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ABSTRACT

The study objective was to determine the effect of capital adequacy on financial distress in commercial banks in Kenya. Descriptive survey research design was used to find the link between capital adequacy and financial distress. The target population was all the 43 commercial banks licensed to operate in Kenya. A census approach was adopted where all branch operations managers, branch managers and credit managers of the 43 commercial banks making a total of 129 as target population. The data was collected and fed in statistical packages of social science (SPSS) and analyzed by use of descriptive and inferential data analysis technique. It was presented in the form of frequency tables. The study adopted primary data which was collected using a structured questionnaire. The study would help investors when making investment decisions. The findings indicated that there was weak positive and non-significant relationship between capital adequacy and financial distress. This implied that improved capital adequacy results in slight increase of financial distress.

The study hopes good relationship between management and shareholders so as to ensure institutions are run professionally and therefore perform well. The study was important for commercial banks to encourage foreign investors and institutional investors because presence of these investors improves the performance of the banks.

Key Words: *Capital Adequacy, Financial Distress, Commercial Banks*

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INTRODUCTION

Commercial banks play a vital role in the economic resource allocation of countries. They channel funds from depositors to investors continuously. They can do as such, on the off chance that they create essential pay to take care of their operational expense they bring about in the proper method (Vincent and Gemechu 2013). Financial performance of banks has basic ramifications for economic growth of counties. Great budgetary execution remunerates the investors for their investment. This, thus, energizes extra venture and achieves financial development. Then again, poor financial execution can prompt financial disappointment and emergency which have negative repercussions on the monetary development.

Financial distress is an important area in financial institutions. Late years have seen that numerous enormous U.S. monetary organizations fizzled or verged on flopping because of their loaning practices and exchanging conduct (Allen, Babus, and Carletti, 2009; Laeven, 2011). Such disappointments have set off a sharp withdrawal in both progressed and rising economies, and the administration salvages related with these disappointments have offered ascend to significant monetary expenses (Laeven and Valencia, 2012). These occasions feature the basic significance of understanding the determinants of budgetary.

In (UK), Riley and Young (2014) displayed reasons in clarifying the droop in UK„s profitability development as an after effects of credit requirements by banks, especially outcome of the ongoing cash emergency that went about as a shortcoming towards efficiency development. Sabina and Mahomet (2015) noticed that the determinants of banks‟ money related execution examination among nationalized and local private issue banks of Asian nation were affected by quality use and in operation potency have significant positive effect on banks' financial performance while credit chance has imperative negative effect.

In Africa, Amadasu (2012) assessed the money distress on business banks in Nigerian from 2003 to 2007, known working capital or complete quality affect the cash misery of the banks. Similarly, Nkegbe and Ustarz (2015) determined banks performance in Ghana pattern, wherever market share of loan is absolutely associated with performance and therefore raising lending rates and lowering their deposit rates is an inefficiency of commercial banks. Matia and Aaron (2013) anticipated that money related soundness markers and banking emergencies in South Africa somewhere in the range of 2005 and 2012, the executives of the banks could be a noteworthy determinant of economic distress. Bank failures and company scandals lately have prompted bank rules changes. This has seen partner increase in capital ampleness proportion by immense edges in Kenyan banks. Nonetheless, the non-performing loans focus has overstated by 33.6% and has come about to crumple of banks like Dubai bank and Imperial bank (CBK, 2016).

Financial distress can be characterized as a circumstance where an organization is having operational, administrative and budgetary challenges (Adeyemi, 2011). The estimation of any organization lessens through the costs it experiences amid the time of distress. Direct expenses of indebtedness incorporate evaluator's charges, lawful expenses, the board commissions, and different installments while indirect expenses are those costs identified with the activity of representatives, providers, financial specialists and investors (Pandey, 2005).

Financial distress diminishes the motivations of the representatives to buckle down and invigorates them to renegotiate their remuneration bundles or to leave the organization. Both declining profitability and substitution of workers are exorbitant and obliterate the organization's esteem. Competitors likewise may seek after a forceful showcasing and value procedure so as to draw in clients of the powerless organization and, along these lines, crush the grieved competitor

out of the market. As an outcome, the upset organization endures misfortunes in deals prompting lost the piece of the overall industry (Natalia, 2017).

Statement of the Problem

Financial distress in commercial banks in Kenya has unequivocally risen because of major banks failure which is a challenge (Kithinji and Waweru, 2017). Studies uncover that in late decades, countless have encountered monetary pain of differing degrees of seriousness, and some have endured rehashed trouble (Tan, 2012). In the 1980's and mid 1990's, a few nations in created, creating and progress economies encountered a few financial emergencies requiring a noteworthy update of their financial frameworks (IMF, 2008). From the inspected outcomes Central Bank of Kenya [CBK], (2013), there was a 4.5 percent decrease in pre-tax profit for the financial business in the year 2012. It is from this viewpoint that examination on monetary trouble in business banks is a need; consequently, it provoked the investigation to find out the effects of capital adequacy on financial distress in commercial banks in Kenya.

Objectives of the study

The objective of the study was to assess how capital adequacy affects financial distress in commercial banks in Kenya.

Research Hypotheses

H_{O1}: There exists no significant relationship of capital adequacy on financial distress in commercial banks in Kenya.

LITERATURE REVIEW

Theoretical Review

Stewardship Theory

The theory was developed by Donaldson and Davis in 1991. According to Abira (2014) this theory unlike the agency theory argues that the decisions made by an organization will always be in the best interest of all the investors the firm ownership structure because management will also benefit when the organization succeeds (Abira, 2014). The steward management will therefore ensure that the various shareholders (institutional, managerial, foreign and individual) wealth is maximized when they perform their duties. According to the theory management who are the steward of the organization tend to be motivated when the organization performs better. According to Mokaya (2015) by the fact that the steward also benefits from the organization there is no need for shareholders having shares in the firm ownership structure to monitor their activities.

Yagit and Anil (2012) the stewardship theory ensures that the interest of the players in a firm's ownership structure is protected. Therefore, the various players in the firm ownership structure can be sure that their interest will protected as far as decisions such as dividends distributions or investments is concerned. Mang'unyi (2012) notes that stewardship theory brings back the trust between various shareholders having a stake in the firm ownership structure. The theory notes that when the interests of management and others shareholders be it institutional, foreign converge the shareholders do not need to worry about the firm dividend policy or critical decisions because their interests will be protected. According to Shukla (2014) management will return fiancé to various shareholders in a firm ownership structure in order to protect their reputation.

Therefore, the shareholders need not to worry about dividend distribution since to protect their reputation management will always distribute dividends. Obiero (2013) argues that there can be no conflict between various shareholders in the firm ownership structure because their interests converge. The scholar further notes that the various shareholders will know the direction of the firm operations something that may ensure shareholders invest in firms that protect their interests be it dividend, distribution capital gain or even financing.

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Empirical Review

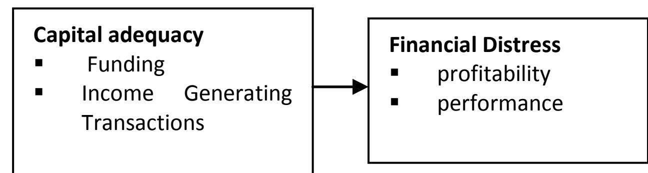
Capital Adequacy and Financial Distress

Capital is one of the bank explicit elements that impact the dimension of bank productivity. Capital is the measure of possess finance accessible to help the bank's matter of fact and go about as a cradle if there should arise an occurrence of antagonistic circumstance (Athanasoglou, Sophocles, and Matthiaos, 2013). Banks capital makes liquidity for the bank because of the way that stores are most delicate and inclined to bank runs. Also, more prominent bank capital lessens the opportunity of misery (Diamond, 2000). Notwithstanding, it isn't without disadvantages that it actuates powerless interest for obligation, the least expensive wellsprings of reserve Capital sufficiency is the dimension of capital required by the banks to empower them withstand the dangers, for example, credit, advertise and operational dangers they are presented to so as to retain the potential loses and ensure the bank's account holders.

As indicated by Dang (2011), the sufficiency of capital is made a decision based on capital ampleness proportion (CAR). Capital ampleness proportion demonstrates the inward quality of the bank to withstand misfortunes amid emergency. Capital sufficiency proportion is legitimately corresponding to the strength of the bank to emergency circumstances. It has additionally an immediate impact on the productivity of banks by deciding its extension to hazardous yet gainful endeavors or zones (Sangmi and Nazir, 2010).

Capital sufficiency for business banks is estimated by various factors including the log of all out resources (LTA), Loan Loss arrangements to add up to advances, credits to resources, assessment to working benefit before duty, overhead costs to add up to resources, non-premium salary to add up to resources, all out income to number of representatives and investors' value to add up to resources. Every one of these measures plan to gauge capital sufficiency of business banks from alternate points of view. The thought behind the measures is to decide the dimension of capital held contrasted with value and other accounting report exercises. For example, capitalization which is viewed as the vital proportion of capital ampleness, is a measure proportion of investor's value to add up to resources. The lower the capitalization or capital proportion is the unsafe the banking foundation is and vice versa.

Conceptual Framework



Independent Variable Dependent Variable

Figure 1 : Conceptual Framework

Source: Author (2019)

METHODOLOGY

Descriptive survey research design was used in this study. The target population was 43 operation managers, branch managers and credit managers of the 43 commercial banks licensed to operate in Kenya as at 31 December 2017. They were used because they were involved in making important company decision including dividend decisions. The study focussed on the operation managers, branch managers and credit mangers of these banks because they not only had an understanding of the banks operations but were also involved formulating and making important company financial decisions. The study adopted a census approach where by operation managers, branch managers and credit managers in all the commercial banks in Kenya 43 commercial banks targeted. The study used primary data. A questionnaire was adopted as the main instrument of the study and hence used to collect the primary data. The data collected in the study was guided by research objectives and research hypothesis. Both descriptive statistics and inferential statistics were

used to analyze data. The descriptive statistics was adopted in the study which mainly included percentage. Inferential statistics on the other hand measure or shows the relationship between or among variables. Inferential statistics that was adopted include regression and Pearson correlation.

FINDINGS

Table 1: Descriptive Statistics of capital adequacy on financial distress

	N	SD (%)	D (%)	U (%)	A (%)	SA (%)	Mean	Std. Dev.	Max	Min
Non-performing loans affects financial distress	125	2 (1.6)	15 (12.0)	24 (19.2)	52 (41.6)	32 (25.6)	4.41	1.300	5	1
The bank is able to meet short term obligations	125	10 (8.0)	21 (16.8)	22 (17.6)	43 (34.4)	29 (23.2)	4.71	1.201	5	1
The amount of highly liquid assets is negatively correlated to the possible likelihood of distress	125	8 (6.4)	11 (8.8)	26 (20.8)	49 (39.2)	31 (24.8)	4.01	1.261	5	1
Higher levels of profitability allow banks to improve their capital and economic performance.	125	3 (2.4)	18 (14.4)	24 (19.2)	67 (53.6)	13 (10.4)	4.56	1.271	5	1
Holding qualitatively inferior assets, the bank is more vulnerable to losses	125	10 (8.0)	14 (11.2)	30 (24.0)	53 (42.4)	18 (14.4)	4.81	1.302	5	1
Bank's capital serves as a cushion to absorb losses and shocks.	125	2 (1.6)	11 (8.8)	16 (12.8)	54 (43.2)	42 (33.6)	4.76	1.264	5	1
The decline in capital relative to assets is as an indication for potential financial difficulties	125	7 (5.6)	14 (11.2)	18 (14.4)	62 (49.6)	24 (19.2)	4.90	1.142	5	1
Unweighted capital measures in estimating the potential effects to financial distress	125	9 (7.2)	15 (12.0)	22 (17.6)	57 (45.6)	22 (17.6)	4.76	1.363	5	1
Short-term capital insufficiency to provoke financial distress	125	12 (9.6)	17 (13.6)	18 (14.4)	67 (53.6)	11 (8.8)	4.09	1.105	5	1
The bank is able to meet short term obligations	125	2 (1.6)	15 (12.0)	14 (11.2)	52 (41.6)	42 (33.6)	4.01	1.261	5	1

The results as illustrated in Table 1 indicated that Non-performing loans affects financial distress (mean =4.41; std dev. = 1.300). The bank was able to meet short term obligations (mean = 4.71; Std dev= 1.201). The amount of highly liquid assets was negatively correlated to the possible likelihood of distress (mean = 4.01; Std dev= 1.261). Higher levels of profitability allow banks to improve their capital and economic performance (mean = 4.56; Std dev= 1.271). Holding qualitatively inferior assets, the bank was more vulnerable to losses (mean = 4.81; Std dev= 1.302). Bank's capital served as a cushion to absorb losses and shocks (mean = 4.76; Std dev= 1.264). The decline in capital relative to assets is as an indication for potential financial difficulties (mean = 4.90; Std dev= 1.142). Unweighted capital measures in estimating the potential effects to financial distress (mean = 4.76; Std dev= 1.363). Short-term capital insufficiency

to provoke financial distress (mean = 4.09; Std dev= 1.105). The bank is able to meet short term obligations (mean = 4.01; Std dev= 1.261).

Table 2: Descriptive Statistics on financial distress

	N	SD (%)	D (%)	U (%)	A (%)	SA (%)	Mean	Std. Dev.	Max	Min
Inadequate Financing results into financial distress	125	1 (0.08)	10 (8.0)	24 (19.2)	63 (50.4)	27 (21.6)	4.23	1.218	5	1
Lack of Access to Credit causes financial distress	125	0 (0.0)	21 (16.8)	12 (9.6)	63 (50.4)	29 (23.2)	4.61	0.972	5	0
Management Succession influences financial distress	125	8 (6.4)	11 (8.8)	12 (9.6)	59 (47.2)	35 (28.0)	4.01	1.352	5	1
Shortage of Skilled Manpower influences financial distress	125	14 (11.2)	18 (14.4)	24 (19.2)	47 (37.6)	22 (17.6)	4.02	1.271	5	1
Policy Changes have an effect on financial distress	125	0 (0.0)	2 (1.6)	10 (8.0)	83 (66.4)	30 (24.0)	4.81	1.302	5	0
Improper Capital Decision has an influence on financial distress	125	2 (1.6)	11 (8.8)	16 (12.8)	54 (43.2)	42 (33.6)	4.61	1.404	5	1
Financial distress affects productivity and Profitability	125	3 (2.4)	10 (8.0)	11 (8.8)	67 (52.2)	37 (29.6)	4.79	1.002	5	1
Inadequate Financing results into financial distress	125	0 (0.0)	0 (0.0)	10 (8.0)	72 (57.6)	43 (34.4)	4.91	1.974	5	0
Lack of Access to Credit causes financial distress	125	1 (0.8)	11 (8.8)	26 (20.8)	59 (47.2)	28 (22.4)	4.67	1.104	5	1

Inadequate Financing results into financial distress(mean = 4.23; Std dev= 1.218)Lack of Access to Credit causes financial distress(mean = 4.61; Std dev= 0.972)Management Succession influences financial distress(mean = 4.01; Std dev= 1.352)Shortage of Skilled Manpower influences financial distress(mean = 4.02; Std dev= 1.271)Policy Changes have an effect on financial distress(mean = 4.81; Std dev= 1.302)Improper Capital Decision has an influence on financial distress(mean = 4.61; Std dev= 1.404)Financial distress affects productivity and Profitability (mean =4.79;Std dev= 1.002)Inadequate Financing results into financial distress(mean = 4.91; Std dev= 1.974) Lack of Access to Credit causes financial distress(mean=4.67;Stddev=1.104)

Testing Hypothesis

This section of the research provides information about testing of the research hypothesis.

Hypothesis 1: Capital adequacy and financial distress

H_o1 There exists no significant influence of capital adequacy on financial distress in commercial banks in Kenya.

Table 3: Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.056[a]	.003	.000	7.865

From the study findings in Table 3, the value of R-square was 0.003. This implied that, 3.0% of variation of financial distress was explained by capital adequacy.

Table 4: ANOVA test on capital adequacy

Model		Sum of Squares	Df	Mean Square	F	Sig.
1	Regression	61.980	1	61.980	1.002	.0.008[a]
	Residual	19486.493	315	61.862		
	Total	19548.473	316			

a. Predictors: (Constant), Capital adequacy

b. Dependent Variable: Financial distress

From the findings in Table 4, at 0.05 level of significance the ANOVA test indicated that in this model the independent variable namely; capital adequacy was important in predicting of financial distress as indicated by significance value=0.008 which was less than 0.05 level of significance ($p=0.008 < 0.05$).

Table 5: Coefficients Model of capital adequacy

Model		Unstandardized Coefficients		Standardized Coefficients	T	Sig.
		B	Std. Error	Beta		
1	(Constant)	34.892	2.084		16.744	.000
	Capital adequacy	.212	.211	.056	1.001	.008

a. Dependent Variable: Performance

From Table 5, the study findings revealed that capital adequacy had significant influence on financial distress in commercial banks in Kenya (t-statistic=1.001, p-value=0.008 < 0.05). Therefore, at 5% level of significance the null hypothesis was rejected, indicating that strategic HRM alignment to corporate strategy had a positive influence on financial distress in commercial banks in Kenya. Thus, for every unit increase in capital adequacy there was a corresponding decrease in on financial distress in commercial banks in Kenya by 0.212.

SUMMARY

In view of statistical results, capital adequacy was found the value of R-square was 0.003. This implied that, 3.0% of variation of financial distress was explained by capital adequacy. From the findings at 0.05 level of significance the ANOVA test indicated that in this model the independent variable namely; capital adequacy was important in predicting of financial distress as indicated by significance value=0.008 which is less than 0.05 level of significance ($p=0.008 < 0.05$)

CONCLUSION

Determinants of financial distress was studied in terms of capital adequacy, credit management, management efficiency, asset quality and their influence. The study has made a number of important contributions into the commercial banks distress. The findings of the study resulted in an understanding that among the financial distress determinants, asset quality, management efficiency, credit management and capital adequacy respectively have influence on financial banks distress.

RECOMMENDATIONS

For organizations to be more competitive so as to cope with more highly dynamic environments there is need to be keener in to enhancing their financial distress. To achieve a competitive advantage in a dynamic business environment, the study

recommended that firms should streamline with all parties in the financial matters in order to improve performance.

Recommendation for Future Research

- The current research focused on commercial banks in Kenya so it can also be done on a wider perspective to include all regions that the banks exist individually
- The relationship between financial distress and organizational performance of financial institutions in Kenya.
- Across-boundary research on other financial distress other than what was mentioned. In future studies should collect data from a larger population and compare with other firms to further validate or extend theories and variables identified in this study

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