield the poor. Central banks were established by governments to regulate interest rates and manage money supply. In case of financial crisis, they are the institutions that come in to arrest the situation and control the economy. But their historical role was politically influenced hence they went through high levels of bureaucracy (klemper 2012). Economist are of the opinion that market can handle market regulation and central bank could be considered of no value. This theory suggests that the idea of controlling interest rate vest on government officials' interests. The theory stipulates that government officials can create barriers to entry into the market and can distribute resources according to their preferences when there are insufficient resources as a result of capping of interest rates. The theory further proposes that interest rates could be controlled further to benefit the state and banks that can bring in resource in the economy in case of shortage. The theory indicates that interest rates are not meant to build the well-being of the economy but that of certain individuals (Toma 2013). Rent seeking theory links charging of higher interest to borrowers directly to the lenders benefit. On interest rates, rent seeking theory argues that capping of interest rate bears no fruit and are likely to gain reverse results. Such interventions end up hurting parties they were meant to shield. Therefore, it is important to evaluate the results that capping of interest rate has on the economy both in short run and in long run.

Theory of Rational Expectation

Theory of rational expectation was used by Keynes, Hicks and Pigou to expound the business phenomenon but it was initially propagated by Muth in 1960. It argues that future economic phenomenon can be determined and influenced by current economic situations. For example, we can predict future interest rate by use of the prevailing one and our expectations will lead them to an anticipated value. Market perceptions are the key elements of real outcome, say the case of bonds and shares for example. Keynes refers to this as "waves of optimism and pessimism" that helped to determine level of business activities. Participants will behave in a way currently because of their perception in the future and such actions will validate the outcome of their expectations. Gorder (2009) in his study notes that unexpected changes in economic factors will lead to change in the future interest rate.

Predictions on future level of interest rate is affected by interest rate cap. If banks predict that interest rate cap will negatively affect issuance of loan to certain entities, such a move will make banks to reexamine loans considered to be extended to risky groups. Commercial banks perception that interest rate caps will adversely affect their business performance makes them to initiate cost cutting measures that include reduction of the amount of unsecured loans reducing availability of credit in the market, closing down branches and retrenching hence raising levels on unemployment.

Liquidity Preference Theory

The economist John Maynard Keynes of united states developed the liquidity preference theory. He argued that people would demand for premiums for investing in liquid assets like real estates, stocks and bonds and would like to hold liquid cash instead of any other form of asset holding all other factors constant (ceteris peribus). Keynes continues to argue that as the period of getting liquidity back increases the compensation demanded for parting with liquidity also increases. In the theory's application for demand of money, it continues to dominate the central concept in economic and finance. Central Banks set the rate of interest in order to control the price of assets through the demand for money with regard to Keynes theory of liquidity ratio. Keynes explained three motives of holding cash in his emphasis on why people will at all times wish to hold liquid cash rather than other forms of asset. The three motives include: the speculative need to hold cash to take advantage of opportunities, the motive to hold cash for precautionary tendencies and the motive to hold cash for daily transaction activities. Liquidity preference theory analogy is imperative liabilities and assets functions of commercial banks. The essence of why banks will seek compensation for their assets and the reason why banks will consider to pay for their liabilities is explained by liquidity preference theory. The interest rate factor that is a risk factor affecting credit risk in commercial banks is described by this compensation. Therefore, banks will consider charging higher interest rates where the probability of default is higher and less rate where probability of default is low hence the theory of liquidity preference.

Portfolio theory

Since the commencement of regulations this theory has been used to look at the success of reducing risks. The risk elements that banks go through such as market risk, interest risk and credit risk is the main area that this theory mainly focuses on. The biggest risk that commercial banks normally undergo remains to be the credit risk but the portfolio model application to credit risk has lagged. Commercial banks performance can be really affected if the prudential regulations are not handled with a great care. There is a great effect of Credit risk concentration on the performance of commercial banks. On mechanism to fight and reduce such risks, banks are now concentrating on quantitative methods. According to portfolio theory, banks are making their best to make appropriate measures in developing tools that can measure credit risk in a portfolio situation. To transfer risk professionally while protecting customer relationships commercial banks have now started using credit product. There has been adoption of productivity indicators and portfolio quality ratios. The progress in managing credit risk has been spearheaded by combination of these developments. This method involves combining the result of this analysis to identify a portfolio's probable losses, spreading out credit risk assessment, and understanding the quality of credit exposures. The asset by asset approach where banks tend to deal in bulk investments to reduce credit risk is what this theory teaches. For instance, to reduce credit risk banks tend to do interbank deals to cover the customer deals. The need to diversify the risk that banks are exposed to is what is derived by this approach. Portfolio theory also explains the need for commercial banks to be regulated to ensure their soundness and safety. Commercial banks can use this theory to keep them in a position to meet their liabilities without much difficulties. By pursuing a portfolio approach companies increasingly attempt to address the inability of the asset-by-asset approach to sufficiently measure unexpected losses. The difficult in measuring and identifying concentration is the main weakness of asset-by-asset approach. additional portfolio risk resulting from increased exposure to a group of correlated creditors or to credit extension is what is referred to as concentration risk. in the effects of profitability on commercial banks in Kenya portfolio theory supports that credit risk management plays a major role since it points out how banks can diversify their asset and reduce the level of the risk. It is important that commercial banks follow the CBK guidelines guided by the portfolio theory to reduce the banks level of credit risk and increase the profitability of the bank.

The Capitalist Theory

Economic principles in capitalist theory demand that demand, supply and prices be determined by market forces rather than by the whims of players in the market; the position being, therefore, that free market forces should determine interest rates as opposed to banks or the Central Bank. Healthy competition among banks and MFIs in a free Kenyan economy should be able to reasonably determine the demand for loans, the repay rate and hence the interest rate charged. Reasonably therefore, one would anticipate that the amount of interest rates levied by such banks on loans would be very fair in an effort to gain as many consumers of credit services as possible. However, this position has invited heavily criticism that the amount of power and influence corporations and large business interest groups have over government policy, including the policies of regulatory agencies, capitalism has encouraged banks to use their huge influence to blatantly ignore the provisions of the Banking Act with regard to levying of interest rates. This has been abated by the ineffectiveness of the CBK in controlling the levying of interest rates on loans by the banks as was experienced in the recent past. This study therefore holds that the capitalist theory is not the best suited in the banking sector.

Empirical literature review

Effect of rate cap law on banks' performance

Capping of interest rate will have a direct effect on income earned by banks since interest income is one of the major sources of their income. It is worth to find out the effect of interest rate controls on the margins on interest income. We can find out profitability and financial performance by measuring return on asset which show how well management use bank's asset to make profits (Rug, 2013). Interest rate cap affect bank profit directly (Aren & Duhn, 2016). According to Hurn and Farl (2013), interest rates affect banks profitability either directly or indirectly. When there are low interest rates in the market, more people will borrow and the more the borrowers the more bank's benefits through interest earnings. When interest rates are higher less individual consumers will borrow leading to less interest income hence reducing lender's profitability (Teern & Regina, 2012). When banks place a lot of bureaucracy in accessing loans, less individual consumers are encouraged to apply hence reducing demand which in turn leads to lower interest earnings. Capping of interest rate leads to more informal borrowing because customers opt for easily accessible loans which eventually have an effect on formal banks credit demand hence affecting their profitability (Rosenberg, Gonzalez, & Narain, 2014).

Capital adequacy on bank financial performance

A research was conducted to examine the role of capital requirements on bank stability and competition by Gudmundsson, Kisinguh and Ondongo (2013) over the period of 2000 to 2011. To measure the level of competition in Kenya's banking industry they used the Panzar and Rosse H-statistic as well as the Lerner index. To measure bank stability and performance they used Return on Equity (ROE). The study found that the core capital increase reduces competition up to a certain point after which competition starts to increase again. This show that the moment consolidation in the banking sectors starts to take place benefits start to be realized. The study concluded that there is an evidence supported by a positive relationship that capital regulation improves financial stability and performance of banks.

A study to find out the effect of financial regulation on financial performance of Deposit-Taking Microfinance institutions (DTMs) in Kenya was carried out by Mureithi (2012). Cross sectional method and descriptive survey method was used in the research design. 6 DTMs in Kenya was the target population. The study concluded that improvement in financial performance of DTMs was as a result of supportive Deposit Taking Microfinance Regulations of 2008. Regulations led to increase of shareholders' equity of DTMs, profit, total assets and the value of outstanding loans hence concluding that regulations do have a positive impact on the profitability of commercial banks.

Determinant of financial performance

Determinant of financial performance are classified into macroeconomic factors and micro economic factors by Ongore & Kusa (2013). The bank's profitability is influenced by Micro economic variables which are specific to each bank. While macro-economic factors are beyond the control of financial institutions, micro economic factors vary from bank to bank and each bank is able to control and manipulate its micro economic factors.

Capital adequacy

Given that customer deposits tend to be prone to bank runs, bank's capital enables it to have liquidity. Capital adequacy protects a bank against operational, market and credit risks so that it can protect debtors and absorb any losses that may arise. Capital adequacy is determined on the basis of capital adequacy ratio (CAR). Capital adequacy ratio is directly proportional to the resilience of the bank to crisis situations. By also determining the bank's expansion to risky but profitable ventures it has a direct effect on the profitability of banks. Capital is referred to as financial resources available for use though its definition majorly depends on the context in which it is used. Societies and companies with more capital might not be better off than societies and companies with less capital. In bank's evaluation and performance measurement, capital adequacy is a widely acknowledged as the key factor (Nwankwo 1991 and Hardy & Bonaccorsi di Patti 2001). In the bank performance assessment of the Bank for International Settlement (BIS), it is the first of the five CAMEL factors recognized and adopted by the Basel system. As stated by the Central Bank of Nigeria which is the bank's monitoring and supervising authority, the used capital adequacy ratio was adopted in the Nigeria banking system in 1990.

The best intervention that can be used to limit the risk of a bank insolvency is capital adequacy. Banks are likely to take less risk of insolvency if there is adequate capital. On a light note, it is argued that capital adequacy may not be always a sole safety path for banks success. it is believed that there are instances where higher capital increases risk rather than decreasing it. According to Santomero and Kim (1988), high leverage is not the only factor influencing insolvency.

Liquidity management

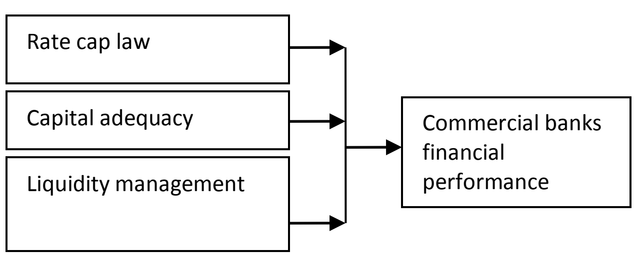
Ongore & Kusa (2013) defines liquidity as the ability of banks to meet their obligations mostly of depositors. Total customer deposits to assets ratio and the loans to customer deposits ratio represents the level of bank liquidity. In order to maintain a stable and efficient banking and financial system, Central Bank of Kenya is empowered by guidelines issued under Section 33(4) of the Banking Act to issue guidelines to be adhered to by financial institutions. Contingency plans for unexpected distress situations, internal controls, management information systems, procedures, policies, ensuring accuracy and uniformity in the computation of the liquidity ratio in the banking sector and guide institutions in the formulation of liquidity management strategies, provision of guidance on compilation of liquidity returns and ensuring that each institution maintains adequate level of liquidity to meet its obligations as they fall due are the main of the liquidity management guidelines.

Financial Performance of Commercial Banks in Kenya

Commercial banks financial performance in Kenya is an important given the significant role the banks play in the economy. Since the number of financial institution has grown over the years and competition has increased, it is important that Banks look at ways in which they can increase the performance of the Banks. Banks profit will reduce since the CBK

ammonized Section 36 (4) of the Central Bank of Kenya Act stipulates that the Central Bank shall publish the lowest rate of interest it charges on loans to banks and that rate shall be known as the Central Bank Rate (CBR) (September 14th 2016), profits will reduce since interest rates is the main source of their profits and since the rates have reduced, commercial banks will need to look at what other prudential guidelines they can focus on to ensure that this act doesn't affect them drastically. (Central Bank Kenya).
The economy normally evaluate a firm's ability based on its performance (Bonn, 2000). This implies that a Bank performance is like a mirror to a firm, if a bank is performing will then it is assumed that the bank is following the rules and regulations (Achrol and Etzel, 2003). Commercial Banks performance is the outcomes achieved in meeting internal and external goals of a firm (Lin et al., 2008). Commercial banks main aim is to make profit,to measure the profitability of commercial banks, there are variety of ratios used such as Return on Asset, Return on Equity and Net Interest Margin are the major ones (Murthy and Sree, 2003; Alexandru et al., 2008).

Conceptual Framework



Dependent Variable **Independent Variables**

Figure 1: Conceptual Framework

(Source: author 2018)

METHODOLOGY

The study used a descriptive design which is a method of collecting information by interviewing or administering a questionnaire to a sample of individuals (Orodho, 2004). The population for this research comprised of all the commercial banks in Nairobi CDB that were in existence in the last five years, licensed and registered under the Banking Act. According to the Central Bank of Kenya, there were 43 licensed banks in Kenya as at 31st December 2017. The survey targets all the 43 commercial banks in Nairobi CBD. The target respondents were senior managers that included SME Relationship manager, Mortgage relationship Manager, Corporate Relationship Manager, Branch Manager, Chief executive officer from each of the commercial banks. The research instruments of the study were Questionnaires. A regression model was used to link the independent variables to the dependent variable as follows;

$$Y = \beta_0 + \beta_1X_1 + \beta_2X_2 + \beta3X_3 + \epsilon$$

Where,

Y–commercial banks financial performance

β_0 – Constant

X_1 – Rate Cap Law effect

X_2 – Capital adequacy

X_3 -Liquidity management

Є= Error term

FINDINGS

Bank Performance

On statements regarding Bank's financial performance, the respondents were asked to indicate the extent to which they agreed or disagreed with the statements. The responses were placed on a five likert scale ranging from 1 (strongly disagree) to 5 (strongly agree). To indicate the dispersion from the mean standard deviation was used. High standard deviation indicated that the data was spread out over a large range of values while low standard deviation indicated that the data points tend to be very close to the mean.

Table 1: Bank Performance

	Mean	Std. Deviation
With prudential regulation, the bank's return on equity has improved	3.9487	.91619
With prudential regulation, the bank's return on assets has improved	3.8205	.75644
Return on equity is greater in banks as compared to industry	3.5897	.93803
The bank has high return on assets compared to industry average	3.6537	.84562

According to findings in the table above, respondents agreed that the banks had good improvement of return on equity in the previous three years (Mean=3.9487), the bank had good improvement of return on assets in the previous three years (Mean=3.8205), the bank had a high return on assets compared to industry average (Mean=3.5897) and the bank had a high return on assets compared to industry average.

Rate Cap Law

On statements regarding Rate Cap Law, the respondents were asked to indicate the extent to which they agreed or disagreed with the statements. The responses were placed on a five likert scale ranging from 1 (strongly disagree) to 5 (strongly agree). To indicate the dispersion from the mean standard deviation was used. High standard deviation indicated that the data was spread out over a large range of values while low standard deviation indicated that the data points tend to be very close to the mean.

Table 2: Rate Cap Law

	Mean	Std. Deviation
With interest rate capping law, the bank Interest income has increased	2.03747	.14365
The bank profitability has increased with interest rate capping	2.10387	.12635
Since the rate cap law came into effect, the bank's lending capacity (liquidity) have reduced	3.57645	.37454
The bank has slowed down on lending since the law came into effect	4.08467	.46243
There has been labor retrenchment in the bank since the rate cap law came into effect	3.37365	.29465
The bank employment rate has slowed down since the inception of interest rate capping law	4.23635	.15634

According to the results in table above, the respondents disagreed that with interest rate capping law, the bank Interest income has increased (Mean=2.03747), The bank profitability had increased with interest rate capping (Mean=2.10387). The respondents agreed that since the rate cap law came into effect, the bank's lending capacity (liquidity) had reduced (Mean=3.57645), The bank had slowed down on lending since the law came into effect (Mean=4.08467), There had been labor retrenchment in the bank since the rate cap law came into effect (Mean=3.37365), The bank employment rate had slowed down since the inception of interest rate capping law (Mean=4.23635).

The study further tested the hypothesis on whether rate cap law influences commercial banks' financial performance. The results were as presented in table below showing the relationship between rate cap law and banks' financial performance.

Table 3: Rate cap and financial performance

		Rate cap law
Financial performance	Pearson Correlation	-0.231
	Sig. (2-tailed)	**0.04
	N	35

Correlation is significant at the 0.05 level (2-tailed).

The results in table above showed that the relationship between the rate cap law and the banks' financial performance was significant but with a negative correlation, r= -0.231, p=0.04. This means there was a significant relationship between the rate cap law and banks' financial performance. Therefore, the study rejected the null hypothesis that there is no significant relationship between rate cap law and financial performance of commercial banks in Nairobi CBD and accept the alternative.

Capital Adequacy

On statements regarding capital adequacy, the respondents were asked to indicate the extent to which they agreed or disagreed with the statements. The responses were placed on a five likert scale ranging from 1 (strongly disagree) to 5 (strongly agree). To indicate the dispersion from the mean standard deviation was used. High standard deviation indicated that the data was spread out over a large range of values while low standard deviation indicates that the data points tend to be very close to the mean.

Table 4: Capital adequacy

	Mean	Std. Deviation
The Bank has strategies for continued funding	3.4566	.42553
Bank has both tier one and tier two capital	3.3442	.36564
There is standard reports on liquid capital	3.6341	.56354
There is daily analysis of capital demands	3.4543	.98574
The banks perform a risk weighting for all its capital.	3.8536	.85634
There is presence of liquidity needs in times of specific bank shocks	3.7846	.76854
The Bank has forecastable and easily analyzed capital	3.6457	.96554

According to the results in table above, the respondents agreed that the Bank had strategies for continued funding (Mean=3.4566), Bank had both tier one and tier two capital (Mean=3.3442), There was standard reports on liquid capital (Mean=3.6341), There was daily analysis of capital demands (Mean=3.4543), The banks perform a risk weighting for all its capital (Mean=3.8536), There was presence of liquidity needs in times of specific bank shocks (Mean=3.7846), There is daily analysis of capital demands(Mean=3.6457).

The study further tested the hypothesis on whether capital adequacy influences commercial banks' financial performance. The results were as presented in table below showing the relationship between capital adequacy and banks' financial performance.

Table 5: Capital adequacy and financial performance

		Capital adequacy
Financial performance	Pearson Correlation	0.681
	Sig. (2-tailed)	**0.04
	N	35

Correlation is significant at the 0.05 level (2-tailed).

The results in table above showed that the capital adequacy was significant and positively correlated with the banks' financial performance, r=0.681, p=0.04. This means there was a significant relationship between capital adequacy and banks' financial performance. Therefore, the study rejected the null hypothesis that there is no significant relationship between capital adequacy and financial performance of commercial banks in Nairobi CBD and accept the alternative hypothesis.

Liquidity Management

On statements regarding liquidity management, the respondents were asked to indicate the extent to which they agreed or disagreed with the statements. The responses were placed on a five likert scale ranging from 1 (strongly disagree) to 5 (strongly agree). To indicate the dispersion from the mean standard deviation was used. High standard deviation indicated that the data was spread out over a large range of values while low standard deviation indicated that the data points tend to be very close to the mean.

Table 6: Liquidity management

	Mean	**Std. Deviation**
The bank has maintained a portfolio of high liquid investments	3.6475	.86735
The bank cash flow estimates are adequate and reasonable	3.5984	.94643
The bank's liquidity management is Adequate	3.9465	.85634
The bank's progressive profitability is adequate to cater for all cost and liability needs	3.1576	.97846
There is adequate liquidity needs for any unforeseen shocks in the bank	3.9846	.95634

As per the findings in the table above, the respondents agreed that the bank had maintained a portfolio of high liquid investments (Mean=3.6475), The bank cash flow estimates were adequate and reasonable (Mean=3.5984), The bank's liquidity management was Adequate (Mean=3.9465), The bank's progressive profitability was adequate to cater for all cost and liability needs (Mean=3.1576), There was adequate liquidity needs for any unforeseen shocks in the bank (Mean=3.9846). The study further tested the hypothesis on whether liquidity management influences commercial banks' financial performance. The results were as presented in table below showing the relationship between liquidity management and banks' financial performance.

Table 7: Liquidity management and financial performance

		Liquidity management
Financial performance	Pearson Correlation	0.631
	Sig. (2-tailed)	**0.04
	N	35

Correlation is significant at the 0.05 level (2-tailed).

The results in table above showed that the capital adequacy was significant and positively correlated with the banks' financial performance, r=0.631, p=0.04. This means there was a significant relationship between liquidity management and banks' financial performance. Therefore, this study rejected the null hypothesis that there is no significant relationship between liquidity management and financial performance of commercial banks in Nairobi CBD and accept the alternative hypothesis.

CONCLUSIONS AND RECOMMENDATIONS

It was been established that CBK prudential guidelines influence performance of commercial banks in Nairobi CBD. In light of this, the Central Bank of Kenya should take this into cognizance during provision of their oversight role over commercial banks. The study concluded that Rate Capping Law was not achieving its primary objective of making credit accessible to the low income earners at an affordable prize. The study concluded that capital adequacy was an important regulation that positively affects financial performance of commercial banks. The study also concluded that liquidity management is an important regulation that positively affects financial performance of commercial banks. The study also concluded that for government, shareholders and Banks themselves to come up with important decision making, this study is vital for them since it enables them to know the effect regulations have on the financial performance of the banks. The study also concluded that the study would help the government in policy formulation because through understanding the relationship between the variables, they would be able to anticipate the effect new policy available on banks. Prudential guidelines have a great effect on financial performance of commercial banks hence the CBK should ensure that they are fully complied with.

Recommendations

Having learnt that the main objective of the Rate Capping Law to ease the access of credit to low income earners has not been achieved, the study recommended the review of rate capping law by the relevant authority. The study also recommended that both capital adequacy and liquidity management were very important regulations that positively affect financial performance of commercial banks in Nairobi CBD hence Central Bank of Kenya should ensure they are strictly complied with by all banks. The study also recommended that Central Bank of Kenya undertake an adequate training to commercial banks employees on the prudential guidelines to empower them and ensure that all the employees clearly comprehends such guidelines. This would make it easier for commercial banks to comply with all the guideline, increase the awareness of the employees and improve their performance. To improve Commercial Banks work ethics and performance, it is important that they understand the regulations that are imposed on them by the CBK. The study also recommended that Central Bank of Kenya must ensure that all banks comply fully with the above stipulated regulations to ensure a stable banking sector which plays a big role in the economy. Financial crisis would be avoided in this country if this sector is stable and the economy would thrive. CBK would also be able to discover banks that are struggling and provide remedial measures before they collapse and lose depositors' money through implementing strict regulations and ensuring that such regulations are strictly adhered to.

Areas for further Research

The researcher came across areas that would be interesting for further investigation during the study. The role of banking on the growth and rise of Small and Micro Enterprises is an area that calls for investigation. Therefore, a research should be carried out to find out the effect of banking system on the growth of SMEs in Nairobi CBD.

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