Abstract

The effect of capital adequacy on the asset quality of deposit-taking microfinance banks in Kenya is the central focus of this research. The study's central premise was based on the agency, moral hazard, and institutional theories. The study's target population was 14 deposit-taking microfinance banks in Kenya, with each bank's panel data collected from their audited reports for the years 2019 to 2023. Longitudinal design was the most ideal given the balanced panel data of the banks. Panel data regression was used to determine the causality between the predictor and response variables. The study findings reveal that capital adequacy positively influenced the asset quality of the DTM banks studied ($B = 2.587$). The association was also significant ($p = 0.002 < 0.05$). This implied that as MFBs accumulated more capital, the level or amount of NPLs decreased, thus leading to an improvement in their asset quality.