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**MEASURES COMMERCIAL BANKS HAVE
TAKEN TO ENSURE COMPLIANCE WITH THE
CAPITAL ADEQUACY REQUIREMENT IN
BASEL III FRAMEWORK**

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Abstract

Purpose: The purpose of the study was to establish measures commercial banks have taken to ensure compliance with the capital adequacy requirement in Basel III framework.

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

Results: Based on the findings the study concluded that the commercial banks in Kenya have taken various measures to ensure compliance with capital adequacy requirement such as cutting back on lending, market rights issue/bonds, increasing revenue growth/cutting costs and withholding dividend payment. In addition, the study concluded that commercial banks, in a bid to reduce the challenges experienced in the implementation of capital adequacy requirement, they opt to purchase high quality liquid assets, increasing their maturity profile and increasing retail deposits.

Unique contribution to theory, practice and policy: The study recommends that it is vital to understand the forces behind the increasing sophistication and efficiency of risk management systems, before adopting them more widely for regulatory purposes

Keywords: *measures, commercial bank, capital adequacy requirement, Basel III framework*

1.0 INTRODUCTION

1.1 Background of the Study

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

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

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

Basel III is the third instalment of the Basel accords and is a global regulatory standard set by the BCBS on capital adequacy (including a new leverage ratio and capital buffers), market liquidity risk (with new short-term and long-term liquidity ratios) and stress testing focusing on stability. The Basel III reforms to global regulatory standards were agreed by the G-20 in November 2010 and were then issued by the Basel Committee on Banking Supervision in December 2010 (BCBS, 2010a). The key aim of these reforms is to strengthen the capital adequacy requirements with regard to quality and quantity of capital which banks must hold in order to absorb losses.

The Basel III framework, whose main thrust has been enhancing the banking sector's safety and stability, emphasises the need to improve the quality and quantity of capital components, leverage ratio, liquidity standards, and enhanced disclosures. Basel III is therefore an effort to control the causes of the most recent crisis. Regulation of this sort has been effective in the past (BCBS, 2010b).

Basel III introduces new and enhanced rules, these includes the introduction of a new and stricter definition of capital – designed to increase consistency, transparency and quality of the capital base – and the introduction of a global liquidity standard (BCBS, 2010a,b). The two new liquidity ratios – the longer-term Net Stable Funding Ratio (NSFR) and the short-term Liquidity Coverage Ratio (LCR)–call on banks to raise high-quality liquid assets and acquire more stable

sources of funding, ensuring that they are in agreement with the principles of liquidity risk management. In addition, Basel III introduces a new leverage ratio, a substitute to the risk-based Basel II framework. By setting 3 percent as the ratio of Tier 1 Capital to total exposure, the new leverage ratio may limit banks' scope of action (BCBS, 2010c).

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

Basel III is poised to have a significant impact on the world's financial systems and economies. The implications for the banking industry from Basel III could be profound. According to BCBS (2010b) new minimum capital standards changes combined with the higher capital charges for trading books make some business models less profitable or even unprofitable going forward and banks will need to rethink their strategy and business portfolio in the light of the changes.

As the ailing global economy blew cavernous holes in national budgets, mounting censure was directed to financial regulators in OECD nations. Their counterparts in emerging economies have not escaped fierce condemnation for blatantly (Ashcraft and Schuermann, 2008). While credit rating firms failed to properly measure the inherent dual risks arising from sub-prime loans and the new financial architecture, policymakers resorted to easy money and low interest rates to further boost house purchases and consumption (Mishkin, 2008). All the more, the openness of international financial markets tempted western governments to expand their expenditure by taking up huge foreign debt at cheap interest rates especially since they were weary of rebounding into a post-2001 recession.

The issuance of government bonds tamed emerging economies' hunger for holding solid sovereign securities (Balin, 2010). Consequently, western fiscal agents accumulated national debt that approached the perilous threshold of 90 percent debt-to-GDP ratio boding an economic predicament (Reinhart and Rogoff, 2010). Despite the fact that Macroprudential regulation is necessary for Africa, the proposals in Basel III are still inadequate in reducing systemic risks on the continent. This is because they do not deal with systemic threats resulting from cross border capital flows arbitrated through the banking system.

Lukonga and Kay (2010) argue that the regulatory shortcomings facing Africa need a larger collection of instruments than those offered in Basel III. These instruments can include limitation to foreign exchange exposure and regulations to limit amassing of large loan. This calls for a more aggressive regulatory regime to warrant a more healthy and flexible financial system in Africa. Most African countries inflict restrictions on business activities, banks' large loan concentrations and foreign exchange exposures which are not within the traditional commercial banking.

Lukonga and Kay (2010) further argued that African bank regulation are more forceful compared to the advanced economies which basically rely on just one regulatory instrument, the capital adequacy requirement, which exposed the advanced economies to “gaming” by banks to reduce the amount of capital they had to hold. The potential impact of Basel III on the banking system is significant. Banks will experience increased pressure on their Return on Equity (RoE) due to increased liquidity and capital costs. In particular, Basel III creates incentives for banks to improve their operating processes – not only to meet requirements but also to increase efficiency and lower costs (BCBS, 2010a).

Kenyan banks are forced to improve their capital buffers through increased capital adequacy requirements, as well as the introduction of liquidity requirements and countercyclical macro prudential measures (BCBS, 2010). The banks are also required to maintain a total capital to risk-weighted assets ratio- a gauge of a bank’s financial strength based on total capital including items such as goodwill and revaluation of 14.50 per cent, up from the current 12 per cent (CBK, 2013). Banks are building their buffer capital in line with the CBK’s prudential requirements and CBK is undertaking stress-testing to ensure that this progresses well within the 18-month build up window.

Currently, the minimum capital requirements for Kenyan banks are already above the proposed minimums as the tier 1 capital to Total Risk Weighted Assets stands at 8 per cent and total capital to total risk weighted assets at 12 per cent. An analysis of the two ratios for banks shows that the top six and other tier two banks such as Diamond Trust and NIC Bank are already in compliance with the new requirements. Equity, Barclays and Co-operative Banks adjusted their ratios in advance, their adoption of new accounting methods resulting in a drop in both ratios as at June 2013 when compared with December 2012 (CBK, 2013).

Further, the progressive increase of the minimum core capital of banks and mortgage finance companies to Ksh1 billion (\$12.5 million) by 2012 will position the Kenyan banks to exploit new market niches and absorb any emerging shocks. As at December 2013, the Kenyan Banking system comprised of 43 commercial banks, 2 NBFIs, 4 building societies and 48 foreign exchange bureaus Central Bank of Kenya, (2013). This study aimed at carrying out a study on the effects of Basel III framework on capital adequacy of commercial banks in Kenya.

1.2 Problem Statement

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

banking industry can help ensure that performance indicators are corresponding with the best practices of the intermediation function that assures financial stability over time.

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

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

1.3 Research Objectives

To establish measures commercial banks have taken to ensure compliance with the capital adequacy requirement in Basel III framework.

2.0 LITERATURE REVIEW

2.1 Empirical Review

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

Lang'at (2013) sought to find out the determinants of lending to farmers by commercial banks in Kenya. The study was conducted through a survey research design. Self-administered structured questionnaires were used to collect primary data. The respondents were given an assessment of their lending policy to farmers vis-a-vis their policies on Credit Standards with Regard to Farmers; their Assessment of Return on Credit to Farmers; and their assessment of Risk on Credit to Farmers. Results indicated that banks give out loans to finance farming activities and that farmers have reliable sources of income that enable them to pay back their loans in time. Results also revealed that credit standards credit standards regard to farmers return on credit to farmers, risk on credit to farmers negatively affected lending to farmers. This is an implication that credit Standards with regard to Farmers; Return on Credit to Farmers; and Risk on Credit to

Farmers reduces the amounts provided to the farmers in Kenya. The study recommended that policies should be scripted to ensure that the income from farmers in Kenya is stabilized to mitigate risk and improve their creditworthiness, to ensure that farmers have skills to manage their finances properly to maintain excellent financial records with banks and to help banks unwind their credit qualification for farmers so as to stimulate the demand and supply of credit.

Mwiroti (2012) sought to investigate the effects of the lending rate policy on the loan portfolio of commercial banks in Kenya. The lending rate policy was measured by the average annual lending rate of the selected commercial banks. Loan portfolio comprised of the annual average of total loans and advances, loan accounts and nonperforming loans. The study employed a quantitative survey design. Secondary data was collected from the audited financial reports of sampled commercial banks for the period between 2002 and 2011. SPSS was used to analyse the data. The findings were presented in bar charts and tables. Descriptive statistics, correlation analysis, regression analysis and test of auto correlation were the techniques used to analyze the data. Results revealed that the lending rates had a positive correlation with total loans and advances, total loan accounts and total nonperforming loans. However, only the nonperforming loans had a significant relationship with the lending rates. The study concluded that the high nonperforming loans portfolio in the Kenyan commercial banks has been as a result of high lending rates caused by the increases in the CBR and the high exchange rates. The study recommended that commercial banks should adopt policies and models that would enable them to reflect the changes in CBR, foreign exchange rates and any other inherent risks in the lending business. Therefore commercial banks will resort to cutting back on lending in order to shore up then capital adequacy ratios.

According to Financial Stability Board (2011), lack of regulation makes transactional and compliance costs very low. However, the volume that is available domestically is limited so long as it is possible to access cheaper funding from outside and then convert it into local currency. Fixed interest end investors (and their advisers) are blocked by the fear of inflation, the lack of liquidity and an inflexible system of equity-biased taxation. The cash for bond investment is increasing the amount of funds available. However, it needs to be in the best interests of the members for the funds to switch from equities to bonds. A liquid domestic bond market would benefit the financial system but to bring it about it will need a more radical stimulus than the requirements of Basel III.

Koka (2012) explored the relationship between issuance of Treasury/ Government bonds and economic growth in Kenya. A case survey research design was used in this study. The study used secondary data that span from the year 2003 to the year 2011. The time series data was on gross domestic product, market capitalization of bonds, value of bonds traded and total new issues of bonds. Regression analysis was used to analyse the data used in this study. The results revealed that the issuance of Government bonds has a positive effect on the level of economic growth in Kenya. This implied that Kenya could enhance its economic growth by effectively and strategically strengthening the Bonds market and the uptake of Government Bonds. The study concluded that the supply-leading hypothesis of economic growth prevailed in Kenya during the period under study from 2003 to 2011. This was an implication that economic growth was

finance-led through funds mobilization. The study recommended that the regulatory authority should adopt policies that would support more companies to access the market and also be more proactive in their inspection role in order to check sharp practices which hinder market integrity and wear away investors' confidence.

The banks are also planning to raise capital in a timely manner and at a proper price. Unfavourable markets may mean issuing shares at a higher discount to market price and issuing more equity shares, thereby causing dilution of shareholding and reducing earnings per share (Moreno, 2011). Banks may be impacted by higher costs of capital and lower returns making it difficult to attract and retain investors. Again, as the cost of capital becomes higher, banks may be unable to provide lending to SME clients/unrated clients. If banks are not able to turn over their assets due to capital constraints, it will impact the GDP and economic growth as well.

In a bid to increase revenue, banks have adopted strategic responses which are dynamic mechanisms to balance sheet management, including rationalisation of branch structures, product rationalisation or implementation of a shared services model, undertaking strategic cost reductions. Banks will have to look at the kind of equity they can raise, the contingent capital and the amount of earnings they have to retain to reduce the need for raising further capital (Caggiano and Calice, 2011). At the same time this will affect the investor community because the investors look at dividends and expect some returns from the banks every year. So it's like a trade-off between retaining capital, retaining earnings and distributing dividends. Banks also have to look at their lines of businesses and make some hard decisions on exiting risky businesses, and businesses that are more capital demanding and also outsourcing or off-shoring non-core functions.

Kimani (2013) considered revenue, cost and profit effectiveness for Kenyan banks between 1998 and 2006. Besides, the study sought to find out the relationship between changes in cost and profit efficiency to stock returns using classical regression models. The study used a DEA methodology. Results revealed that banks had declining cost efficiency over the sample period while the revenue efficiency was linearly increasing. Malmquist total factor productivity index measures revealed that technical efficiency and technological efficiency were the main drivers of profit efficiency in the banking industry. Results also revealed that there exists a significant relationship between stock returns and changes in both cost and profit efficiency for the listed commercial banks. Cost efficiency influenced stock returns of banks as poor cost management lowers banks' profits. Poor profits led to low future dividends to investors. Subsequently, the share price was bid down at the stock market. Hence, a bank which is capable of mobilizing its deposits, other funds and staff earns high profits, resulting to high dividends to investors and the share will be highly priced which implies high stock returns.

Mwange (2013) conducted a study seeking to establish the impact of mobile banking on the Financial Performance of Commercial Banks in Kenya during a period of five years. A causal research design was used in this study. The study used secondary data obtained from the Central Bank of Kenya reports and published financial reports of the 43 Commercial Banks in Kenya for a period of five years between 2008 through 2012. Results revealed that Mobile Banking has a restrained influence on profitability of commercial banks in Kenya. Thus, there exists positive

relationship between mobile banking and bank performance. The study concluded that mobile banking enables banks to increase revenues in various ways such as increasing the return on asset (ROA). The study recommended that commercial banks should adopt new technologies which will improve their profit margins. Government policy makers should also revise policies related to promotion of innovation and transfer of technology that will improve profitability of organizations as it will translate to better tax revenues for the government.

The goal of corporate entities is to maximize the value of shareholders' investment in the firm. Managers pursue this goal through their investment and financing decisions. Investment decisions involve the selection of positive net present value projects while financing decisions involve selection of a capital structure that would minimize the cost of capital of firm. Apart from the investment and financing decisions, managers need to decide on regular basis whether to payout the earning to shareholders, reducing the agency problem. As Richard and Stewart (2003) posit the objective of the corporation is to maximize the total discounted dividends paid out to shareholders and companies that pay dividends are historically stable.

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

Kimathi (2010) sought to establish the forms of dividend payout of firms listed at the Nairobi Stock Exchange by industry and to find out their influence of industry on dividend pay-out policies of firms. This study was a relational survey. The population of interest in this study consisted of all the firms quoted at the Nairobi Stock Exchange. Lack of readily available data from private companies limited this study to listed companies. Results showed that cash was the only form of dividend which was paid out by these firms. Hence, in terms of industry, it is not possible to conclude that a particular form of dividend payout is preferred over the other since all the firms paid their dividends in the form of cash. Results also revealed that industry factors had a strong positive effect on dividend payout ratios in three industries namely agriculture, finance and investment, and industrial and allied. In addition, industry factors had a weak positive influence on dividend payout ratios in the commercial and services industry. The study recommended that the management of various companies listed on the NSE should take into account the findings of this study in a bid to understand how industry factors influence the dividend payout ratios of their firms.

The second objective of the study was to seek to investigate the challenges commercial banks are facing in the implementation of capital adequacy requirement. Accordingly, the respondents

were required to indicate the extent their banks experience various challenges in the implementation of capital adequacy requirement.

3.0 RESEARCH METHODOLOGY

This study used a descriptive research design. The population of this study comprised of the commercial banks operating in Kenya. The target respondents included the 159 departmental heads, assistant departmental heads and lower cadre staffs like the supervisors, accounts and finance officers from the selected commercial banks' offices in Nairobi. The study used stratified sampling. Sample of responding staff was drawn from 159 top and middle level managers from the staff working in the banks' head offices in Nairobi. The study used stratified random sampling. The study used a sample of 30% of the entire population which was selected from within each group in proportions that each group contributes to the study population. This study used primary data collected using questionnaires. Data was analysed using SPSS and Microsoft excel. SPSS was used to produce descriptive statistics such as means, standard deviation, percentages and frequencies. Results were presented in form of tables, pie charts and graphs. The qualitative data was analyzed using content analysis and presented in prose form. Both quantitative and qualitative data was compiled to generate the final project report.

4.0 RESULTS AND DISCUSSIONS

4.1 General Information

4.1.1 Response Rate

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

4.1.2 Distribution of the Respondents by Gender

Table 1: Gender of the Respondents

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

The respondents sampled comprised male and female staff of the commercial banks in Kenya. They were to indicate their gender by ticking on the spaces provided in the questionnaire. Table 1 shows the distribution of the respondents by gender.

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

4.1.3 Response Rate Based on the Respondents' Departments

Table 2: Respondents' Departments

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

Capital requirements and implementation of Basel III decisions affect the various aspects of performance of the organizations across various departments. It was therefore important to ensure that questionnaires were distributed and returned from various departments within the selected commercial banks. This was to ensure that the all areas influenced by Basel III are captured in the study. The results are as depicted in Table 2.

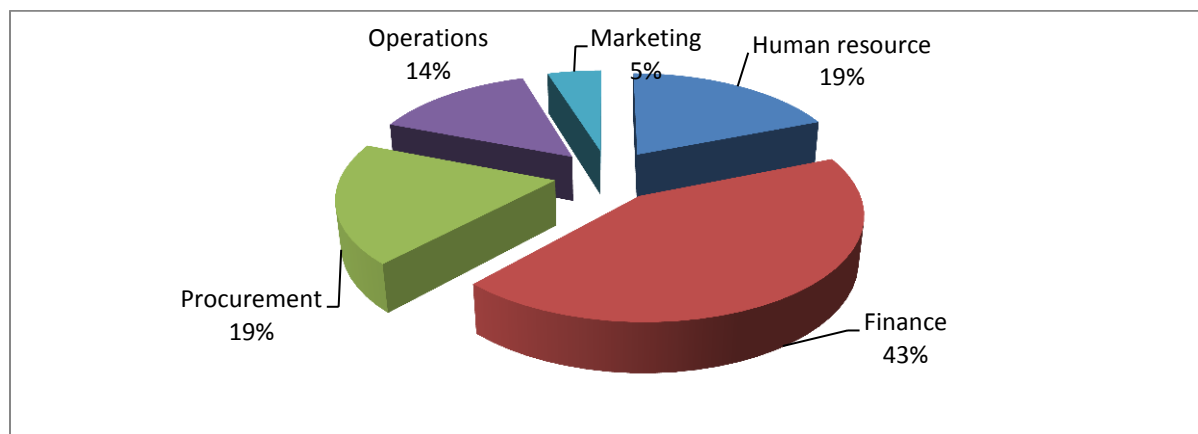


Figure 1: Respondents' Departments

From the results shown in table 2 and figure 1, 42.9% of the respondents were working in the finance departments, 19.0% of them were working in the human resource departments, 19.0% worked in procurement department, and 14.3% worked in the operations department, while 4.8% worked in marketing departments. This implies that all departments that were targeted by the study were involved and that the findings are not biased hence representative of the various

departments' views on effects of Basel III framework on capital adequacy requirement in commercial banks in Kenya.

4.1.4 Respondents Managerial Positions

Table 3: Respondents Designations

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

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

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

4.1.5 Distribution of Respondents by Working Experience in the Banking Industry

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

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

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

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

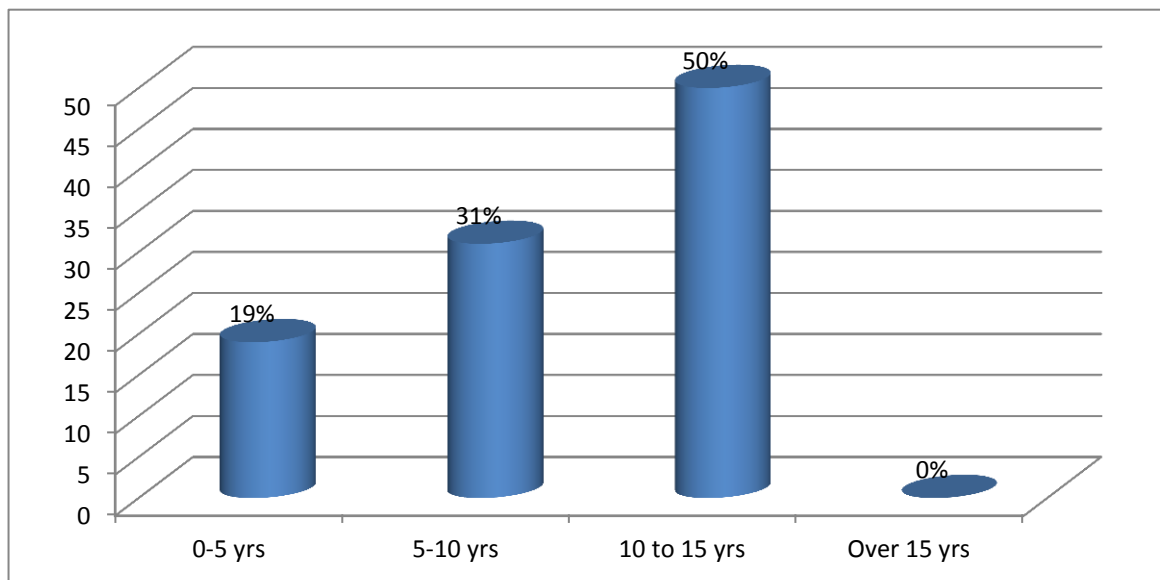


Figure 2: Working Experience in the Banking Industry

4.1.6 Highest Formal Qualification

Table 5: Level of Education

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

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

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

4.2 Descriptive Statistics

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

Table 6: Measures taken for Compliance with Capital Requirement

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

Results in Table 6 reveal that a majority (39%) of the respondents stated that commercial banks have taken measures to ensure compliance with the capital adequacy requirement to a great extent and 33% to a very great extent while 23% said commercial banks have taken some measures to ensure compliance with the capital adequacy requirement to a moderate extent. According to 4.5% of the respondents, commercial banks have taken some measures to ensure compliance with the capital adequacy requirement to a little extent. These results indicate that commercial banks have taken some measures to ensure compliance with the capital adequacy requirement to a great extent as shown by majority of the respondents, 72%.

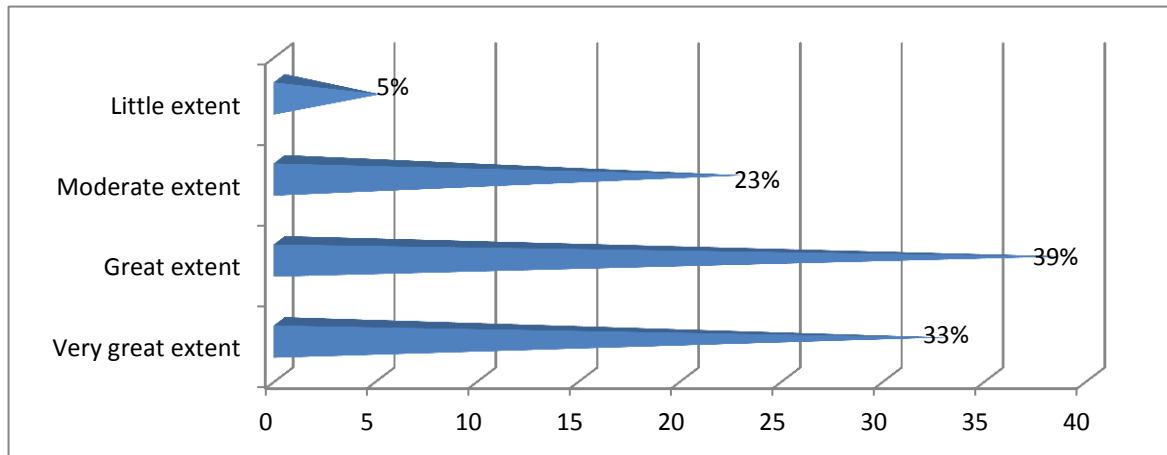


Figure 3: Measures are taken for Compliance with Capital Requirement

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

Table 7: Measures to Ensure Compliance with the Capital Adequacy Requirement

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

Majority of the respondents recapped that their banks have practiced cutting back on lending and withholding dividend payment to great extents as shown by mean scores of 3.6667 and 3.5528 to ensure compliance with the capital adequacy requirement while their banks have been increasing revenue growth/cutting costs as well as market rights issue/bonds to a moderate extents shown by mean scores of 3.1000 and 3.0071 respectively.

5.0 DISCUSSION CONCLUSIONS AND RECOMMENDATIONS

5.1 Discussion

The study found out that the banks have adopted various measures in a bid to comply with capital adequacy requirement. This include; cutting back on lending and withholding dividend payment to great extents, increasing revenue growth/cutting costs as well as market rights issue/bonds to a moderate extents. Additionally, the commercial banks can minimize the capital adequacy gap with a steadfast secured liquidity facility after reducing its liquid asset requirement by other means, market rights issue for banks listed at the NSE, bonds issues for listed and non-listed firms, advertising, reducing interest rates on loans and mortgages, increasing interest rates on fixed deposits and introducing new products into the market, cutting costs through staff retirement packages, reduction of travelling costs and in-house training and development for staff.

These findings agree with those of BCBS (2010) a group that argued that banks may be impacted by higher costs of capital and lower returns making it difficult to attract and retain investors. As such, increasing efficiency, strategic cost reduction, and reassessing risky processes so that operating costs will be reduced and productivity will simultaneously increase. They also added that banks may consider changing group structure by buying minority and banks can mitigate the impact through cost-reduction programmes, changing internal change, adopting capital efficiency measures, de-risking and price adjustments. As a result of the foregoing measures, the average there has been a strong financial status of overall industry performance.

5.2 Conclusions

The study thus concluded that the commercial banks in Kenya have taken various measures to ensure compliance with capital adequacy requirement such as cutting back on lending, market rights issue/bonds, increasing revenue growth/cutting costs and withholding dividend payment. In addition, the study also concluded that commercial banks, in a bid to reduce the challenges experienced in the implementation of capital adequacy requirement, they opt to purchase high quality liquid assets, increasing their maturity profile and increasing retail deposits.

5.3 Recommendations

The study further recommends that it is vital to understand the forces behind the increasing sophistication and efficiency of risk management systems, before adopting them more widely for regulatory purposes. Accordingly, ensuring that the Basel III regulations function effectively will require substantial investment in the human capital of supervisors in the Country as well as in other developing countries. Further the commercial banks should ensure that they are well versed with the measures that include risk-management incentives, including incentives to move over-the-counter derivative contracts to central counterparties, to reduce systemic risk across the financial system from counterparty exposures. This would ensure that the commercial banks take the appropriate measures for ensuring compliance with the capital adequacy regulations through cutting back on lending, market rights issue/bonds, increasing revenue growth/cutting costs and withholding dividend payment.

5.4 Suggestion for Further Research

Basel III framework is founded on strengthening the banking industry through the three key principles of capital adequacy, leverage ratio and liquidity requirements. This study has only analyzed the impact of capital adequacy. Therefore, further research could be done on the Impact of leverage ratios in the commercial banking industry in Kenya as Basel III requires banks to maintain a leverage ratio in excess of 3%.

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

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