

ASSET-LIABILITY MANAGEMENT AND FINANCIAL PERFORMANCE OF TIER II COMMERCIAL BANKS IN KENYA

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Abstract: The study's goal was to investigate how asset-liability management components, capital adequacy affected Tier II commercial banks' financial performance in Kenya from 2014 to 2023. The study's particular goals were to ascertain how capital adequacy affected the financial performance of Kenya's tier II commercial banks. Agency theory served as the study's guiding theory. A descriptive research design was used in the study. All eight of Kenya's Tier II commercial banks as of December 31, 2023, were included in the target population. The study made use of secondary data gathered from KBA reports, Central Bank of Kenya reports, and the audited and published financial statements of commercial banks since 2014. Data was analyzed using descriptive method inferential analysis. Descriptive analysis involved the use of means and standard deviation. Inferential analysis was done using correlation analysis and regression method. The analysis findings indicated that Capital adequacy had a positive and significant effect on ROE ($\beta = .021$, $p = 0.016 < 0.05$), indicating that well-capitalized banks are better cushioned against shocks and sustain higher profitability. This highlighted the detrimental impact of inefficiencies, fraud, system failures, and weak internal controls on profitability. The study recommended tier II commercial banks to adopt proactive capital adequacy management techniques. The Central Bank of Kenya is recommended to continue enforcing capital adequacy requirements to improve resilience and safeguard financial stability.

Keywords: Asset-Liability Management, Capital Adequacy, Financial Performance, Tier II Commercial Banks in Kenya, Return on Equity.

1. INTRODUCTION

1.1 Background of the Study

Performance is a multifaceted concept consisting of both financial and nonfinancial measures Chen & Huang, (2017). The ability of a company to use resources from its main business model and produce income is measured subjectively by its financial performance (Dalrymple, 2017). A common measure of financial performance among commercial banks is profitability, which involves the capacity to make benefits from all the business operations of an organization, firm or company (Muya & Gathogo, 2016). Further, according to Kamande (2017) "one way to measure bank financial performance is by determining the profitability of the bank. A commercial bank is usually said to be profitable only if it has accrued a lot of gains and incomes in financial perspective from invested capital". Therefore "a bank's success is determined from the profits it has made in a given financial year" (Adeusi, Kolapo & Aluko, 2014)

The ability to accumulate more than they are charged in cost and taxation on a yearly basis is referred to as profitability. Banks accumulate their revenues by charging money for services and interest on assets. The payment of interest on their liability on a yearly basis is the most expensive for banks. Any difference between expenses and revenues in favor is referred

to as profitability in any financial organization. Consumer loans, corporate loans, and institution loans and bank holdings in the form of securities form the assets of the bank, which provide revenues to the organization. Deposits and money borrowed by banks or through money market sale of commercial paper are the largest liability for banks. In the opinion of Adeusi, Kolapo and Aluko (2014), commercial bank must make a greater profit in monetary terms on capital invested so that it can earn profits.

Asset-liability management (ALM) is a strategic approach taken by deposit-taking institutions in particular banks, insurance institutions and pension funds to manage risk resulting from asset-liability mismatches. Evolution of the concept of the ALM was a counter-reaction to the hedging of the risk of financial intermediation. Simply put, asset and liability management is the process through which an organization strategically approaches the balance sheet in an effort to manage the risk that the organization faces (Sanjay 2015). Commercial banks' asset liability management is defined as their ability to hold onto capital, absorb loan losses, support future asset growth, and reimburse investors. (Makau & Mamba, 2014). Key objectives of ALM are among others liquidity management, interest risk management, profitability management and compliance with regulations including having to adhere to regulations relating to the adequacy of capital, liquidity as well as risk management

Capital adequacy is a component of Asset-liability management (ALM), where ALM is a strategic approach taken by deposit-taking institutions in particular banks, insurance institutions and pension funds to manage risk resulting from asset-liability mismatches. Evolution of the concept of the ALM was a counter-reaction to the hedging of the risk of financial intermediation. Simply put, asset and liability management is the process through which an organization strategically approaches the balance sheet in an effort to manage the risk that the organization faces (Sanjay 2015). Commercial banks' asset liability management is defined as their ability to hold onto capital, absorb loan losses, support future asset growth, and reimburse investors. (Makau & Mamba, 2014). Key objectives of ALM are among others liquidity management, interest risk management, profitability management and compliance with regulations including having to adhere to regulations relating to the adequacy of capital, liquidity as well as risk management

Capital adequacy refers to the amount of capital needed by a commercial bank to help them withstand risks like market, credit, and operational risks to which they are still exposed in order to secure the organization's debtors and absorb potential losses. Among the most essential bank specific factors that have it has an instant consequence upon the level of banks' profitability. Capital is an amount of own funds are available to finance a commercial bank's operations. A bank capital serves to act as a cushion in situations where the institutional issues emerge in unfavorable conditions. The CBK Prudential Guideline on Capital Adequacy (CBK/PG/04) requires banks to have prescribed capital adequacy ratios in place. The current minimum regulatory capital adequacy ratios for Core Capital to Total Deposits, Core Capital and Total Capital to The Total Weighted Assets amount to 8.0 percent, 10.5 percent, and 14.5 percent. In terms of Capital Efficiency, good ALM practices help ensure that a bank's capital is well utilized, reducing lowering capital costs and raising return on equity (ROE). Banks can maximize returns on assets, optimize their capital structure, and lower the cost of capital by aligning their short- and long-term assets and liabilities.

CBK) is "the primary regulator of the banking industry established by an Act of Parliament of March 24, 1966 and opened its doors to the public on September 14, 1966 and as at 31st of it listed 38 commercial banks, one mortgage finance company, and one mortgage refinance company as of December 2023. Of the 39 banks, 37 were privately held, and two were majority-owned by the Government of Kenya (GOK). Out of the privately-owned banks numbering 37, 20 are locally-owned (where controlling shareholders have residence in Kenya) while 17 are foreign-owned. Among the 20 locally-owned institutions, 19 are commercial banks while only 1 is a mortgage finance company. Among the 17 foreign-owned institutions, all are commercial banks where 14 are locally-owned subsidiaries of foreign-owned banks while 3 are foreign-owned branches. All licensed money remittance providers, digital credit providers, non-operating bank holding companies, money bureaus, credit bureaus and microfinance banks are privately-owned.

Kithinji (2010) reports that "Kenyan commercial banks are classified in three tier classes based on the asset size of bank." "Tier one are banks with an asset base of more than Ksh40 billion, and has cumulative assets worth hundreds of billions and owns nearly half of the market share (Kajirwa, 2018). Under the same thematic area, tier two are commercial banks with asset sizes between Ksh10 billion and Ksh40 billion and they have 41.7% market share while tier three are banks with an asset size of less than Ksh10 billion (Ondieki & Jagongo, 2013). In addition, a bank belongs to any of these tiers category depending on its weighted composite index. This index includes net worth, customer deposits, reserves and capital, account of deposits and account of loans. A bank is categorized as a large bank (Tier I) if its weighted composite index is 5 percent or higher. A small bank (Tier III) has a weighted composite index of less than 1 percent, whereas a medium bank (Tier II) has one to five percent (CBK 2016).

1.1.1 Global Perspective of Asset-Liability Management and Financial Performance of Commercial Banks

Asset-liability management (ALM) is a critical process for commercial banks worldwide, focusing on managing risks that arise from mismatches between assets and liabilities. This management is essential for ensuring financial stability, profitability, and regulatory compliance. The global perspective on ALM encompasses various factors, including interest rate risk, liquidity risk, credit risk, and the impact of macroeconomic conditions on bank performance. In the global context, the practices of ALM vary according to regulatory frameworks, market conditions, and the sophistication of financial markets in different regions. The global banking environment faces different challenges due to differing economic, financial, and regulatory conditions, but there are universal principles of ALM that banks apply worldwide.

Globally, the landscape of ALM is evolving, influenced by factors such as regulatory changes, technological advancements, and shifting economic conditions. The COVID-19 pandemic, for example, has highlighted the importance of robust ALM practices as banks faced unprecedented challenges related to liquidity and interest rate volatility.

1.1.2 African Perspective of Asset-Liability Management and Financial Performance of Commercial Banks

Asset-Liability Management (ALM) is a crucial financial strategy for banks in Africa, aimed at balancing assets and liabilities to mitigate risks and enhance profitability. Given the unique economic challenges faced by African banks, including fluctuating interest rates, currency volatility, and regulatory pressures, effective ALM practices are essential for maintaining financial stability and achieving sustainable growth. Research indicates that ALM significantly impacts commercial banks' financial performance throughout Africa. For example, a study on sub-Saharan African microfinance institutions (MFIs) found that the composition of assets and liabilities has both positive and negative effects on financial returns. Specifically, factors such as the net loan portfolio and the size of the institution were positively correlated with return on assets, while deposits and borrowings negatively impacted financial performance.

The banking regulatory framework across Africa varies considerably from nation to nation but generally includes capital adequacy requirements, liquidity ratio requirements, and risk management practices: Capital Adequacy Requirements imposes minimum capital requirements to ensure banks' capacity to absorb losses during economic downturns while for Liquidity Ratios, these Banks are required to maintain certain liquidity ratios to ensure their capacity to repay short-term obligations. Despite the importance of ALM in financial performance enhancement, African commercial banks face a series of challenges such as Limited Data Availability where many banks are confronted with inadequate data for effective risk assessment and decision-making. Also the issue of Underdeveloped Financial Markets where the lack of depth in the local capital markets limits opportunities for hedging against interest rate and currency risks. High Cost of Borrowing where accessing funds at reasonable costs can be challenging due to the high-interest rates prevalent in most African economies.

1.1.3 Kenyan Perspective of Asset-Liability Management and Financial Performance of Commercial Banks in Kenya

In Kenya, the Central Bank of Kenya (CBK) plays a pivotal role in regulating asset-liability management practices among commercial banks. The CBK has established prudential guidelines that require banks to form an Asset Liability Committee (ALCO). This committee is responsible for managing liquidity risk, credit risk, and interest rate risk. Effective ALM practices are essential for ensuring that banks can meet their future cash flow needs while maintaining capital adequacy. Recent studies have focused on various aspects of ALM in Kenyan banks.

Research on Kenyan commercial banks has determined that sound ALM practices are linked to higher profitability. For instance, research on bank practices determined that banks with sound ALM practices were more resistant to economic downturns and had better financial performance. Case studies, for instance, those on Diamond Trust Bank, have provided insight into the effect that targeted ALM efforts can have on financial performance. Such studies often highlight the necessity of aligning asset and liability structures to market and customer needs. The effect of macroeconomic conditions on the ALM-profitability link has also been a research theme. Inflation, interest rates, the potential of ALM practices to improve financial performance can be strongly influenced by macroeconomic factors, such as economic growth rates

1.2 Statement of the problem

Positive financial performance is crucial for commercial banks as it directly impacts their stability, growth, and ability to serve customers effectively. Financial performance is typically assessed through various metrics, including Return on Assets (ROA), Return on Equity (ROE), net interest margins, and overall profitability. A strong financial position not only enhances a bank's reputation but also contributes to the broader economic stability. A strong financial performance indicates that a bank is effectively managing its risks and maintaining adequate capital reserves.

The Reality in place which is the main problem of this research is that currently Kenya's Tier II commercial Banks are not doing well profitably with only 4 out of the 8 registering favorable average return on equity of above 15% while the rest of the 5 have registered lower ROEs below 15% over the study period of 10 years. Specifically, Bank of Baroda, BOI Prime Bank and Citibank have registered ROEs of 25%, 17%, 15% and 31% respectively. Consequentially, Eco bank, Family Bank, NBK and SBM Bank only managed a handful -9%, 13%, 0% and -31% respectively throughout the study period of 10 years. From these statistics these Tier II commercial banks have been impacted by the recent fall in commercial banks' performance in Kenya and as researched by (Waweru & Kalani, 2019; Onuonga, 2020), it is because of this that numerous a number of these low-tier banks, including Chase Bank (now SBM bank have declared bankruptcy in the recent past.

The Ideal Scenario is that Financial Performance, as shall be measured by a good ROE should be at the rate of between 15% to 20%, a rate that has been advocated for by a number of decorated scholars in the field of financial management. In fact, Warren Buffet (2023), an American heavyweight investor advises investors to prioritize return on equity (ROE) at the same rates rather than earnings per share (EPS). Furthermore, according to Wong et al. (2008), the measurement of banks' efficiency can be accomplished through the utilization of ROE. Failure by these Tier II commercial banks to properly manage their assets and liabilities may negatively signal to investors that the institution will not be effectively managing its resources or generating sufficient profits relative to shareholders' equity. A low ROE usually as well indicates that a bank is not generating enough profit to reinvest into its operations or distribute dividends. As a result, these banks may struggle to raise capital through equity markets since potential investors are likely to demand higher returns for taking on perceived risks associated with poor performance.

1.3 Research Objectives

General Objective

The study aimed to determine the effect of asset-liability management on financial performance of tier II commercial banks in Kenya.

Specific objective

To determine the effect of capital adequacy on financial performance of tier II commercial banks in Kenya

1.4 Hypotheses of the Study

H01: Capital Adequacy does not have significant effect on financial performance of Tier II commercial banks in Kenya

2. LITERATURE REVIEW

2.1 Theoretical Literature Review

This section entails the Conceptual Framework; an evaluation of empirical studies and ultimately provided an overall conclusion to this literature review summarizing gaps that this work is attempting to fill and the novel contribution that it shall have to the discipline in general. The theory in support of the study was reviewed as follows:

2.1.1 The Agency theory

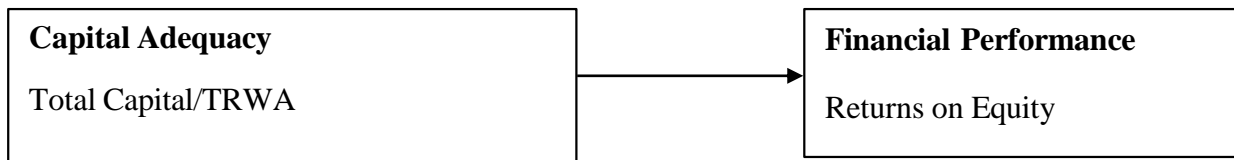
This theory was postulated in 1976 by Jensen and Meckling who laid the foundation for agency theory by formally defining the principal-agent relationship. They introduced the concept of agency costs, which arise when agents pursue their own interests at the expense of principals. A framework known as "agency theory" examines the relationship between principals and agents, especially when one party gives another party decision-making authority. Agency theory looks at how management's (agents') and shareholders' (principals') interests can conflict in the context of capital adequacy, particularly regarding the management of a risk exposure and capital structure of the bank. The ability of a bank to keep enough cash on hand to cover possible losses while carrying on with business is known as capital adequacy.

To maintain financial stability and safeguard depositors, regulatory frameworks like Basel III impose minimum capital requirements on banks. The primary goal is to mitigate risks associated with lending and investment activities. In the banking sector, shareholders are concerned with maximizing their returns on investment, while management may have different priorities, such as personal compensation or growth ambitions. This divergence creates an agency problem where management might take excessive risks or undercapitalize the bank to pursue short-term gains at the expense of long-term stability. Due to risk-taking initiative, the management may engage in riskier lending practices or investments that could jeopardize capital adequacy. For instance, if executives are compensated based on short-term performance metrics, they might prioritize high-risk loans that yield immediate profits but threaten the bank's solvency

Similarly, due to information asymmetry: Shareholders often lack complete information about the bank's operations and risk exposure. This asymmetry can lead to mistrust and misalignment of interests. Management may possess more detailed knowledge about potential risks but may not disclose this information fully to shareholders. The theory informed the variable of capital adequacy where capital adequacy requirements act as a mechanism to align the interests of managers, shareholders, reducing the potential for excessive risk taking.

2.2 Conceptual Framework

A conceptual framework, according to Smith (2004), is a hypothesized model that examines the relationship between independent and dependent variables. It illustrates in which manner the researcher imagines and organizes diverse concepts and variables in his or her work. Capital adequacy



CAR is determined by the following formula:

$$\text{CAR} = \frac{\text{Tier One Capital} + \text{Tier Two Capital}}{\text{Risk Weighted Assets}} \text{ (Mulualem, 2015)}$$

The minimum accepted CAR is 8%. A higher ratio indicates that the bank is at a higher risk of insolvency from excessive losses. A lower value of CAR shows that a bank is under the minimum threshold and possesses a higher ability to deal with the risk of insolvency (Mulualem, 2015).

2.3 Empirical Literature

Capital is the amount of own fund available to support the bank's business and act as a buffer in case of adverse situation (Athanasoglou, Sophocles, & Matthias, 2013). Banks capital creates liquidity for the bank due to the fact that deposits are most fragile and prone to bank runs. Moreover, greater bank capital reduces the chance of distress (Diamond, 2000). The amount of capital needed by a commercial bank to withstand the risks to which it is exposed credit, market, and operation risks—in order to absorb possible losses and cushion organization debtors is known as capital adequacy.

One among the factors influencing the level of bank profitability is capital. Capital is the internal finance amount available to finance enterprise by a commercial bank. Banks' capital is used to act as cushion in an eventuality where negative things take place in an organization. Additionally, capital provides liquidity in respect to a commercial bank since deposits have greater vulnerability in undergoing bank run. Optimal capital minimizes distress occurrences in an organization in the banking sector. Capital adequacy is calculated in respect to capital adequacy ratio (CAR) (Nyanga, 2012). Overallly for Kenya's banking system as at December 2023, the total capital adequacy ratio stood at 18.6 percent in December 2023, above the minimum adequacy ratio of 14.5 percent.

Ebrahimi et al. (2017) used CAMEL Indicators to evaluate the performance of banks listed on the Tehran Stock Exchange. This used a descriptive design that only looked at the 14 commercial banks that were listed in Tehran. This employed panel data in taking a multivariate regression. From this work results, capital adequacy was revealed to have a positive effect in performance in listed commercial banks. However, this was conducted among banks in Tehran stock exchange while this work shall focus on tier II banks in Kenya not NSE

Ryan (2017) researched whether or not impacts of accounting requirements have an influence to undermine regulatory capital adequacy of banks to affect financial stability. Research was carried out in respect to US commercial banks during year 2007-2009 financial crises. Desk top review of literature was employed in this research. From this research, results indicated that impacts of accounting requirements have little influence to affect the stability of commercial banks was impacted by their capital adequacy. The investigator established that to possess additional core capital in addition to requirements has an influence towards stability of finance of banks. Desk top review was employed in this research while this work utilized quantitative research supplemented by secondary data.

Tsuma and Gichinga (2016) surveyed Kenyan commercial banks on factors influencing their financial performance, using the National Bank of Kenya Coast Region as a case study. Research employed a descriptive design where secondary and primary data have been utilized. The research used both descriptive statistics and inferential statistics in data analysis.

According to the study's findings, commercial banks' financial performance improves when their core capital requirements are met. Research results indicated that ensuring adequate levels of capital will help banks invest optimally and withstand macroeconomic shocks. Research employed secondary and primary data whereas my research is to employ secondary data alone.

Kamau (2009) conducted research on Kenyan commercial banks with the goal of "establishing the how capital adequacy effects profitability in the banking sector." He discovered that banks' capital structures are subject to strict regulations. This is due to the fact that capital was essential in lowering the number of bank failures and losses to depositors when a bank fails as highly leveraged firms are likely to take excessive risk in order to maximize shareholder value at the expense of finance providers. To this extent, he concluded that banks with enough capital were more profitable than banks which were struggling to maintain the statutory capital adequacy requirement.

3. RESEARCH METHODOLOGY

A descriptive research design was adopted. All eight of Kenya's Tier II commercial banks as of December 31, 2023, served as the study's temporal population, meaning there was no need for sampling. The study relied on quantitative data in addressing the research problem where quantitative data was gathered from secondary data sources embedded in the published and audited financial statements of the Tier II commercial banks within the time frame 2014-2023. Descriptive statistics and inferential statistics were used in the analysis of quantitative data. The finding was presented using tables.

Data was thus collected from the Central Bank of Kenya Reports, KBA reports, and the annual reports freely available to the public from the banks online websites using data collections schedules. The collected data was processed by editing and cleaning before being coded in to SPSS 29. Correlation tests and tests of regression were employed in analyzing this research. Descriptive statistics tests included means, standard deviation, max/min and aggregates. Correlation was conducted through Pearson Correlation.

Regression was conducted to determine magnitude between independent variables and dependent variable in this research. To investigate the relationship between asset-liability management and the profitability of tier II commercial banks in Kenya, this study used a multivariate regression model. Below is an illustration of the regression model that was employed.

$$\text{Financial Performance (ROE)} = \alpha + \beta_1 X_1 + e$$

Where:

Y designates dependent variable (Financial Performance) measured as Return on Equity

α is used to designate the value of the intercept.

β designates the coefficient of the explanatory X variable.

e designates the error term

X1

Represents the Capital Adequacy that was dully measured by the ratio of total capital to total risk weighted assets

4. RESULTS AND DISCUSSIONS

This section brings forth the important findings of the study in relation to the research objectives and hypothesis. The results are organized systematically to provide a clear understanding of the data collected and the statistical analyses undertaken.

4.1 Descriptive Analysis

The section presents descriptive statistics of the study variables, including the mean, maximum, minimum, standard deviation, and number of observations. Data were collected from 8 Tier II commercial banks in Kenya in which all of them participated representing a participation rate of 100%. The descriptive statistics highlight the distribution of each study variable over the period 2014-2023. The mean represents the average value of each variable across the study period, while the standard deviation indicates the extent of variation

Table 1: Capital Adequacy

Descriptive Statistics

Variable	N	Minimum	Maximum	Mean	Std. Deviation	Skewness	Kurtosis
Capital adequacy	10	20.51	27.41	24.2468	2.15419	-.292	-.699

Source: Research Data (2026)

Capital adequacy ranged from 20.51 to 27.41, with a mean of 24.25 and standard deviation of 2.15. This indicated that most Tier II banks maintained capital levels above regulatory requirements, which reflected financial stability and compliance. The low standard deviation suggested minimal variation and consistent capitalization across banks. The skewness value of -0.292 indicated a nearly symmetrical distribution with a slight negative skew, meaning most values clustered around the mean. The kurtosis value of -0.699 showed a platykurtic distribution which implied fewer extreme values. Generally, capital adequacy remained stable with limited fluctuations throughout the study period.

4.2 Diagnostic Test

Diagnostic tests were carried out to ascertain whether the data was appropriate for regression analysis and to ascertain the validity and dependability of the regression model. The purpose of the tests is to confirm that the underlying assumptions of multiple regression analysis are not violated thus enhancing the accuracy and credibility of the findings. The tests conducted included multicollinearity tests.

Table 2: Multicollinearity Test

Variables	Collinearity Statistics	
	Tolerance	VIF
Capital adequacy	.257	3.888

Source: Research Data (2026)

The collinearity diagnostics indicated that all the independent variables fall within acceptable thresholds, confirming that multicollinearity was not a major concern in the regression model. Capital adequacy recorded a tolerance value of 0.257 and a VIF of 3.888, which reflects moderate but acceptable levels of collinearity.

4.3 Inferential Statistics Results

The inferential statistics involved correlation analysis and regression analysis.

Correlation Analysis Results

Table 3: Correlation Analysis Results

		Capital adequacy
Return on equity	Pearson Correlation	.463**
	Sig. (2-tailed)	.000
	N	80

Source: Research Data (2026)

Correlation analysis was carried out to investigate the type and degree of correlation between Kenyan Tier II commercial banks' financial performance and asset-liability management metrics. Particularly, the analysis assessed the relationship between return on equity as the indicator of financial performance and the key asset-liability management variables of capital adequacy. Capital adequacy, on the other hand, showed a statistically significant positive correlation with ROE ($r=0.463$, $p=0.001<0.05$), implying that well-capitalized banks tend to achieve better performance.

4.4 Regression Analysis Results

Table 4: Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.900 ^a	.810	.800	.46977

Source: Research Data (2026)

The regression analysis model yielded an R value of 0.900 indicating that there was strong positive correlation between of capital adequacy and financial performance of Tier II commercial banks in Kenya. The adjusted R square value obtained 0.800 indicate that capital adequacy explains 80.00% of variability in the performance of Tier II banks as measured by ROE. This indicates that selected asset-liability management indicator of capital adequacy alongside other indicators are key drivers of financial performance among the tier II banks. The remaining 20% of the variation in other elements not included in the model

Table 5: ANOVA Table

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	70.422	4	17.605	79.777	.000
	Residual	16.551	75	.221		
	Total	86.973	79			

Source: Research Data (2026)

The ANOVA results indicate that the regression model is statistically significant and suitable in explaining the variations in ROE caused by asset-liability management among the tier II banks. This is because the p value 0.0001 was less than 0.05. The regression sum of squares (70.422) was considerably larger than the residual sum of squares (16.551). Also, the residual mean square of .221 was relatively smaller than the regression means squares (17.605). These findings indicated that a substantial proportion of the variation in ROE was explained by the independent variables, capital adequacy being at forefront of the analysis.

Table 6: Regression Coefficients

Model		Unstandardized Coefficients		Standardized Coefficients		Sig.
		B	Std. Error	Beta	t	
1	(Constant)	23.870	.243		98.063	.000
	Capital adequacy	.021	.009	.245	2.468	.016

Source: Research Data (2026)

The regression analysis the findings showed that financial performance was positively and statistically significantly impacted by capital adequacy. ($\beta = .021$, $t = 2.468$, $p = 0.016$). This indicates that well-capitalized banks are better cushioned against financial shocks and can sustain higher profitability. This aligns with prudential regulatory requirements that emphasize adequate capitalization for stability and growth.

The results indicate that financial performance would be at 23.8740 when capital adequacy is kept constant. The resultant regression model is expressed as;

$$\text{Financial Performance of Tier II Commercial Banks in Kenya} = 23.8740 + 0.245 (\text{Capital Adequacy})$$

The study established that technology adoption resulted to a beta value of 0.245 (24.5%) which was symbol that for each unit increase in capital adequacy, the financial performance would reach a considerable 24.5% improvement. The significance level was lower at 0.016 which confirmed that these results were statistically strong, emphasizing that capital adequacy was strong influencing factor in improving financial performance of Tier II Commercial Banks in Kenya.

5. CONCLUSION AND RECOMMENDATIONS

5.1 Conclusions

The regression analysis the findings showed that financial performance was positively and statistically significantly impacted by capital adequacy. ($\beta = .021$, $t = 2.468$, $p = 0.016$). This indicates that well-capitalized banks are better cushioned against financial shocks and can sustain higher profitability. This aligns with prudential regulatory requirements that emphasize adequate capitalization for stability and growth. The findings indicated that during the study period selected tier II banks maintained capital buffers above regulatory requirements throughout the study period and capital adequacy had a significant positive influence on ROE. Adequately capitalized banks were more resilient to shocks, enjoyed greater regulatory compliance, and inspired higher levels of depositor and investor confidence. This in turn improved their ability to expand lending and achieve better returns. The study also found that tier II banks' financial performance is positively and significantly impacted by capital adequacy. Strong capital position of the bank serves as a shield against financial shocks and also as a foundation for growth, profitability, and investor confidence. Therefore, adequate capitalization emerged as both a regulatory necessity and a strategic advantage.

5.2 Recommendations

The study determined that the performance of Kenya's tier II banks was significantly impacted by capital adequacy. It is advised that the Central Bank of Kenya keep up its enforcement of the efficient capital adequacy standards and push banks to keep their capital buffers above the legally required minimums. This will protect depositor confidence and increase resilience during periods of economic volatility.

The study only focused on Tier II commercial banks which limits the generalizability of the findings. There is a need for comparative studies focusing on Tier I, II, and III banks to determine whether similar dynamics hold across different bank sizes. Secondly, the study only focused on traditional risk categories. Future research could examine the growing importance of emerging risks such as cyber risk, climate risk, and reputational risk, which is influencing banks' financial performance more and more in the digital age.

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