

Effect of Equity on Market Concentration among Commercial Banks in Kenya

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Abstract

Market concentration remains a key concern in the banking sector due to its implications for competition, financial stability, and systemic risk. In Kenya, a small number of large commercial banks dominate the market, raising concerns about the factors driving their sustained market power. This study examined the effect of equity on market concentration among commercial banks in Kenya. It was anchored on Agency Cost Theory, Information Asymmetry Theory, and Market Power Theory. A post-positivist research philosophy and a descriptive correlational design were adopted. The study targeted all 38 commercial banks licensed by the Central Bank of Kenya between 2019 and 2023. Both primary and secondary data were used; secondary data were obtained from published financial statements and Central Bank of Kenya reports, while primary data were collected from bank managers using structured questionnaires. Data were analyzed using descriptive statistics, correlation analysis, and regression analysis. The findings established that equity had a positive and statistically significant effect on market concentration ($r = 0.687$; $\beta = 0.749$, $t = 19.843$, $p < 0.05$), indicating that banks with stronger equity positions were more likely to command larger market shares. The results suggest that strong capital reserves, retained earnings, and shareholders' equity enhance depositor confidence, support regulatory compliance, and strengthen the market position of large banks. The study concludes that equity is a critical driver of market concentration in Kenya's banking sector and recommends that regulators develop proportionate capital policies that strengthen financial stability while promoting competitive balance.

Keywords: Equity capital, Market concentration, Commercial banks, Financial stability, Kenya

Introduction

The banking sector is a critical component of economic development because it facilitates financial intermediation, mobilizes savings, allocates credit, and supports investment activities that stimulate economic growth. A stable banking system enhances economic resilience by ensuring efficient resource allocation and maintaining public confidence in financial institutions (Levine, 2005). Consequently, financial stability has become a major concern for

regulators, policymakers, and financial institutions worldwide, particularly following episodes of financial crises that exposed vulnerabilities within banking systems. Among the various dimensions of financial stability, equity capital has emerged as one of the most important indicators of a bank's ability to withstand shocks, absorb losses, and sustain operations during periods of economic uncertainty (Berger & Bouwman, 2013).

Equity capital represents the residual ownership interest in a bank after liabilities have been deducted from total assets and comprises shareholders' funds, retained earnings, and statutory reserves (Rose & Hudgins, 2013). It serves as a financial cushion that protects depositors and creditors against unexpected losses while enhancing a bank's solvency and operational sustainability. Well-capitalized banks are generally perceived as more stable and less vulnerable to financial distress, enabling them to attract deposits, secure investments, and expand their lending activities more effectively than weaker institutions (Demirgüç-Kunt et al., 2013). Strong equity positions also facilitate compliance with prudential regulatory requirements, thereby strengthening public confidence and enhancing competitive advantage within the banking industry (Basel Committee on Banking Supervision, 2018).

Over the past three decades, the global banking industry has undergone significant structural transformation characterized by financial liberalization, technological advancement, globalization, and consolidation through mergers and acquisitions. These developments have contributed to increasing levels of market concentration in many banking systems across the world. Market concentration refers to the extent to which a small number of institutions control a substantial share of industry assets, deposits, loans, and profitability (Bikker & Haaf, 2002). While moderate concentration may improve operational efficiency and economies of scale, excessive concentration may reduce competition, limit financial inclusion, and increase systemic risk because the failure of dominant institutions can have far-reaching consequences for the entire financial system (Beck et al., 2006).

The relationship between bank capitalization and market concentration has attracted growing scholarly attention due to its implications for competition and financial stability. According to the concentration-stability hypothesis, larger and better-capitalized banks are more stable because they possess diversified portfolios, stronger risk management systems, and greater capacity to absorb financial shocks (Beck et al., 2006). Conversely, the concentration-fragility hypothesis argues that excessive dominance by a few institutions may encourage risk-taking behavior and create systemic vulnerabilities due to moral hazard and reduced market discipline (Uhde & Heimeshoff, 2009). These competing perspectives suggest that while strong equity capital may enhance financial stability, it may also contribute to market concentration by enabling large banks to strengthen their competitive position and increase their market share.

The global financial crisis of 2008 further intensified the debate regarding the role of capital adequacy in shaping banking sector structures. In response to the crisis, regulators introduced Basel III reforms aimed at strengthening capital requirements, improving liquidity management, and enhancing financial system resilience (Basel Committee on Banking Supervision, 2018). Although these reforms improved banking sector stability, they also increased compliance costs and capital requirements, disproportionately affecting smaller institutions with limited capital accumulation capacity. Consequently, many smaller banks

either consolidated with larger institutions or struggled to compete effectively against highly capitalized market leaders, resulting in increased concentration across banking sectors in both developed and developing economies (Berger & Bouwman, 2013).

In developed economies such as the United States, the United Kingdom, Germany, and France, large commercial banks have expanded their market dominance through strong capitalization, technological innovation, and strategic acquisitions. Institutions such as JPMorgan Chase, Bank of America, HSBC, and Barclays have continued to strengthen their competitive positions by leveraging their substantial capital reserves to finance expansion, absorb losses, and invest in advanced banking technologies (Carletti et al., 2024). Strong equity positions have enabled these institutions to maintain depositor confidence and achieve sustainable growth, thereby increasing their market share relative to smaller competitors. While such dominance may contribute to financial stability, it also raises concerns regarding excessive market power and reduced competition within the banking industry (Beck et al., 2006).

Similar patterns have been observed across emerging and developing economies. In many African countries, banking sectors are characterized by oligopolistic market structures where a few dominant institutions control a significant proportion of total banking assets and deposits (Saif-Alyousfi et al., 2020). Regulatory reforms aimed at strengthening capital adequacy have often accelerated consolidation because larger institutions possess greater capacity to comply with prudential requirements and invest in technological innovation. Consequently, strong equity positions have become a source of both financial resilience and market dominance. Studies conducted in African banking systems indicate that well-capitalized banks are more likely to attract deposits, maintain profitability, and expand their market presence than smaller competitors with weaker capital structures (Ozili, 2019).

Kenya provides an important context for examining the relationship between equity capital and market concentration. The Kenyan banking sector is among the most developed in Sub-Saharan Africa and has experienced significant transformation through financial liberalization, regulatory reforms, technological innovation, and regional expansion. Despite the existence of 38 licensed commercial banks, the sector remains highly concentrated, with a small number of tier-one banks accounting for the majority of banking assets, deposits, and profitability (Central Bank of Kenya [CBK], 2024). Major institutions such as Equity Bank, KCB Bank, Co-operative Bank, NCBA Bank, and ABSA Bank Kenya continue to dominate the industry through strong capitalization, extensive branch networks, and advanced digital banking platforms. Their ability to mobilize deposits, attract investors, and comply with regulatory requirements has strengthened their competitive advantage and reinforced their market dominance.

The importance of equity capital in shaping this dominance cannot be overstated. Strong equity positions enhance a bank's ability to absorb losses, support lending activities, comply with capital adequacy requirements, and pursue growth opportunities. Furthermore, highly capitalized banks are often perceived as safer by depositors and investors, enabling them to attract additional financial resources that further strengthen their market position (Berger & Bouwman, 2013). Over time, this advantage may contribute to increasing market concentration as large banks continue to expand while smaller institutions face capital constraints and

operational limitations. Consequently, equity capital may serve not only as an indicator of financial stability but also as a driver of structural dominance within the banking sector.

Despite extensive literature on banking concentration and financial stability, empirical studies have largely focused on concentration as an independent variable influencing profitability, competition, efficiency, and systemic risk (Beck et al., 2006; Uhde & Heimeshoff, 2009). Similarly, studies examining capital adequacy have predominantly focused on its impact on financial performance and stability (Demirgüç-Kunt et al., 2013; Berger & Bouwman, 2013). Limited attention has been given to the reverse relationship, specifically whether stronger equity positions contribute to market concentration. Furthermore, most existing studies have been conducted in developed economies whose institutional environments differ substantially from those of developing countries such as Kenya. This creates a contextual and empirical gap regarding the influence of equity capital on market concentration within the Kenyan banking sector.

Given the continued dominance of large commercial banks and ongoing regulatory efforts to strengthen financial stability, understanding the role of equity capital in shaping market concentration has become increasingly important. Such understanding can assist policymakers in designing prudential regulations that promote financial resilience without unintentionally reinforcing oligopolistic market structures. It can also provide valuable insights for commercial banks regarding capital management strategies that support sustainable growth and competitive positioning. Therefore, this study sought to examine the effect of equity capital on market concentration among commercial banks in Kenya.

Statement of the Problem

The Kenyan banking sector remains highly concentrated, with a few large commercial banks controlling a substantial share of industry assets, deposits, and profitability (CBK, 2024). While strong capitalization enhances financial stability and resilience, it may also strengthen the competitive advantage of large banks, enabling them to expand their market share and reinforce market dominance. This raises concerns regarding the role of equity capital in shaping market concentration within the banking sector.

Existing studies have largely examined the effects of market concentration on financial stability, competition, and bank performance (Beck et al., 2006; Uhde & Heimeshoff, 2009). Similarly, studies on equity capital have focused on its influence on profitability, risk management, and financial resilience (Berger & Bouwman, 2013). However, limited empirical attention has been given to whether stronger equity positions contribute to market concentration, particularly in developing economies such as Kenya. Consequently, there is insufficient evidence on the extent to which equity capital influences market concentration among commercial banks in Kenya. This knowledge gap limits the ability of regulators and policymakers to formulate capital policies that promote financial stability while maintaining a competitive banking environment. Therefore, this study sought to examine the effect of equity capital on market concentration among commercial banks in Kenya. The study addressed the research question; To what extent does equity capital influence market concentration among commercial banks in Kenya?

Hypothesis

The null hypothesis was stated as follows:

H₀: Equity capital has no statistically significant influence on market concentration among commercial banks in Kenya.

Literature Review

This study was anchored on Market Power Theory, developed by Chamberlin (1933) and further advanced by Lerner (1934), which posits that firms with superior resources and competitive advantages can influence market outcomes and strengthen their market position. In the banking sector, market power arises when institutions possess sufficient financial capacity to expand operations, attract customers, and increase market share relative to competitors (Igan et al., 2021). Equity capital represents a critical resource that enhances a bank's ability to absorb losses, comply with regulatory requirements, invest in technology, expand branch networks, and strengthen depositor confidence (Berger & Bouwman, 2013). Consequently, banks with stronger equity positions are better placed to sustain growth and reinforce their competitive advantage, potentially increasing their market dominance over time. The theory therefore suggests that higher levels of equity capital may contribute to market concentration by enabling well-capitalized banks to capture larger market shares and strengthen their position within the banking industry. Market Power Theory was considered appropriate for this study because it provides a theoretical explanation of how equity capital can influence market concentration among commercial banks in Kenya.

Equity capital has been widely recognized as a critical determinant of bank stability, growth, and competitiveness. Berger and Bouwman (2013) examined the role of capital in enhancing bank performance during financial crises and found that well-capitalized banks were more likely to survive financial shocks and maintain market share than their less-capitalized counterparts. The study concluded that strong capital reserves provide banks with strategic flexibility to sustain lending activities and pursue growth opportunities during periods of economic uncertainty. Although the study established the importance of capital for bank survival and growth, it did not examine its influence on market concentration.

Demirgüç-Kunt et al. (2013) investigated the relationship between bank capital and financial stability using data from commercial banks across several countries. The findings revealed that banks with stronger capital positions exhibited lower risk levels and greater resilience during financial crises. The study further noted that highly capitalized institutions attracted greater depositor confidence and funding opportunities, enabling them to strengthen their competitive position. However, the study focused primarily on financial stability and did not evaluate whether stronger capital positions contributed to increased concentration within the banking sector.

In a study conducted in Europe, Uhde and Heimeshoff (2009) examined the relationship between banking sector consolidation and financial stability. The findings indicated that stronger capital bases encouraged growth through mergers, acquisitions, and market expansion, leading to increased concentration within the banking industry. The study argued that larger

and better-capitalized institutions possessed competitive advantages that enabled them to dominate market activities. However, the study was conducted in developed economies whose institutional and regulatory environments differ from those of developing countries such as Kenya.

Within the African context, Ozili (2019) examined the effects of banking sector reforms on financial stability and competitiveness. The study established that stronger capitalization requirements improved banking sector resilience but also enhanced the dominance of large banks because smaller institutions faced challenges in meeting regulatory capital thresholds. Consequently, market concentration increased as larger banks expanded their market share. While the findings highlighted the link between capitalization and market structure, the study did not specifically assess the effect of equity capital on market concentration.

In Kenya, studies have largely focused on the influence of capital adequacy on financial performance and stability. For example, Mwaniki (2021) found that strong capital positions enhanced the stability and profitability of commercial banks in Kenya by improving their ability to absorb losses and withstand economic shocks. Similarly, Kilonzo and Atheru (2024) reported that well-capitalized banks demonstrated superior financial performance and competitive strength compared to weaker institutions. However, these studies concentrated on financial performance and stability outcomes, leaving limited empirical evidence on whether equity capital contributes to market concentration among commercial banks in Kenya. This study sought to address this gap by examining the effect of equity capital on market concentration among commercial banks in Kenya.

Conceptual Framework

The conceptual framework for this study is presented in Figure 1. It depicts equity capital as the independent variable—operationalized through shareholders' equity, retained earnings, and statutory reserves—and market concentration, measured using the Herfindahl-Hirschman Index (HHI), as the dependent variable.

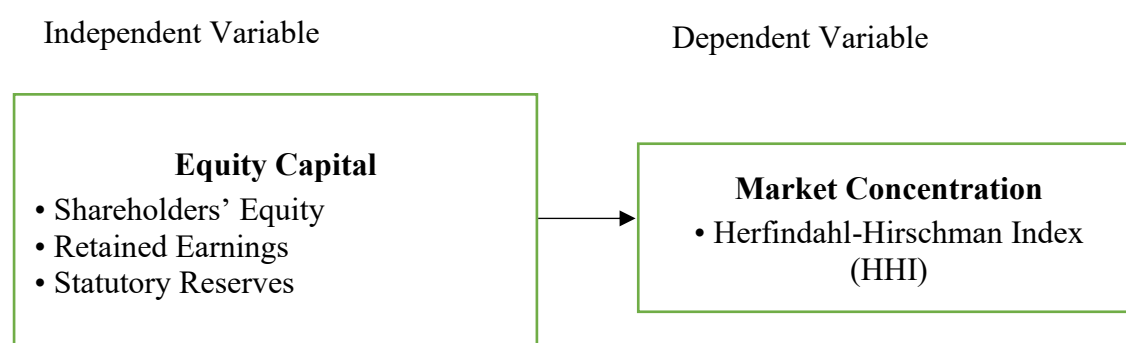


Figure 1

Conceptual Framework

Methodology

This study adopted a descriptive correlational research design to examine the effect of equity capital on market concentration among commercial banks in Kenya. The study targeted all 38 commercial banks licensed by the Central Bank of Kenya (CBK) between 2019 and 2023, and a census approach was employed. Secondary data were collected from audited financial statements of commercial banks and CBK annual supervision reports. Equity capital was measured using shareholders' equity, retained earnings, and statutory reserves, while market concentration was measured using the Herfindahl-Hirschman Index (HHI). Data were analyzed using the Statistical Package for Social Sciences (SPSS) Version 25. Descriptive statistics, including means and standard deviations, were used to summarize the data, while Pearson correlation and linear regression analyses were employed to determine the relationship between equity capital and market concentration. The study tested the null hypothesis that equity capital has no statistically significant influence on market concentration among commercial banks in Kenya at a 5% level of significance.

Results

Descriptive Statistics of Equity Capital

A total of 400 questionnaires were distributed to bank managers drawn from commercial banks in Kenya, out of which 291 were properly completed and returned, representing a response rate of 72.75%. The remaining 109 questionnaires (27.25%) were not returned. The achieved response rate was considered adequate for statistical analysis and generalization of the findings, as it exceeded the minimum threshold recommended for survey research (Babbie, 2004). The high response rate enhanced the reliability and validity of the study findings.

Descriptive statistics were computed to examine the distribution of equity capital among commercial banks in Kenya over the period 2019–2023. The results indicate that the study comprised 189 observations. Equity capital recorded a minimum value of Ksh. -12,000,000 and a maximum value of Ksh. 1,810,000,000, with a mean value of Ksh. 75,782,767.56 and a standard deviation of Ksh. 235,569,209.50. The relatively high standard deviation compared to the mean suggests substantial disparities in equity levels across commercial banks, indicating that a few large banks possessed significantly stronger capital positions than smaller institutions.

The findings further revealed that average equity capital increased steadily during the study period, rising from Ksh. 61,421,244.29 in 2019 to Ksh. 98,013,171.11 in 2023. Similarly, the maximum equity level increased from Ksh. 1.14 billion in 2019 to Ksh. 1.81 billion in 2023, reflecting continued capital accumulation among the largest commercial banks. In contrast, some banks recorded negative equity positions throughout the period, an indication of financial challenges and weak capitalization. The widening variation in equity levels suggests that dominant banks strengthened their capital bases at a faster rate than smaller competitors, potentially reinforcing market concentration within the Kenyan banking sector.

Table 1

Descriptive Statistics of Equity Capital

Variable	N	Minimum	Maximum	Mean (Std. Dev.)
Equity Capital	189	-12,000,000	1,810,000,000	75,782,767.56 (235,569,209.50)

Correlation Analysis between Equity Capital and Market Concentration

Pearson correlation analysis was conducted to determine the nature and strength of the relationship between equity capital and market concentration among commercial banks in Kenya. The results revealed a strong positive and statistically significant relationship between equity capital and market concentration ($r = 0.687$, $p < 0.05$). This finding implies that commercial banks with stronger equity positions tended to exhibit higher levels of market concentration. The positive association suggests that well-capitalized banks possess greater financial capacity to expand their operations, attract deposits, absorb risks, and strengthen their competitive position within the banking sector.

Table 2

Correlation between Equity Capital and Market Concentration

Variable	Market Concentration
Equity Capital (r)	0.687*
Sig. (2-tailed)	0.000
N	189

**Correlation is significant at the 0.05 level.*

The results indicate that equity capital is positively associated with market concentration, providing preliminary evidence that stronger capitalization may contribute to the dominance of large commercial banks within the Kenyan banking sector.

Regression Analysis of Equity Capital and Market Concentration

Regression analysis was conducted to examine the effect of equity capital on market concentration among commercial banks in Kenya. The results showed that equity capital had a positive and statistically significant effect on market concentration ($\beta = 0.749$, $t = 19.843$, $p < 0.05$). This implies that an increase in equity capital was associated with a corresponding increase in market concentration. The findings suggest that banks with stronger equity positions are more likely to expand their market presence and strengthen their dominance within the industry.

Table 3

Regression Results for Equity Capital and Market Concentration

Variable	Beta (β)	t-value	p-value
Equity Capital	0.749	19.843	0.000
Constant	—	13.083	0.000

The findings led to the rejection of the null hypothesis that equity capital has no statistically significant influence on market concentration among commercial banks in Kenya. The study therefore concludes that equity capital is a significant predictor of market concentration in the Kenyan banking sector.

Discussion of Findings

The study established that equity capital has a positive and statistically significant influence on market concentration among commercial banks in Kenya ($\beta = 0.749$, $p < 0.05$). The findings indicate that banks with stronger equity positions are more likely to strengthen their market presence and increase their share of industry assets, deposits, and lending activities. This suggests that equity capital serves not only as a buffer against financial shocks but also as a strategic resource that enhances competitiveness and supports market expansion.

The findings are consistent with Market Power Theory, which posits that firms possessing superior financial resources are better positioned to expand operations, attract customers, and strengthen their dominance within an industry. Strong equity capital enables banks to meet regulatory capital requirements, absorb unexpected losses, invest in technological innovations, and pursue growth opportunities that may be inaccessible to less-capitalized institutions. As a result, well-capitalized banks are likely to gain competitive advantages that reinforce their market position and contribute to higher levels of concentration.

The findings also concur with Berger and Bouwman (2013), who reported that well-capitalized banks were more resilient during periods of financial distress and were better able to maintain and expand their market share. Similarly, Demirgüç-Kunt et al. (2013) found that stronger capital positions enhanced depositor confidence and improved banks' capacity to withstand financial shocks, thereby strengthening their competitive standing within the industry. The current findings extend this evidence by demonstrating that strong equity capital not only enhances stability but may also contribute to increased market concentration.

Further, the results support the observations of Ozili (2019), who argued that capitalization requirements tend to favor larger institutions because they possess greater capacity to accumulate capital and comply with prudential regulations. Consequently, smaller banks may face difficulties competing with highly capitalized institutions, leading to increased dominance by a few large banks. Similarly, Gudmundsson, Kisinguh, and Odongo (2013) noted that higher capital requirements can create barriers to entry and expansion, thereby reinforcing concentration within the banking sector.

The positive relationship between equity capital and market concentration observed in this study suggests that continued capital accumulation among large commercial banks may strengthen their market dominance over time. While strong capitalization promotes financial stability and resilience, it may also contribute to competitive imbalances if smaller institutions are unable to accumulate capital at a comparable rate. Therefore, policymakers should seek an appropriate balance between strengthening capital adequacy and maintaining a competitive banking environment that supports the growth and sustainability of both large and small commercial banks.

Conclusion

This study examined the effect of equity capital on market concentration among commercial banks in Kenya and established that equity capital has a positive and statistically significant influence on market concentration. The findings indicate that banks with stronger equity positions are more likely to strengthen their market presence, expand their operations, and command larger market shares than less-capitalized institutions. Strong equity capital enhances banks' ability to absorb losses, comply with regulatory requirements, attract depositor confidence, and finance growth initiatives, thereby reinforcing their competitive advantage. While enhanced capitalization contributes to financial stability and institutional resilience, it may also accelerate market concentration by enabling dominant banks to consolidate their market power. The study therefore concludes that equity capital is a significant determinant of market concentration within the Kenyan banking sector.

Recommendations

The study recommends that regulators formulate capital adequacy policies that strengthen financial stability while safeguarding competition within the banking sector. Policymakers should establish mechanisms that support the capitalization and growth of smaller commercial banks to minimize excessive market concentration and promote a more balanced competitive environment. Commercial banks should continue strengthening their equity positions to enhance resilience and support sustainable growth, while leveraging capital resources to improve innovation, operational efficiency, and customer value creation. Future studies should examine the influence of other financial stability indicators, such as liquidity, profitability, and asset quality, on market concentration and explore the moderating effects of banking regulations and technological innovation on the relationship between equity capital and market concentration.

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