



EFFECTS OF BANK SPECIFIC GUIDELINES ON FINANCIAL PERFORMANCE OF COMMERCIAL BANKS IN KENYA: A CASE OF KENYA COMMERCIAL BANK, NAIROBI COUNTY.

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ABSTRACT

The objective of this study was to establish if there is a relationship between bank specific guidelines and financial performance of Commercial Banks in Kenya. Regulations are the independent variable while financial performance is the dependent variable. The study adopted a descriptive research design. Financial performance in this study was measured using two financial ratios; return on assets and return on equity. The population of study was 95 top management employees in the 19 branches of Kenya Commercial Banks in Nairobi County and the period of study was from 2013 to 2017. The study mainly used primary data. A pilot test was conducted in selected commercial banks in Kiambu County. The validity and reliability of instruments was ensured to enhance consistency. The data collected was coded, validated, and edited for accuracy, uniformity, consistency and completeness. The study then used Statistical Package for Social Science (SPSS 24) to analyze the quantitative data. A linear regression model of financial performance versus regulations was then applied to examine the effect of banking regulations on financial performance of commercial banks in Kenya. The study findings indicated that there is a positive and significant effect of loan management policies (Beta = 0.478, Sig = 0.000), liquidity management (Beta = 0.243, Sig = 0.000), capital adequacy (Beta = 0.324, Sig = 0.000) and management quality (Beta = 0.461, Sig = 0.008) on financial performance of commercial banks in Kenya. However, asset quality did not have a significant effect on financial performance of commercial banks in Kenya (Beta = 0.101, Sig = 0.362). The study concluded that favorable bank specific regulations can positively improve the performance of commercial banks in Kenya. The study recommended commercial banks to come up with better policies to cope with the central bank of Kenya bank specific regulations in order to improve their performance.

Key Words: Loan Management Policies, Liquidity Management, Capital Adequacy, Management Quality, Asset Quality

INTRODUCTION

Prudential regulation is an appropriate legal framework for financial operations. It is a significant contributor to preventing or minimizing financial sector problems. Evidence shows that the absence of prudential regulations in some key areas can lead to bank failures and systemic instability, while establishing sound, clear and easily monitored rules for financial activities both encourages managers to run their institutions better and facilitates the work of supervisors (Brownbridge, 2002). A major weakness of some financial systems is the fact that various financial institutions, especially cooperatives and intermediaries in rural areas, operate completely outside prudential regulations (Brownbridge, 2002). Some countries have one single general banking law, which tries to assemble all regulations, but in many countries the operational issues are left to statutory notes, circulars or even simply the routine decisions of the supervisory institution. Various other laws can have an impact on the operations of financial institutions, for example, company laws, debt recovery laws and laws on liquidation and bankruptcy. Bank regulations are a form of government regulation which subject banks to certain requirements, restrictions and guidelines (Kirkpatrick, 2002).

Globally, the financial services sector continues to evolve and different emerging trends are now being witnessed (Antonio & Luis Costa, 2011). Some of these trends include micro and macro prudential regulations limiting banks' operations, others are technological advancements such as online and mobile banking services, new distribution services, mergers and acquisition activity as well as increased competition across the sector.

In reference to the US, Sabrina, Walter and Wescott (2009) while conducting a case study of the United States financial regulatory system argues that the changes which have taken place in the US financial system have necessitated a shift from its decentralized financial regulatory system. They

further reviewed the advantages and disadvantages of regulatory consolidation and the effects of consolidation on regulators' incentive. They have also evaluated what would be the best entity to regulate the US financial markets. The authors discuss the four main goals of financial regulation consolidation. These include taking advantage of the economies of scale, eliminating apparent overlaps and duplication that are found in decentralized structures, improving accountability and transparency and adoption to the increased prevalence of financial conglomerates in the financial industry. The paper however acknowledges that there may be disadvantages of consolidation of financial regulation. It argues that if the systems are well articulated, then consolidation is beneficial to an economy. This paper is important to the current study because it has also reviewed the transitions to consolidated regulation in the United Kingdom, Germany, Japan and Australia (Sabrinna *et al.*, 2009).

Commercial Banks in Kenya form an important part of financial markets, which play a crucial role in the growth of Kenya's economy. They support virtually all sectors of the economy by offering diverse services which go a long way in fostering the growth of these sectors. The roles played by commercial banks in Kenya include: providing a payment system for the exchange of goods and services, providing finance and financial advice to the businesses and the general public and offering safe custody for deposits (CBK Bank Performance Report, 2010).

In the period between 1989 and 1995, many Kenyan commercial banks were closed down and others placed under statutory management after experiencing financial crises. The situation was mainly caused by unethical and improper management of the institutions. It was in a bid to contain the trend of bank closures that the government, in the year 1995, through the Central Bank of Kenya instituted various measures, among them prudential regulations. The CBK was mandated to ensure compliance with the

regulations by all commercial banks (DPFB Report, 2006).

In Kenya, commercial banks are regulated by the Central Bank of Kenya, which publishes prudential guidelines regularly and relays these to all commercial banks. It also ensures compliance with the guidelines through close monitoring. The emergence of many commercial banks in Kenya is a measure of the growth and expansion of the sector. It is important to evaluate the effect of the prudential regulations on the stability of the industry. Banks' financial structures are influenced greatly by macro prudential regulators rather than solely by market forces and competition. It may be the case that leverage and liquidity requirements that are just sufficient to ensure bank solvency throughout the credit cycle or 'stress test' are not consistent with the optimal financial structures that would best align the incentives of shareholders with the broader economy, and also allow shareholders respectively to pass on these incentives to directors and executives.

Statement of the problem

The financial sector and to a large extent banking, are among the most heavily regulated sectors in the Kenyan economy. However, the issues of financial regulation particularly in relation to the banking sector is often considered a controversial subject influencing banks performance (Bizuayehu, 2015). Many critics have argued that regulations interfere with the efficiency of the market. On the other hand, scholars such as Mwega (2014); Sabrina, Walter and Wescott (2009) have argued that regulations in the financial sector have strengthened the banking sector over the last ten years.

Recently, the commercial banks have recorded poor performance. In terms of capital adequacy, the banking industry's overall capital adequacy ratio averaged 19% against a statutory minimum of 14.5% which is also an indicator of poor operational performance in the industry (Kenya Financial Sector Stability Report, 2016). The Kenya Financial Sector

Stability Report (2016) further revealed an increase in non-performing loans (NPLs) by 36.04%. These signaled elevated credit risks in the sector. In terms of the pretax profits, it was established that the banking industry cumulatively performed poorly since the cumulative audited pre-tax profits, declined by 5% during the same period (Kenya Financial Sector Stability Report, 2016). A report by KPMG (2016) indicated that commercial banks had recorded a reduction in profits as a result of the regulations.

The empirical review on the topic still provides inconsistency. Some studies have indicated negative effects of bank regulations. Vianney (2013) carried out a study in Rwanda and observed that there was no relationship between regulations and the financial performance of commercial banks, on the other hand, Chiarella, Harle, Poppensieker and Raufuss (2011) in a survey conducted by McKinsey and Company observed that new regulation on corporate banking businesses in Europe had resulted in significant reductions in credit costs and profits had decreased while a study by Brownbridge (2016) in Nigeria investigated the effects of deregulation and concluded that it increased the financial fragility of even the most well managed banks.

On the other hand, studies have also indicated positive effects of commercial banks regulations. A study by Gudmundsson, Kisinguh and Odongo (2013) established a positive relationship between capital regulation and the improved performance of banks and financial stability, Mureithi (2012) carried out a study on the effect of financial regulation on financial performance of Deposit-Taking Microfinance institutions in Kenya and established a positive relationship while Mwega (2014) also established a positive relationship between micro prudential regulations and performance of commercial banks in Kenya. The various studies showed that there was lack of clarity on what the true impact of regulations is. The inconsistency provided by the studies motivated this study to focus on establishing the

effect of bank specific guidelines on performance of commercial banks in Kenya.

Objective of the Study

The general objective of this study was to investigate the effects of bank specific guidelines on performance of commercial banks in Kenya. The specific objectives were:-

- To determine the effect of loan management policies on financial performance of Kenya commercial banks in Nairobi County
- To determine the influence of liquidity management on financial performance of Kenya commercial banks in Nairobi County
- To examine the effect of capital adequacy on financial performance of Kenya commercial banks in Nairobi County
- To determine the influence of Asset Quality on financial performance of Kenya commercial Banks in Nairobi County
- To determine the effect of Management Quality on financial performance of Kenya commercial banks in Nairobi County

Research Hypotheses

- Ha₁: Loan Management policies significantly affect financial performance of Kenya Commercial Banks in Nairobi County
- Ha₂: Liquidity Management significantly affect financial performance of Kenya Commercial Banks in Nairobi County
- Ha₃: Capital Adequacy significantly affect financial performance of Kenya Commercial banks in Nairobi County
- Ha₄: Asset Quality significantly affect financial performance of Kenya Commercial Banks in Nairobi County
- Ha₅: Management Quality significantly affect financial performance of Kenya Commercial Banks in Nairobi County

LITERATURE REVIEW

Theoretical Review

Public Interest Theory of Regulation

The public interest theory was first developed by Pigou (1938). The public interest theory proposes that government regulation is a response to public demands for government to rectify situations of market failure through imperfect competition, market disequilibria, missing markets or market outcomes that are undesirable for social reasons (Hertog, 2002). The public interest theory of regulation assumes that market outcome represents a failure, and the markets do not have the ability to fix the problem itself, that the governments have the ability to fix the failure so that the optimal efficient outcome will be achieved and that the benefits will outweigh the additional costs created by the intervention. The public interest theory also assumes that the regulatory regime achieves economic efficiency (Hertog, 2002; Shleifer, 2005).

The theory therefore supports the role of regulations imposed by CBK such as the micro prudential regulations in enhancing efficiency of commercial banks. It predicts a positive relationship between the micro prudential regulations and performance of commercial banks based on the argument that the government steps in through regulations to correct the market weaknesses.

Regulatory Capture Theory

The regulatory capture theory is associated with Stigler (1971) and Posner (1974). The regulatory capture theory provides a contrary perspective of regulation and argues that although regulation is often introduced to protect the public, the regulatory mechanisms are often subsequently controlled so as to protect the interests of particular self-interested groups within the society.

The theory as advanced by Stigler (1971) postulates that in the course of time, regulation will come to serve the interests of the branch of industry involved.

Regulatory capture occurs where, due to industry control of information, and the regulator comes to serve the interests of the regulated. This can be through direct subsidies, entry restrictions or tariffs, controls on substitutes, or price fixing (Stigler, 1971). The theory hence predicts a negative effect of regulations. According to the theory, the role of regulators is not necessarily to protect the interest of the public but to safeguard the interests of some self-interested groups thus distorting the market operations and affecting performance negatively. The theory therefore predicts a negative effect of micro prudential regulations on performance of commercial banks in Kenya.

The Market Power (MP) Theory

This theory posits that the performance of bank is influenced by the market structure of the industry. There are two distinct approaches within the MP theory; the Structure-Conduct-Performance (SCP) and the Relative Market Power hypothesis (RMP). According to the SCP approach, the level of concentration in the banking market gives rise to potential market power by banks, which may raise their profitability. Banks in more concentrated markets are most likely to make “abnormal profits” by their ability to lower deposits rates and to charge higher loan rates as a results of collusive (explicit or tacit) or monopolistic reasons, than firms operating in less concentrated markets, irrespective of their efficiency (Tregenna, 2009). Unlike the SCP, the RMP hypothesis posits that bank profitability is influenced by market share. It assumes that only large banks with differentiated products can influence prices and increase profits. They are able to exercise market power and earn non-competitive profits. This theory therefore applies in this study since the study will be done in Nairobi County which has the largest concentration of commercial banks in Kenya.

Conceptual Framework

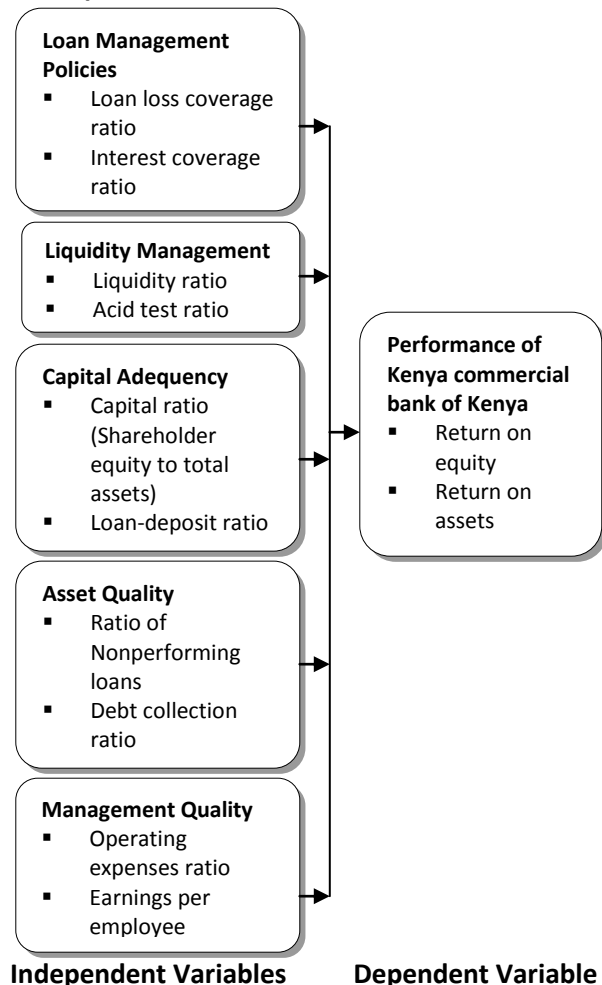


Figure 1: Conceptual Framework

Source: Author (2018)

Empirical Literature Review

Loan Management Policies

A study on the stability, efficiency and outreach of Kenya's banking system highlighted that while Kenya's financial system was by far the largest and most developed in East Africa and its stability had improved significantly over the past years, of the major challenges included a fragmented banking system and non-performing loans. This was caused by; under-capitalization, high levels of non-performing loans, hence the need of sound loan management policies and provisioning aggressively against non- performing loans (Thorsten *et al*, 2009).

A study by Bizuayehu (2016), assessed effect of the management of credit risk on profitability of Ethiopian banks. This study established that, credit risk which is measured by Non-Performing Loan ratio, which indicated a significant inverse impact on financial performance of Ethiopians commercial banks. Sufi and Qaisar (2015) carried out a study on importance of management practices of credit risk on the performance of loan when the credit terms are taken and loan policy, appraisal of clients and control of credit risk in Pakistan. The study established that credit terms and appraisal of clients has a positive and a significant impact on performance of loan, whereas credit policy and control of credit risk has insignificant but positive effect on loan performance. Further, Aduda and Gitonga (2011) explored a relation between the management of credit risk and the banks' lending profitability and concluded that management of credit risk has a great impact on commercial banks profitability.

Liquidity Management

Liquidity of the commercial bank is considered as a significant predictor of financial performance of a commercial bank. Researchers note that insufficient liquidity of commercial banks is considered to be one of the major reasons why they fail. It is however important to note that when a commercial bank holds a lot of liquid assets, then it incurs an opportunity cost of getting higher returns from investing with those assets. It is noted from the various studies that there is a positive relationship between liquidity and the performance of commercial banks although it is also noted that during times of instability in the business environment, commercial banks will tend to increase their cash reserves (holdings) as a way of mitigating themselves against risks. It is therefore clear that there is a negative correlation between the level of liquidity and the financial performance of commercial banks (Mommel & Raupach, 2010); measure of capital adequacy, is a measure ratio of shareholders' equity to total assets.

The lower the capitalization or capital ratio is the risky the banking institution is and vice versa.

Capital Adequacy

Capital adequacy has been shown as a firm specific factor that researchers have found to have an influence on the financial performance of commercial banks both in the developing world and in the developed world. The studies argue that commercial banks that have higher levels of capital post better financial results than their counterparts who have less capital at their disposal. Staikouras and Wood (2003) claim that there exists a positive link between a greater equity and financial performance among EU commercial banks. Abreu and Mendes (2001) also show that there is a positive impact of the equity level of a commercial bank on the financial performance of that bank. Goddard *et al.* (2004) further supports the prior finding of a positive relationship between capital/asset ratio and bank's earnings.

Asset Quality

Grier (2007) argues that poor asset quality is the main cause of bank failures. Further, Chaudhry and Singh (2012) assessed the impact of financial reforms on the soundness of the Indian Banking sector and established that Nonperforming loans levels, risk management methods, effective cost management and financial inclusion as key players. In a study on the causes of financial distress in local banks in Africa, Brownbridge (1998) noted that most bank failures in Kenya was as a result of nonperforming loans and insider lending. Similarly, Waweru and Kalani (2009) investigated the causes and remedies of commercial banking crises in Kenya. They concluded that non-submission of vital information by customers during loan application and inadequate debt collection policies were the key contributors to nonperforming loans in Kenya.

Management Quality

Aziz (1999) indicated that management competence, integrity, quality of board and level of professionalism are critical in ensuring a sound banking system. Similarly, Grier (2007) pointed out that management is deemed a significant element as it plays a role in a banks success. Pasiouras, Gaganis and Zopounidis (2006) noted that management efficiency in terms of revenue generation and control of expenses is an indicator of bank creditworthiness.

In a case study on the health of Joint venture banks in Nepal, Baral (2005) established that earning per employee and operating expenses ratios were above the Nepalese industry average indicating an efficient management hence positively related to a healthy Nepalese joint venture banks. Similarly, in their study on whether the collapse of Lehman Brothers would have been predicted, Dardac and Barbu (2005) established that management quality declined prior to the collapse of the bank and that the banks management poorly assessed borrowers resulting in bad loans. Moreover, White (1993) argued that mismanagement was one of the causes of bank failures.

METHODOLOGY

This study adopted a descriptive survey design. Kothari (2007) describes descriptive research as including survey and fact finding enquiries. Further, Cooper and Schindler (2007) posits that research design aids in the allocation of the perceived limited resources by coming up with crucial choices in methodology. The target population for this study was all the 19 branches of KCB bank in Nairobi County (KCB, 2018). The unit of observation were the Branch Managers, Operations managers, Customer care managers, Business Development managers and the Credit Managers. A total of 95 respondents were targeted. A census was conducted on all the branches of KCB bank in Nairobi County hence no sampling was conducted. The data collected was analyzed using Statistical Package for Social Sciences (SPSS 24).

Correlation analysis was also carried out for variable relationship. Below is the analytical model used;

$$Y = \alpha + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4 + \beta_5 X_5 + \epsilon$$

Where;

Y= Commercial Banks' Performance measured by ROA and ROE

α = Constant Term

β = Beta Coefficient –This measures how many standard deviations a dependent variable will change, per standard deviation increase in the independent variable.

X_1 = Loan Management policies X_2 = Liquidity management X_3 = Capital adequacy

X_4 = Asset Quality X_5 =Management Quality ϵ = Error term

RESULTS

Loan Management Policies

The first objective of the study sought to determine the effect of loan management policies on financial performance of Kenya commercial banks in Nairobi County. The respondents agreed that sound loan management policies affected profits (mean = 4.63), proper loan risk assessment plays a role in financial performance (mean = 5.00), loan risk evaluation influences bank's financial performance (mean = 4.50) and that policies on interest coverage ratio affected the performance of the bank (mean = 3.53). However, the respondents were uncertain on the statements that loan granting process and control affects performance and on whether policies on loan loss coverage ratio affected the performance of the bank as shown by means of 3.34 and 3.19 respectively. On average, however, respondent agreed on statements on loan management policies as shown by an average mean of 4.06 and a small variation indicated by an average standard deviation of 0.76. The study findings concurred with Bizuayehu (2016) findings that credit risk which is measured by Non-Performing Loan ratio, have a significant impact on financial performance of commercial banks.

Table 1: Descriptive Statistics on Loan Management Policies

Statement	1	2	3	4	5	Mean	Standard Deviation
Sound loan management policies affects our profits	0.00%	0.00%	18.80%	0.00%	81.20%	Mean	Standard Deviation
Proper loan risk assessment plays a role in financial performance.	0.00%	0.00%	0.00%	0.00%	100.00%	4.63	0.79
Loan granting process and control affects our performance	9.40%	6.20%	40.60%	28.10%	15.60%	5.00	0.00
Loan control affects our performance	0.00%	0.00%	0.00%	78.10%	21.90%	3.34	1.12
Loan risk evaluation influences our financial performance	0.00%	0.00%	0.00%	50.00%	50.00%	4.22	0.42
Policies on loan loss coverage ratio affect the performance of the bank	12.50%	15.60%	25.00%	34.40%	12.50%	4.50	0.50
Policies on interest coverage ratio affect the performance of the bank	12.50%	6.20%	25.00%	28.10%	28.10%	3.19	1.22
Average						3.53	1.31

Liquidity Management

The second objective sought to determine the influence of liquidity management on financial performance of Kenya commercial banks in Nairobi County. The respondents agreed that the statutory liquidity level for the bank affected the banks' profits (mean = 3.8), liquidity management practices affected the banks financial performances (mean = 3.9) and that the bank practices cash forecasting to enhance liquidity management (mean = 4.0). The respondents also agreed that the bank has target liquidity levels which they pursue (mean = 3.8) but were uncertain whether the level of liquidity held by the bank affects its financial performance (mean = 3.4), whether there

was a comprehensive balance and information reporting to help improve cash flow management of the bank (mean = 3.2) and on whether there was a comprehensive balance and information reporting to help improve cash flow management of the bank (mean = 3.4). On average, the respondents agreed on the statements on liquidity management as indicated by an average mean of 3.6 and average standard deviation of 1.2. The findings of the study correspond to Memmel and Raupach (2010) findings that there exist a positive relationship between liquidity and the performance of commercial banks where adequate level of liquidity relates positively to profitability of commercial banks.

Table 2: Descriptive Statistics on Liquidity Management

Statement	1	2	3	4	5	Mean	Standard Deviation
The statutory liquidity level for this bank affects our profits	6.20%	15.60%	21.90%	0.00%	56.20%	3.8	1.4
The level of liquidity held by this bank affects its financial performance	12.50%	25.00%	18.80%	0.00%	43.80%	3.4	1.5
Liquidity management practices affects our financial performances	9.40%	12.50%	9.40%	12.50%	56.20%	3.9	1.4
The bank practices cash forecasting to	0.00%	0.00%	31.20%	40.60%	28.10%	4.0	0.8

Statement	1	2	3	4	5	Mean	Standard Deviation
enhance liquidity management							
The bank has target liquidity levels which they pursue	0.00%	0.00%	43.80%	31.20%	25.00%	3.8	0.8
There is comprehensive balance and information reporting to help improve cash flow management of the bank	15.60%	15.60%	28.10%	12.50%	28.10%	3.2	1.4
There is a keen focus on receivables and payables to enhance the cash position of the bank	12.50%	3.10%	31.20%	40.60%	12.50%	3.4	1.1
Average						3.6	1.2

Capital Adequacy

The third objective sought to examine the effect of capital adequacy on financial performance of Kenya commercial banks in Nairobi County. The study findings revealed that respondents agreed on the statements that there is a comprehensive and sound assessment of risks for proper capital allocations (mean = 3.9), the banks reviews the ICAAP policies annually with the approval of the board (mean = 4.3) and that the relative capital the bank has affect profit levels (mean = 3.5). Additionally, respondents agreed that bank maintains the loan deposit ratio as per the requirements and keeps the current and prospective total capital necessary to support all material risks

that the institution is exposed to as shown by a mean of 4.5. Similarly, the respondents agreed that the board and senior management takes part in ensuring the bank has adequate capital to manage its risks (mean = 3.7) and that the bank had established adequate and effective capital planning and management policies (3.9). On average, all respondents agreed to the statements on capital adequacy as shown by an average mean of 4 and average standard deviation of 1.0. The findings of the study concurred with Abreu and Mendes (2001) conclusions that there exist a positive impact of the equity level of a commercial bank and financial performance of that bank.

Table 3: Descriptive Statistics on Capital Adequacy

Statement	1	2	3	4	5	Mean	Standard Deviation
There is comprehensive and sound assessment of risks for proper capital allocations	9.40%	3.10%	25.00%	15.60%	46.90%	3.88	1.30
The banks reviews the ICAAP policies annually with the approval of the board	3.10%	6.20%	6.20%	25.00%	59.40%	4.31	1.05
The relative capital the banks has affects our profit levels	9.40%	12.50%	6.20%	59.40%	12.50%	3.53	1.15
The bank maintains the loan deposit ratio as per the requirements	0.00%	0.00%	0.00%	50.00%	50.00%	4.50	0.50
The bank keeps the current and prospective total capital necessary to support all material risks that the institution is exposed to	0.00%	0.00%	0.00%	53.10%	46.90%	4.47	0.50

Statement	1	2	3	4	5	Mean	Standard Deviation
Board and senior management takes part in ensuring the bank has adequate capital to manage its risks	6.20%	18.80%	9.40%	28.10%	37.50%	3.72	1.31
The bank has established adequate and effective capital planning and management policies	9.40%	3.10%	25.00%	15.60%	46.90%	3.88	1.30
Average						4.04	1.02

Asset Quality

The fourth objective sought to determine the influence of Asset Quality on financial performance of Kenya commercial Banks in Nairobi County. The study findings revealed that respondents agreed with the statements that the bank maintains low levels of Non-performing loans to improve their assets quality (mean = 4.6), the bank normally evaluated its assets to measure its credit risk (mean = 4.8) and that the bank maintained its loan portfolio value as a way of managing its asset quality (mean = 4.6). Consequently, respondents agreed that non-performing loans were restructured to improve the asset quality (mean = 4.0), bank had sets aside cash

deductible as an expense to cushion it against bad debts and loan defaults (mean = 4.3) and that the asset quality evaluation of the bank emphasizes on how adequate the allowance for loan losses is (mean = 4.4). The average mean of 4.5 and a small variation in responses indicated by average standard deviation of 0.6 showed that all respondents agreed to the statements on asset quality on financial performance. The findings were consistent with Dang (2011) who postulated that quality of bank loans was affected by the level of nonperforming loans, appropriateness of loan loss provisions, management and administration of loans.

Table 4: Descriptive Statistics on Asset Quality

Statement	3	4	5	Mean	Standard Deviation
The bank maintains low levels of Non-performing loans to improve their assets quality	18.80%	0.00%	81.20%	4.63	0.79
The bank normally evaluates its assets to measure its credit risk	0.00%	21.90%	78.10%	4.78	0.42
The bank maintains its loan portfolio value as a way of managing its asset quality	0.00%	43.80%	56.20%	4.56	0.50
The non-performing loans are restructured to improve the asset quality	31.20%	37.50%	31.20%	4.00	0.80
The bank has set aside cash deductible as an expense to cushion it against bad debts and loan defaults	21.90%	21.90%	56.20%	4.34	0.82
The asset quality evaluation of the bank emphasizes on how adequate the allowance for loan losses is	0.00%	59.40%	40.60%	4.41	0.50
Average				4.45	0.64

Management Quality

The fifth objective sought to determine the influence of management Quality on financial performance of Kenya commercial Banks in Nairobi County. The study findings indicated that the operating expenses in the bank was within the range stipulated (Mean = 4.37), continuous management training improved the financial performance of the commercial banks

(4.28), the management of the banks was capable in efficiently deploying its resources in profitable investments (mean = 4.14), the management of the banks was capable of engaging in activities that reduced the operating costs (Mean = 4.79) and that the management of the bank was capable in making key decisions that maximize the banks income (Mean = 3.78).

Table 5: Descriptive Statistics of Management Quality

Statement	1	2	3	4	5	Mean	Standard Deviation
The operating expenses in the bank is within the range stipulated	0.00%	0.00%	18.80%	0.00%	81.20%	4.37	0.79
Continuous management training improves our financial performance.	0.00%	0.00%	0.00%	0.00%	100.00%	4.28	0.83
The management of the bank is capable in efficiently deploying its resources in profitable investments	0.00%	12.50%	15.60%	46.90%	25.00%	4.14	0.80
The management of the bank is capable of engaging in activities that reduce the operating costs	0.00%	18.80%	18.80%	18.80%	43.80%	4.79	1.12
The management of the bank is capable in making key decisions that maximize the banks income	0.00%	21.90%	12.50%	31.20%	34.40%	3.78	1.34
Average						4.27	0.98

Performance of KCB Bank Management Quality

The study also established the performance of KCB bank for the last five years in terms of the ROA and ROE and established trends analysis. The findings reveal mixed trends with increasing trends in ROA recorded. However in the year 2017, the ROA for the bank decreased. On returns on equity trend, the findings similarly reveal mixed trends with increasing trends in ROE just like the behaviour of ROA. However in the year 2017, the ROE for the bank decreased.

The results of the correlation analysis indicated that the correlation between loan management policy and financial performance of commercial banks was 0.394 and a p-value of 0.001. This meant that the correlation was positive and significant implying that increases in the practices on loan management practices would lead to increase in financial performance of commercial banks. The results were consistent with Aduda and Gitonga (2011) findings that management of credit risk had a great impact on commercial banks profitability which enhanced the bank's financial performance.

Correlation Results

The correlation results further indicated that the correlation between liquidity management and financial performance of commercial bank was 0.255 and a p-value of 0.042. The correlation was positive and significant implying that increase in practices on liquidity management would lead to increase in financial performance of commercial bank. The correlation results also indicated that the correlation between capital adequacy and financial performance of commercial banks is 0.435 and a p value of 0. The results indicated a positive and a significant relationship between capital adequacy and financial performance of commercial banks implying that increase in attributes of capital adequacy will lead to increase in financial performance of commercial banks. The correlation results also showed that the correlation between asset quality and financial performance of commercial banks was 0.091 and a p-

value of 0.201. The results showed that the relationship was positive and not significant implying that increase in the practices on asset quality could lead to increase financial performance of commercial banks although the increase was not significant. The correlation findings further indicated that the correlation between management quality and financial performance of commercial banks was 0.345 and a p-value of 0.003. The results showed that the relationship was positive and significant implying that increase in the practices on management quality could lead to increase financial performance of commercial banks. The findings were consistent with Christopoulos *et al.*, (2011) who established that management quality plays a significant role in improving financial performance and that banks managed poorly leads to bank failure.

Table 6: Correlation Analysis

		Loan Managemen nt Policy	Liquidity Managemen t	Capital Adequac y	Asset Quality	Managemen t Quality	Financial Performance
Loan Managemen t Policy	Pearson Correlation Sig. (2-tailed)	1					
Liquidity Managemen t	Pearson Correlation Sig. (2- tailed)	-0.191 0.131	1				
Capital Adequacy	Pearson Correlation Sig. (2- tailed)	-0.1 0.431	-.263*	1			
Asset Quality	Pearson Correlation Sig. (2- tailed)	0.07 0.581	0.138 0.278	.341** 0.006	1		
Managemen t Quality	Pearson Correlation Sig. (2- tailed)	0.09 0.145	0.234 0.135	0.654 0.001	0.134 0.234	1	
Financial Performanc	Pearson Correlation	.394**	.255*	.435**	.091**	0.345**	1

e						
	Sig. (2-tailed)	0.001	0.042	0.000	0.201	0.003
	N	64	64	64	64	64

** Correlation is significant at the 0.01 level (2-tailed).

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

Multiple Regression Analysis

The results showed a strong relationship between loan management policies, liquidity management, capital adequacy, management quality and asset quality and financial performance of commercial banks as indicated by $R = .796$. The model also indicated that R-squared was .633 implying that 63.3% of variation in financial performance of commercial banks can be explained by loan management policies, management quality, liquidity management, capital adequacy and asset quality.

The ANOVA results in table 8 also indicated that the overall model linking loan management policies, liquidity management, management quality, capital adequacy and asset quality with financial performance of commercial banks was significant. The significance levels are confirmed since the F value of 25.466 is significant (Sig = 0.000, < 0.05).

The model coefficient showed that loan management policy had a positive and significant effect on financial performance of commercial banks as shown by $\beta = 0.478$ and Sig = 0.000 < 0.05. This implied that a unit change in loan management policies results to an increase of 0.478 units in financial performance of commercial banks. The results presented also indicated that liquidity management had a positive and significant effect on financial performance of commercial banks as shown by $\beta = 0.243$ and Sig = 0.000 < 0.05.

Table 7: Model Summary

R	R Square	Adjusted R Square	Std. Error of the Estimate
.796	0.633	0.608	0.258

Table 8: ANOVA (Model Significance)

	Sum of Squares	df	Mean Square	F	Sig.
Regression	6.825	4	1.706	25.466	.000

The results presented further revealed that Capital adequacy had a positive and significant effect on financial performance of commercial banks as shown by $\beta = 0.324$ and Sig = 0.000 < 0.05. This implied that a unit change in capital adequacy would result to an increase of 0.324 units in financial performance of commercial banks. The findings were consistent with Cook and Heiser (2011) who indicated that there existed a positive link between equity level and performance commercial banks.

The results presented also indicated that asset quality had a positive but insignificant effect on financial performance of commercial banks as shown by $\beta = 0.101$ and Sig = 0.362 > 0.05. This implied that a unit change in asset quality would result to an increase of 0.101 units in financial performance of commercial banks.

Finally, it was established that management quality had a positive and significant effect on financial performance of commercial banks as shown by $\beta = 0.461$ and Sig = 0.008 < 0.05 > 0.05. This implied that a unit change in management quality would result to a significant increase of 0.461 units in financial performance of commercial banks. The results were consistent with the findings of a study by Pasiouras *et al.*, (2006) which indicated that management efficiency in terms of revenue generation and control of expenses is an indicator of bank creditworthiness.

Residual	3.953	59	0.067
Total	10.777	63	

Table 9: Model Coefficients

Predictors	Unstandardized Coefficients		Standardized Coefficients		
	B	Std. Error	Beta	t	Sig.
(Constant)	-0.206	0.536		-0.384	0.703
Loan management policy	0.478	0.073	0.544	6.58	0.000
Liquidity management	0.243	0.042	0.504	5.756	0.000
Capital adequacy	0.324	0.05	0.595	6.528	0.000
Asset quality	0.101	0.11	0.081	0.92	0.362
Management Quality	0.461	0.166	0.455	2.778	0.008

The Optimal Linear Regression Model Therefore Becomes:

Financial performance of commercial banks = (0.206) + 0.478 (Loan management policy) + 0.243 (Liquidity management) + 0.324 (Capital adequacy) + 0.461 (Management Quality)

Asset quality was not included in the final optimal regression model, since it was not significant.

CONCLUSION

The study findings led to conclusion that loan management policies positively and significantly influences financial performance of commercial banks. The study further established that focusing on various aspects of loan management policies such as having sound loan management policies, proper loan risk assessment and loan granting process, loan control and risk evaluation, policies on loan loss coverage ratio and interest coverage ratio positively and significantly influence financial performance of commercial banks.

The study findings also led to conclusion that liquidity management positively and significantly influences financial performance of commercial banks. Remarkably, the study established that having a statutory liquidity level, maintaining a certain level of liquidity, focusing on liquidity management practices, practicing cash forecasting to enhance liquidity management, having a target liquidity levels to

pursue, having a comprehensive balance and information reporting to help improve cash flow management and having a keen focus on receivables and payables to enhance the cash position of the bank positively and significantly influence financial performance of commercial banks.

The study findings further led to conclusion that capital adequacy positively and significantly influence financial performance of commercial banks. This implies that having a comprehensive and sound assessment of risks for proper capital allocations by the bank, reviewing the ICAAP policies annually with the approval of the board, maintaining the loan deposit ratio as per the requirements, keeping the current and prospective total capital necessary to support all material risks that the institution is exposed to and the board and senior management taking part in ensuring the bank has adequate capital to manage its risks positively and significantly influence financial performance of commercial banks. The study findings led to the conclusion that asset quality positively but insignificantly influence financial performance of commercial banks. The findings indicate that improvement on practices such as maintaining low levels of non-performing loans to improve assets quality by the bank, evaluating the bank's assets to measure its credit risk, maintaining loan portfolio value as a way of managing asset quality, restructuring non-performing loans to

improve the asset quality and setting aside cash deductible as an expense to cushion the bank against bad debts and loan defaults positively but insignificantly influence financial performance of commercial banks.

The study concludes that an improvement in management quality practices such as having operating expenses within the range stipulated, continuous management training, efficiently deploying bank's resources in profitable investments, engaging in activities that reduce the operating costs and making key decisions that maximize the banks income leads to a significant improvement in financial performance of the commercial banks.

RECOMMENDATIONS

The study recommended that commercial banks should focus on improving their loan management policies since the practice leads to a positive and significant improvement on financial performances of commercial banks. Commercial banks can do this by focusing on various aspects of loan management policies such as sound loan management policies, proper loan risk assessment and loan granting process, loan control and risk evaluation, policies on loan loss coverage ratio and interest coverage ratio.

The study recommended that commercial banks should improve their liquidity management practices since the practices leads to positive and significant effects on financial performances of commercial banks. Commercial banks can achieve this by having a statutory liquidity level, maintaining a certain level of liquidity, focusing on liquidity management practices, practicing cash forecasting to enhance liquidity management, having target liquidity levels to pursue, having a comprehensive balance and information reporting to help improve cash flow management and having a keen focus on receivables and payables to enhance the cash position.

The study recommended that commercial banks should improve their capital adequacy since it leads to positive and significant effects on financial

performances of commercial banks. Commercial banks can achieve this by having a comprehensive and sound assessment of risks for proper capital allocations, reviewing the ICAAP policies annually with the approval of the board, maintaining loan deposit ratio as per the requirements, keeping the current and prospective total capital necessary to support all material risks that the institution is exposed to and the board and senior management taking part in ensuring the bank has adequate capital to manage its risks.

The study recommended that commercial banks should focus on improving their asset quality since the practice leads to positive and significant effects on financial performances of commercial banks. Commercial banks can achieve this by improving on practices such as maintaining low levels of non-performing loans to improve their assets quality, evaluating the bank's assets to measure its credit risk, maintaining loan portfolio value as a way of managing asset quality, restructuring non-performing loans to improve asset quality and setting aside cash deductible as an expense to cushion the bank against bad debts and loan defaults.

There is a need for the commercial banks to enhance their adoption of management quality practices in order to improve their financial performance. Among them is having operating expenses within the range stipulated, continuous management training, and efficiently deploying bank's resources in profitable investments, engaging in activities that reduce the operating costs and making key decisions that maximize the banks income.

Areas for Further Study

The current study was conducted on commercial banks in Nairobi County. The study recommended further studies on micro prudential regulations on other financial institutions such as Saccos. Similarly, the study recommended future studies on other indicators of micro prudential regulations affecting financial performance of commercial banks since loan

management policies, liquidity management, capital adequacy and asset quality accounts for only 63.3% on variations in financial performance of commercial banks. The remaining 36.7% is accounted by other

indicators not included in the study. There is a need for future studies to focus on a wider scope other than just KCB bank. Furthermore, other counties can also be focused on.

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