INTEREST RATE CAPPING AND FINANCIAL PERFORMANCE OF COMMERCIAL BANKS IN KENYA

MWERESA WANGARI JANE
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DECLARATION

This research project is my original work and has not been presented for a degree in any other university.

Signature………………………… Date…………………………………………

MWERESA WANGARI JANE

D53/OL/CTY/26917/2015

This research project has been submitted for examination with my approval as the University supervisor.

Signature………………………… Date…………………………………………

Dr. FREDRICK NDEDE

Lecturer, Department of Accounting & Finance

Kenyatta University
DEDICATION
I dedicate this project to my husband for his encouragement and support and my children for being my motivation. Thank you very much for your well wishes and may God bless you.
ACKNOWLEDGEMENT
First and foremost, I give thanks and praises to our Almighty God for His blessings, guidance and protection while carrying out this study. I would like to convey my sincere gratitude to my supervisor Dr. Fredrick Ndede for his consideration and well executed professional and academic guidance offered to me while conducting this project study, may God bless you so much. I would like to thank husband and children, for their support and wonderful ideas throughout this process. Lastly, I also appreciate my friends who share this journey with me and encouraged me in the adventure of academics and have been my anchor.
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<th>Term</th>
<th>Definition</th>
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<tr>
<td>Central Bank Rate</td>
<td>is the rate of interest which a central bank charges on the loans and advances to a commercial bank</td>
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<tr>
<td>Client Risk</td>
<td>risk of default on a debt that may arise from a borrower failing to make required payments</td>
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<tr>
<td>Commercial bank</td>
<td>type of financial institution that accepts deposits, offers checking account services, makes business, personal and mortgage loans, and offers basic financial products to individuals and small businesses.</td>
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<td>Financial Performance</td>
<td>a subjective measure of how well a firm can use assets from its primary mode of business and generate revenues</td>
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<tr>
<td>Interest rate</td>
<td>the amount charged, expressed as a percentage of principal, by a lender to a borrower for the use of assets</td>
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<tr>
<td>Lending rate</td>
<td>the amount that a bank charges on money that it lends</td>
</tr>
<tr>
<td>Deposit rate</td>
<td>the rate of interest which amount deposited by a customer in a bank gains usually expressed in percentage on the principal</td>
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<tr>
<td>Interest rate capping</td>
<td>an interest rate that is allowed to fluctuate, but which cannot surpass a stated interest cap</td>
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ABBREVIATIONS AND ACRONYMS

ATA - Average of Total Assets

BOZ - Bank of Zambia

CAMELS - Capital adequacy, asset quality, management quality, earning, liquidity and sensitive to market risk

CBK - Central Bank of Kenya

CBR - Central Bank Rate

CIRP - Covered Interest Rate Parity

ES - Efficiency Structure

FOMC - Federal Open Market Committee

IPR - Interest Rate Parity

KBA - Kenya Bankers Association

MFIs - Microfinance Institutions

MP - Market Power

MPC - Monetary Policy Committee

NBFI - Non-banking financial Institutions

NPLs - Nonperforming Loans
NSE - Nairobi Securities Exchange

PBT - Profit before tax

ROAA - Return on average assets

ROI - Return on Investment

SAP - Structural Adjustment Programs

UCIRP - Uncovered Interest Rate Parity

USA - United States of America
ABSTRACT

Interest rate capping is a form of government control in the financial sector. Over the recent years, there has been a decline on the number of countries using this form of control mainly because most countries are aiming at having liberal financial policies. There are several reasons why governments may opt to use interest rate caps, most of which are political and economic. One of them could be to support an industry or sector where there is a market failure or in areas where a greater financial resource is needed. Market failures usually result from market information asymmetries, moral hazards, adverse selections or the inability of financial institutions to differentiate between high risk and low risk clients. Interest rates have a direct effect on the activities of commercial banks because of the strong belief that they affect the financial performance banks. The valuation of bank assets is the most important factor when it comes to the valuation of bank stocks followed by the rise and fall of interest rates. Traditionally, retail banks make money by relying on the relationship between interest rates, deposits and the loans issued to clients. Therefore, it makes sense for financial analysts to focus on bank stocks as the interest rates rise or fall. The performance of commercial banks depends on a wide range of business, but interest rates still play a key role in determining the financial performance of banks. The critical role of interest rates in determining the performance of commercial banks explains why government regulation is one of the factors that affect the return on bank stocks. This study seeks to establish the influence of interest rate capping on the performance of commercial banks in Kenya. It will be based on the following specific objectives; to establish the effect of Central Bank Rate, Banking lending rate and deposit rates on financial performance of commercial banks in Kenya. The study will be based on three theories which include; interest rate parity, Irving fisher theory of interest and expectations theory of interest rate. A descriptive research design will be employed to analyse the findings. The target population of the study will be 42 commercial banks in Kenya. However, 10 banks will be selected through purposive random sampling to form sample size. Secondary data will be collected from the finance, operations and administration departments of the banks at the headquarters and will be analyzed using descriptive and inferential statistics then presented using charts, percentages, frequencies and tables.
CHAPTER ONE

INTRODUCTION

1.1 Background to the Study

Economic activity is seriously hampered if commercial banks which are the most significant agents in the credit markets cannot execute their lending function properly (Mallik & Bhar, 2011). It is therefore well considered and understood that beyond intermediation; the financial performance of banks has direct implications on performance and growth of economies in different countries. According to Irungu (2012) sustained growth in profitability and performance also ensures continued reward for investors and shareholders which encourages increased investment that spurns economic growth. Because a profitable banking sector is better able to perform its lending function, a banking sector that is profitable makes a significant contribution to the stability of the encompassing financial system. Conversely, poor banking performance leads to banking failure and ultimately crisis in growth of economies.

Bank lending rate is the interest rate that commercial banks charge their most credit-commendable clients (Jones, 2010). Managing with the bank rate is strategy by which central banks influence economic activity. Lower bank rates can extend the economy by bringing down the cost of assets for borrowers, and higher bank rates help to reign in the economy when expansion is higher than wanted. The bank interest rate, or prime loaning rate, is to a great extent dictated by the Central bank rate (CBR).

The performance of commercial banks can be affected by both internal and external factors (Altamimi, 2010). These factors can be classified into those which are considered directly attributable to the bank itself (internal) and macroeconomic variables (external) which includes
factors such as interest rates, exchange rates and inflation. Internal factors are bank-specific characteristics that influence bank performance and are influenced by internal decisions of the board and management of the bank. External factors are industry-wide which are beyond the control of the company and which have direct effect on the profitability of the bank such as the macroeconomic variables noted. Studies also show that performance of banks can also be influenced by ownership identity as either foreign or indigenous local bank (Ongore, 2013).

The banking industry in Kenya is administered by the companies Act, the banking Act, the commercial bank of Kenya Act, and the different prudential rules issued by the Central Bank of Kenya (CBK). The keeping money segment was changed in 1995 and trade control lifted. The business bank of Kenya which falls under the Ministry of Finance is in charge of planning and actualizing fiscal approaches and encouraging the liquidity, dissolvability and legitimate working of the budgetary framework. CBK distributes data on Kenya's business banks and non-managing an account money related organizations, loan fees and different productions and rules (Basel Committee on Banking Supervision, 2010).

Commercial banks in Kenya are experiencing huge change endeavors to adapt to the always showing signs of change business condition. Expanding local and worldwide rivalry, monetary downturn, quickly changing business sector patterns, and unpredictable budgetary markets have all additional to the weight on associations to think of successful reactions to survive and succeed. The part of banks in an economy is principal since they execute fiscal strategies and give intends to encouraging installments for products and enterprises in the domestic and international trade (Shambe, 2003).
The magnitude of interest rate spread, be that as it may, differs over the world. It is contrarily identified with the level of effectiveness of the budgetary division, which is a branch of a competitive environment. The nature and productivity of the budgetary divisions have been observed to be the significant explanations for contrasts in spread in nations over the world. In economies with frail monetary areas, the intermediation costs which are engaged with store assembly and directing them into gainful utilizations, are considerably bigger (Jayaraman and Sharma, 2003).

Commercial banks in Kenya use interest rates as their pricing strategy to differentiate their credit products in market. The overall weighted average lending rate has been too high especially for personal loans. The increase in lending rates is attributed to low liquidity in the financial system due to increased Government borrowing (CBK, 2007). However Central Bank of Kenya has the responsibility to ensure that all commercial banks makes a full disclosure of interest rates charged on loans and advances to enable potential borrowers to make wise decisions, however potential borrowers still complain of high interest rates charged by commercial banks.

Management efficiency is one of the key inward factors that decide the execution of the bank. The execution of administration is frequently communicated through subjective assessment of administration frameworks, authoritative train, control frameworks, nature of staff and numerous others. Anyway ability of administration to convey its assets effectively, salary augmentation and cost decrease can be accomplished by estimating distinctive money related proportions like aggregate resource development, credit development rate, profit development, working benefit to wage proportion (Rahman et al., 2009).
The more the proficient administration is as far as operational effectiveness and salary age the higher the nature of administration set up which decides the level of working costs and thusly influences the general execution of the bank (Angbanzo, 2005). The banking sector recorded an improved performance in 2014 and extended credit to critical economic sectors such as trade, manufacturing, Agriculture, transport and communication. During the year 2014, gross loans increased by 20.7 percent from Ksh. 1,440.4 billion in December 2013 to Ksh. 1,898.8 billion in December 2014 (Banking Supervision Report, 2014).

Since the capping of interest rates has tendency to distort the market and cause unfavorable predispositions, financial organizations tend to support their loaning to generally safe customers which thusly prompts wasteful aspects in the money related intermediation process. As indicated by Ramsey (2013), this segregation prompts a circumstance where those in critical need of monetary help being bolted out of the accessible funds since they are viewed as high risk. Financial institutions can anyway still stay gainful amidst of interest rate capping by the administration by wandering into different sources of income, for example, non-funded pay and in addition cutting their expenses. The interest capping amendment put a cap on loaning rates at 4.0% over the Central Bank Rate (CBR) and a story on the store rates at 70% of the CBR. This isn't the first run through such an Act has been proposed. In 2001, there was an endeavor to revise the CBK Act and cap the loaning rates at 4.0% over the 91-day T-charge and the store rates at 4.0% underneath the 91-day T-charge, bringing the spread to 8.0%. Additionally in 2013, the Kenya Parliamentary Budget office proposed the pegging of the lending rates to the loaning rates. In both of these endeavours it the limitations were not effective.

In any economy, banks go about as a center individual through which people store funds and get credits. Thusly banks fundamentally have money from the impact between the rate which they
pay supporters and the rate which they charge borrowers. These rates are controlled by showcase powers, that is, request and supply, yet furthermore a couple of various segments turn out to be potentially the most vital factor. Putting a top on credit expenses will influence the business' profitability as it doesn't speak to a couple of elements that may impact the banks decision to pick certain spreads. Besides, pegging it to the Central Bank Rate will depend, as it were, on the transmission instrument of money related plan decision into the economy and the ampleness of the Monetary Policy Committee in looking over the state of the economy. Regardless of the way that the cash related game plan is grabbing significance, we are yet to see it a certified assessing instruments for theorists and banks. This study therefore seeks to establish the influence that interest capping has on the profitability of commercial banks in Kenya.

1.1.1 Interest Rate Capping

Interest rate capping is a type of government control in the financial segment. Over the recent years, there has been a decrease on the quantity of nations utilizing this type of control essentially in light of the fact that most nations are going for having liberal financial strategies. There are a few reasons why governments may select to utilize interest rate caps, a large portion of which are political and monetary. One of them could be to help an industry or division where there is a market disappointment or in regions where a more noteworthy money related asset is required. Market failure as a rule result from advertise data asymmetries, moral hazards, unfavorable choices or the inability of financial institutions to differentiate between high risk and low risk clients. In this way as indicated by Miller (2013), financing cost tops are a helpful apparatus to help a segment until it's ready to support itself.

Limitations brought by the capping of interest rates may lead into alternative loaning by the financial sectors, for example, loaning to the government and in outrageous situations where the
capping may wind up unbeficial, banks and microfinance institutions may pull back from specific locales, for example, rural areas or from costly market sections since they can't take care of their expenses. This situation thus drives the low salary, high risk borrowers to swing to shylocks and other unlicensed money lenders for financing and time after time these credits come at a staggering expense. As per evidence, interest rate caps on credits demoralize microfinance non-governmental organizations (NGOs) and different wellsprings of back for the poor from changing over into authorized financial institutions (Helms and Reille, 2004).

In Japan, the 2006 Act diminished the interest rate cap under the Capital Subscription Law from 29.2% to the 20% level, in spite of the fact that by and by loan specialists had been constrained into decreasing rates to this level by the Supreme Court Decisions toward the beginning of 2006 (Honda and Kuroki, 2006). In spite of the fact that lenders protested that limiting rates to this level would make the business unbeficial and drive them out of the market, figures discharged by the Financial Services Agency in 2004 demonstrated that the real cash loaning organizations were obtaining their capital from banks at only 2% while loaning this onto to customers at in the vicinity of 27% and 29%. Furthermore, every one of the four main lenders had working benefits of around 1 billion yen. As a result, there was little sensitivity for lenders with this contention.

Numerous nations in Africa have built up interest rate ceilings to shield buyers from high interest rates charged by banks. A large portion of these ceilings are the reaction of governments that are confronting political and social weight from its residents. The general thought is that interest rate ceilings constrain the propensity of some monetary specialist co-ops to build their advantage yields (all pay from credits as a level of the bank's normal yearly gross advance portfolio) particularly in business sectors with a mix of no straightforwardness, restricted divulgence prerequisites and low levels of financial proficiency (Maimbo and Henriquez 2014).
In spite of good expectations, loan fee roofs can really hurt low-salary populations by constraining their access to fund and reducing price transparency. In the event that roofs are set too low, financial service providers find it difficult to recuperate costs and are probably going to grow all the more gradually, lessen benefit conveyance in country territories and other all the more expensive markets, turn out to be less straightforward about the aggregate cost of credit, and even leave the market totally. At the point when rates are capped, most speculators may see this to imply that the banks’ income will decrease and hence they may shy away putting resources into the shares of banks that are recorded in a country’s stock exchange (Maimbo and Henriquez 2014).

As indicated by Richard, Scott, and William, (2013), there is empirical that would help outline the question of the sensibility of bank interest rates. Their paper demonstrates a reduction of interest rate yield in Africa from 39% to 25% in the vicinity of 2004 and 2011 notwithstanding the expansion over a similar time of the money related costs and credit misfortunes. Africa is the district that demonstrates the most generous proceeded with decays of its loan cost yield (-2.5 percent in the vicinity of 2006 and 2011). The paper additionally demonstrates that working costs are the biggest determinants of the rate the borrowers wind up paying. In Africa, the working cost proportion diminished from 28% to 19% in the vicinity of 2004 and 2011. In spite of a 1.5 percent for each annum diminish, the working cost proportion in Africa remains the most noteworthy contrasted with different regions of the world. There is a need to comprehend the drivers of operating costs in Africa and make sense of what should be possible to decrease them while keeping up money financial institution’s efficiency and sustainability.

By 2013, 17 nations in Sub Saharan Africa had presented interest rate caps. The West Africa Economic and Monetary Union, which incorporates eight francophone African nations, brought
down the interest rate ceiling, at first settled in 1997, by three percent. As indicated by the Council of Ministers, the new most extreme viable loan cost banks could charge was 15%, while Microfinance establishments (MFIs) could charge 24%. The Economic and Monetary Community of Central Africa, containing 6 nations (Cameroon, the Central African Republic, Chad, the Republic of Congo, Gabon, and Equatorial Guinea), set up a loan fee roof in October 2012. The interest rate ceiling particular to the microfinance sector is figured by applying an edge of 33% to the normal successful loan fee charged by microfinance foundations amid the past a half year (Djibril, 2013).

In Zambia, the central bank, known as the bank of Zambia (BOZ) introduced a ceiling on the annual interest rate on loans in charged by non-bank financial institutions (NBFI) in 2013. The ceiling stated that the maximum effective annual lending interest rate for NBFI designated as microfinance service providers by the Bank of Zambia would not exceed 42% and the maximum effective annual lending rate that will be charged by all other non-bank financial institutions would not exceed 30%. NBFIs included development banks, microfinance institutions, credit institutions and forex bureaus.

BOZ reasoned that most non-bank financial institutions were charging extremely high rates to their customers in the guise of cushioning themselves from high risks involved. As a result, credit access was locked out of the reach of a majority of clients and so the government had to intervene. The measures taken were supposed to make loans more affordable and equitable to vulnerable borrowers. Interest rate capping did not work in Zambia and was lifted in November 2015.
The issue of interest rates capping has also been introduced severally in Kenya with different outcomes. In 2000, the Donde Bill, (named after its mover, Member of Parliament, Joe Donde) endeavoured to address the issue of loan costs however did not get much help from partners including banks. The draft laws planned to have the legislature manage the sum charged on credits by financial institutions since the banks had made obtaining distant for the larger part of Kenyans.

Mr. Donde contended that a greater part of organizations were failing as banks moved in to sell their assets when they were not able administration their advances because of the high rates and he recommended that the interest be pegged on the 91-day treasury bills with an edge of 4%. Industry players in the nation except for banks respected the bill, saying that it would frame some portion of recuperation endeavors the nation expected to kick begin the economy. The government, in a notice to parliament, anyway forewarned the officials on the threats of controlling interest rate and referred to that such a move would be against the soul of the progression approach of the Kenyan economy.

There was also a bone of contention between the government and Mr. Donde on the requirement that a nine-man committee be formed to be in charge of formulating and implementing monetary policy. The government’s amendment proposed that the committee should have 10 members which were to include the central bank governor, the deputy governor, the chief economist and seven other members, of whom two had, are women. The committee was also supposed to change its role to be more of advisory rather than just being proactive.

In 2015, there were new endeavors to cap bank interest through a proposition made by the Kiambu Member of Parliament Hon. Jude Njomo. The bill was at long last consented by
President Uhuru Kenyatta on the 24th August 2016. The Bill tried to revise section 33A of the Banking Act by presenting another area (section 33B) which accommodates interest ceilings, giving a notice to the borrowers to know about the premium they get on their stores and repercussions to every single monetary organization that do the capacity of loaning on giving interest rates higher than those set by the law. Segment 33B (1) (b) of the Banking Amendment Bill likewise said that any Kenyan with an investment account in a bank will get a foreordained loan fee on the store with the reference rate being the Central Bank rate (CBR).

This statement set the minimum interest rate that a bank would pay for a savings deposit at 70% of the base rate set by the Central Bank of Kenya. This is to imply that with a CBR of 10%, the base measure of intrigue payable for an investment account is 7% and the most extreme premium charged on advances is 14% which is 400 premise focuses over the CBR. The enactments fundamental point is to confine keeping money establishments from setting high interest rates on credits and low loan costs on stores. In particular, the law recommends that no managing an account organization that issues a credit would charge a financing cost that is in excess of 400 premises focuses over a base rate set by the Central Bank of Kenya. For the bank customer who is looking for an advance, it is currently conceivable to foresee the most extreme enthusiasm on a credit to be given utilizing the base rate as would be pronounced by the Central Bank.

1.1.2 Financial Performance of Commercial Banks

From the perspective of investors, financial performance of an organization is reflected in the trends of yields arising from their investments in the organization and the trend of the organization’s market stock price. Whereas stock price is a key indicator of performance for both investors and management, banks and other organizations monitor performance through
accounting measures, because these measures, among other factors, affect stock prices and yields.

Profitability is one of the most important parameters considered in evaluating the performance of banks. Profitability measures like ROA and ROE summarize banks' performance in all areas. Margarida (200) established that net interest margin impacts positively on operating cost. Adjusting market conditions impacts market interest rates in turn having a direct impact on profit. High interest rates are desired by banks since they increase return on investments and increase profit margin on loans.

Bank profitability increases with increase in interest rates. Mang’eli (2012) argued that the banking system as a whole is immeasurably helped rather than hindered by an increase in interest rates. Financial performance of banks is evaluated based on profitability. The most popular profitability measures are: profit margin on sale, return on equity and return on investment ratios. Banks make profit on the difference between what they incur to borrow funds and the rate at which they on-lend the funds borrowed from depositors.

1.1.3 Commercial Banks in Kenya
Kenya has 42 commercial banks operating under CBK regulations through the banking Act, 11 of the banks are listed on the Nairobi Securities Exchange (NSE) which is an essential reflection of how well or poorly a bank is performing. The regulations are meant to protect the depositors of money in the bank, to ensure that banks are not being misused and are operating clean business as opposed to money laundering and to fundamental role of maintaining confidence in the banking sector by ensuring clients are given quality service the levels of competition in the market. The Banking Act, Banking (Amendment) Bill 2015 is now law and it marks a new era for the banking industry in Kenya. On Wednesday 25th August 2016, the president signed into
law the bill that caps interest rates for bank lending and deposits. The new amendments cap banks’ lending interest rates to no more than four per cent above the Central Bank Rate (CBR) currently at 10.5 per cent.

The Government has transformed banking to make it globally competitive. In 2007, the Ministry of Finance proposed to raise bank capital from Sh250 million ($2.94 million) to Sh 1 billion ($11.8 million) by 2010. This deadline has since been pushed to 2012. Foreign banks (Nigerian, South African and others) are investing in low-capital organizations. After the profit development of the first five years of the Kibaki administration, bank extension has since crossed fringes to Tanzania, Rwanda, Southern Sudan, Mauritius and Uganda. Nearby banks, for example, Equity, KGB, Diamond Trust, l&M, ABC and Cooperative are available in the locale.

Kenyan banks posted flat or reduced earnings in 2016 following interest rate caps introduced last September. At least four banks have announced their earnings in the last few days, with their results highlighting how the fixing of interest rates has affected the financial institutions. Kenya capped commercial banks’ lending rates last November at 4 percent above the Central Bank Rate (CBR), which currently stands at 10 percent and further set a minimum interest rate for deposits in interest-earning accounts.

Before the law, lending charges stood at between 19 percent and 27 percent, with proponents of capping then noting that banks were exploiting their customers through their high rates to make billions of dollars in profits. According to the Central Bank, the banking sector profit in 2015 stood at 1.3 billion U.S. dollars, mainly driven by interest earnings from customers. However, total commercial banks' earnings has fallen significantly in 2016 if results of commercial banks released in the last few days are indicative.
Kenya Commercial Bank (KCB), Barclays Bank, NIC Bank and Stanbic are among banks that have announced their results out of the 40 in the east African nation. KCB, the country's largest bank by assets, posted a flat net profit of 191 million dollars in its 2016 results. On the other hand, NIC Bank recorded a 3.3 percent decline in earnings, driven by a 35.8 percent growth in total operating expenses which outpaced a 17.5 percent growth in total operating revenue. Similarly, Barclays Bank and Stanbic Bank recorded 12.6 percent and 9.9 percent reduction in earnings. For KCB, besides rate capping, regional expansion strategy eroded shareholders value as the bank was affected by the ongoing political instability in South Sudan, coupled with the devaluation of the country's pound and hyper-inflationary effects, which resulted in the bank subsidiary reporting a net monetary loss.

1.2 Statement of the problem

In any given economy, banks act as a link through which clients deposit funds and get credit facilities. Commercial banks are the dominant players in the financial services in Kenya. Consequently commercial banks make money from the difference between the rate at which they accept customers’ deposits and the rate which they charge the borrowers. These two rates vary and are largely open to market forces of demand and supply and other several factors. The assenting of interest cap into law have a sequel on the industry’s efficiency as the interest capping does not account to several factors that might affect the banks, decisions to opt for certain spread.

Obumuyi et al. (2010) assert that there is a very close relationship between the commercial bank lending and the economic output. Consequently, any failure in the sector is likely to have adverse impact on the country's economy. Such failure was witnessed in 2016 where some banks were
put under receivership for example the Imperial Bank and Chase Bank and can lead to financial crisis and economic meltdown.

The year 2017 was the first full year of operation by commercial banks under the interest rate capping. The interest capping law came to effect in October 2016 as it was successfully passed by the parliament. In the previous reign of fully regulated interest rates, most commercial banks mostly set their base rates and gave them to their customers with the biggest muscle. Such subsequent increased payments stressed borrowers but enabled banks to continue enjoying high profit margins. In contrast the full effect of the new regime and how it has disbanded banks can be seen clearly from the third quarter trading results of the year 2017 that were released by the banks. For example Equity Bank’s net profit dropped by 3% to Sh14.6 Billion, Co-operative banks Profit dropped by 9.5 % to Sh9.5 Billion and Barclays bank saw its profit down 12 per cent to sh5.3 billion. On the other hand some of banks found themselves in the negative territory. Jamii Bora bank widened its loss to sh337 million, Sidian bank posted a loss of 274 million which was a 225 per cent drop and Consolidated Bank of Kenya posted a loss of 301 million (KBA,2017).

The banks that dropped in profitability or posted losses have been left stranded as they cannot push the interest rates up so as to record more revenue. Other banks have been forced to take up other drastic measures to reduce the cost of operation including laying off staff and also offering early retirement packages for the case of National Bank and Family Bank. Further banks have been seen changing their strategies for example Equity Bank CEO Dr James Mwangi said that the bank was now concentration on non-funded income other than the funded income (Equity, 2017).
It is therefore important to understand the effect of regulating interest rates on the performance of commercial banks in Kenya. Were and Wambua (2014) examined the factors that drive interest rate spread of commercial banks using empirical evidence from Kenya. Robison (2010) established in his study that the bank earnings are affected by the anticipated changes in the lending interest rates. The effect of interest rates on the performance of commercial banks has been of great concern to scholars, policy makers and the bankers for a long period of time. Mang’eli (2012) using descriptive research design showed the relationship between interest rate spread and financial performance of commercial banks in Kenya pointing out that interest rate affect the performance of commercial banks, as it increases the costs of loan charged. This has led to an increased number of non-performing loans thus forcing banks to maintain high lending rates in order to minimize losses associated by these loans (Matu 2006).

The above studies provide a comprehension on the effect of interest rates on financial performance but they do not provide the information on the effect of interest rate regulation and interest rate capping laws on the banking sector and the their financial performance. This study is therefore done to investigate the effect of interest capping on the financial performance of commercial banks in Kenya.

1.3 Objectives of the study

1.3.1 General objective

The study aimed to establish the effects of interest rate capping on the financial performance of commercial banks in Kenya.

1.3.2 Specific objectives

This study was guided by the following specific objectives:
i. To establish the effect of central bank rate on financial performance of commercial banks in Kenya

ii. To analyse the relationship between banking lending rates on the financial performance of commercial banks in Kenya

iii. To assess the effect of deposit interest rates on financial performance of commercial banks in Kenya

1.4 Research questions

The study sought to answer the following questions;

i. How does the central bank lending rate affect financial performance of commercial banks in Kenya?

ii. What is the effect of bank lending rate on the financial performance of commercial banks in Kenya?

iii. How does deposit interest rate affect the financial performance of commercial banks in Kenya?

1.5 Significance of the study

The findings of this study will benefit the commercial banks, microfinance institutions, SACCOs and other financial sector players on effects of the new law on interest rate capping on their profitability and cushion their profits. The outcome of the proposed research will inform Central Bank of Kenya, the government and policy makers on how the capping affects profitability of the banking sector.

To future researchers and academicians, the study will be important as it will offer suggestions of areas requiring further research to build on the topic of effects of interest rate capping on
financial performance of commercial banks in Kenya. In addition, the findings of the study will also be important source of reference for future scholars and researchers and further contribute to the existing body of knowledge on interest rates and performance of financial sector players.

1.6 Scope of the study
The population for this study was 42 the banks listed in the NSE and regulated by the Central Bank of Kenya. This study was limited to examine the effect interest rate capping and financial performance of commercial banks in Kenya. The study covered from 1st September 2016 to 1st September 2017 or the 2016/2017 financial year since this is when the Bill became law.

1.7 Organization of the study
This research project comprised of five chapters. Chapter one involved background of the study, statement of the problem, purpose of the study, objectives of the study, research questions, and significance of the study, scope of the study and organization of the study.

Chapter two reviews literature which include theoretical review, empirical review, research gaps and the conceptual framework. Chapter three deals with research methodology which explains the research design, target population, sampling design, rationale for sample selection, data collection instruments, questionnaires, validity of the research instrument, reliability, data analysis and ethical considerations while chapter four had presentation of findings and discussions. Chapter five covered the summary of findings, conclusions and recommendations.
CHAPTER TWO
LITERATURE REVIEW

2.1 Introduction
This chapter will be segmented into theoretical and empirical literature review. The Literature review will be obtained from secondary sources obtained from relevant magazines and journals, institutional research publications, websites and reports among others. A summary of literature, research gaps and conceptual framework to illustrate variable relationship will also be included.

2.2 Theoretical Review
The study will be guided by three theories which include interest rate parity theory, Irving Fisher’s theory of interest and expectations theory of interest rates. Different theories have been suggested by different authors that argue about the relationship between lending interest rates and financial performance of commercial banks and other financial sector players.

2.2.1 Interest Rate Parity Theory
Interest rate parity theory was created by Bleaney and Fielding in the year 1937. This hypothesis shows that the interest rate differential between two nations is equivalent to the differential between the forward conversion scale and the spot exchange rate. Interest rate equality assumes a fundamental part in outside trade markets, interfacing interest rates, spot exchange rates and foreign exchange rates (Radha, 2011).

Interest Rate Parity (IPR) hypothesis is used to analyze the association between at the spot rate and a looking at forward (future) rate of rate of monetary forms. The IPR theory states loan cost differentials between two one of a kind monetary forms structures will be reflected in the premium or refund for the forward trade scale outwardly cash if there is no arbitrage-the activity
of obtaining offers or trade out one budgetary market and offering it at an advantage in another. The theory furthermore states size of the forward premium or refund on outside cash should be comparable to the loan cost differentials between the countries in examination (Bleaney, and Fielding, 2002).

Interest rate is the rate of premium charged for the measure of money borrowed. Banks or crediting associations as a general rule have general standards for the rate they intend to charge. Money obtained by the wager on at this very moment preface, (for instance, overdraft office) or whole deal commence (debentures, home advances, or bank progresses) has differing financing cost. The advance charge uniformity condition was made by Keynes (1933), as what is called financing cost fairness nowadays, to interface the change scale, credit cost and development. The theory furthermore has two structures: secured loan cost equality (CIRP) and revealed financing cost equality (UCIRP). CIRP portrays the relationship of the spot and expected trade rates with credit expenses on securities in two economies (Ngugi, 2001). UCIRP depicts the relationship of the spot and expected change standard with apparent financing costs on bonds in two economies (Radha, 2011). This is the typical type of the secured loan fee equality, which communicates that the nearby interest rate must be higher than the remote advance cost by an entirety equal to the forward premium (markdown) on family unit money. As showed by CIRP, if the swapping size of, say, the shilling against the USD is settled, the interests of the two countries should be equal. In this way, a little country with a pegged change scale organization can't finish monetary methodology unreservedly (Salloumand, 2012).

Interest rates, inflation, and exchange rates are in general exceedingly related (Central Bank of Kenya, 2012). By controlling interest rate, national banks apply affect over both expansion and
trade rates, and changing financing costs influence swelling and cash regards (Devereux and Lane, 2001). Higher advance charges offer moneylenders in an economy a higher come back as for various countries. As nees be, higher advance costs attract remote capital and cause the transformation scale to rise. The impact of higher loan fees is eased, in any case, if development in the country is essentially higher than in others, or if additional variables serve to drive the cash down. The opposite relationship exists for lessening financing costs that is, cut down loan costs have a tendency to decrease trade rates (Bergen, 2010).

Karfakis and Kim (1995) using Australian swapping scale data found that sudden current record lack is connected with conversion scale cheapening, and a rising in loan costs. Parity hypothesis will clarify the factors behind the interest rate fluctuation and adjustment by the central bank of Kenya.

2.2.2 Irving Fisher’s theory of Interest

Irving Fisher’s theory of interest rates was proposed by Yrving Fisher in 1906. The theory relates the nominal interest rate to the rate of inflation $\pi$ and the “real” interest rate $r$. The real interest rate $r$ is the interest rate after adjustment for inflation. It is the interest rate that lenders have to have to be willing to loan out their funds (Keynes, 1933). The relation Fisher postulated between these three rates is:

$$(1+i) = (1+r) \cdot (1+\pi) = 1 + r + \pi + r\pi$$

This is equivalent to:

$$i = r + \pi (1 + r)$$

Thus, according to this equation, if $\pi$ increases by 1 percent the nominal interest rate increases by more than 1 percent. This means that if $r$ and $\pi$ are known then $i$ can be determined. On the other hand, if $i$ and $\pi$ are known then $r$ can be determined and the relationship is:
At the point when $\pi$ is small then $r$ is roughly equivalent to $1-\pi$, yet in circumstance including a high rate of swelling the more precise relationship must be considered. Fisher accept that $r^*$ is given by innovation and tastes. $r^*$ is a physical rate of return. Nonetheless, in his investigation, Fisher perceives that $r^*$ is really figured in cash terms and that value desires matter for the choice the rate of return over cost is the fiscal articulation of $r^*$ and is the basic variable for speculation (Fisher1930). Afterward, Keynes unequivocally expressed that the minimal effectiveness of capital and the rate of return are indistinguishable ideas. One could then think about whether it is defended to condemn Fisher's investigation for not considering the significance of cash and fiscal desires. The Fisher hypothesis will extraordinarily bestow on this examination by clarifying the connection between the ostensible and the genuine rate of intrigue. It will further provide useful insights in understanding how the changes in the Nominal and real rate of interest affects the financial performance of Commercial Banks of Kenya.

2.2.3 Expectations Theory of Interest Rates

This theory was similarly created by Irving Fisher in 1930. Expectations theory of interest rates implies to clarify the state of the yield bend, or the term structure of interest. The powers that decide the state of the yield bend have been generally bantered among scholastic business analysts for various years (Fisher, 1930). The American financial analyst Irving Fisher propelled the desires hypothesis of loan fees to clarify the state of the bend. As indicated by this hypothesis, longer-term rates are dictated by financial specialist desires for future here and short-term rates.

In mathematical terms, the theory suggests that: $(1+R2)^2 = (1+R1) \times (1+E(R1))$ Where; $R2=$ the rate on two-year securities, $R1 =$ the rate on one-year securities. $E(R1) =$ the rate expected on
one-year securities one year from now. The left side of this equation is the sum per dollar contributed that the investor would have after two years in the event that he put resources into two-year securities. The correct side exhibits the whole he can want to have following two years in case he places assets into one-year duties. Competition is relied upon to make the left side proportional to the right side. The theory is easily summed up to cover any number of improvement classes. In addition, anyway various improvement classes there may be, the speculation reliably illuminates the nearness of longer-term rates similarly as expected future shorter-term rates (Keynes, 1933). The desires hypothesis of credit costs gives the theoretical introduce to the usage of the yield twist as a logical gadget by fiscal and cash related analysts. For example, an upward-slanting yield twist is cleared up as a sign that the market expects ascending without a moment's hesitation rates later on. Since rising rates commonly occur in the midst of money related augmentations, an upward-inclining yield twist means that the market expects continued with improvement in the level of financial development (Keynes, 1933). Financial agents at times use this condition to get a market-related gauge of future interest rates.

It can be rewritten as follows: $E(R_1) = \frac{(1 + R_2)^2}{1 + R_1} - 1$

The equation suggests that short-term rate expected by the market next period can be gotten from information of rates today (Kregel, 1985). On the off chance that desire for the general population is that premium will rise numerous individuals will abstain from getting this consequently will influence bank execution because of diminished procuring on interest rate, however in the event that individuals anticipate that loan fee will drop individuals would acquire and this will enhance banks performance because of increment in interest rate gaining (Bekaert, 1998).
2.3 Empirical Review

This section entails the analysis of other studies done by other researchers in this field and other policy frameworks on interest rate capping and financial performance of commercial banks.

2.3.1 Factors affecting the performance of Commercial Banks in Kenya

Since the introduction of Structural Adjustment Programs (SAP) in the late 1980's, the banking sector area worldwide has experienced genuine changes in its working condition. Countries have encouraged controls on financing costs, decreased government commitment and opened their approaches to worldwide banks (Ismi, 2004). As a result of this change, firms of the made nations have ended up being more observable in making countries through their assistants and branches or by getting of remote firms. More especially, outside banks' quality in various countries over the globe has been growing immensely. Since 1980's, various outside banks have set up their branches or helpers in different parts of the world. Over the latest two decades or close, the amount of remote banks in Africa when all is said in done and Sub-Saharan Africa particularly has been growing out and out.

As a matter of fact, the amount of family banks declined (Claessens and Hore, 2012.) These have pulled in light of honest to goodness worry for masters to dissect bank execution in association with these progressions. There has been seen a significant change in the cash related course of action of countries when in doubt and its effect on the advantage of commercial banks particularly. Obviously sound and beneficial saving money a division can withstand negative dazes and add to the soundness of the fiscal structure (Athanasoglou et al. 2005.) Moreover, commercial banks accept an immense part in the money related improvement of countries. Through their intermediation work banks expect a fundamental part in the successful task of advantages of countries by actuating resources for useful activities. They trade saves from the
people who don't have useful usage of it to those with beneficial meander. Notwithstanding asset allotment great bank execution remunerates the investors with adequate return for their venture. At the point when there is return there will be a venture which, thusly, realizes financial development. Then again, poor keeping money execution has a negative repercussion on the monetary development and improvement. Poor execution can prompt runs, disappointments and emergencies.

Banking crisis could involve monetary emergency which thusly gets the financial emergency as happened USA in 2007 (Marshall, 2009.) That is the reason governments direct the managing an account area through their national banks to encourage a sound and solid saving money framework which abstain from saving money emergency and ensure the contributors and the economy (Heffernan, 1996; Shekhar and Shekhar, 2007.) Thus, to dodge the emergency due consideration was given to keeping money execution. A more sorted out investigation of bank execution began in the late 1980's (Olweny and Shipho, 2011) with the use of Market Power (MP) and Efficiency Structure (ES) speculations (Athanasoglou et al., 2005.) The MP hypothesis expresses that expanded outside market powers come about into benefit. In addition, the speculation propose that lone firms with extensive piece of the overall industry and very much separated portfolio (item) can win their rivals and gain monopolistic benefit. Then again, the ES hypothesis recommends that upgraded administrative and scale proficiency prompts higher fixation and afterward to higher gainfulness.

As indicated by Nzongang and Atemnkeng in Olweny and Shipho (2011) adjusted portfolio theory likewise included extra measurement into the investigation of bank execution. It expresses that the portfolio organization of the bank, its benefit and the arrival to the investors is the aftereffect of the choices made by the administration and the general approach choices. From the
above speculations, it is conceivable to infer that bank execution is impacted by both inside and outer elements. As per Athanasoglou et al., (2005) the interior variables incorporate bank estimate, capital, administration productivity and hazard administration limit. Similar researchers battle that the real outside components that impact bank execution are macroeconomic factors, for example, financing cost, expansion, monetary development and different elements like possession.

2.3.2 Central bank rate and financial performance of commercial banks

A bank rate is the financing cost at which a country's national bank credits money to local banks, consistently as without a moment's hesitation propels. Managing the bank rate is strategy by which national banks impact monetary development. Lower bank rates can develop the economy by cutting down the cost of advantages for borrowers, and higher bank rates help to reign in the economy when swelling is higher than needed.

In the United States, the bank rate is frequently implied as the administration saves rate or the markdown rate. In the United States, the Board of Governors of the Federal Reserve System sets the refund rate and what's more the hold necessities for banks. The Federal Open Market Committee (FOMC) buys or pitches Treasury securities to control the money supply. Together, the administration stores rate, the estimation of Treasury securities and spare necessities huge influences the economy. The organization of the money supply thusly is suggested as cash related methodology.

The rebate rate, or bank rate, is now and then mistaken for the medium-term rate. While the bank rate alludes to the rate the national bank charges banks to acquire reserves, the medium-term rate alludes to the rate banks charge each other when they get stores among themselves. Banks get
cash from each other to cover insufficiencies in their stores.

Banks are required to have a specific level of their stores close by as save. On the off chance that they don't have enough money toward the day's end to fulfill their save prerequisites, they obtain it from another bank at the medium-term rate. On the off chance that the markdown rate falls beneath the medium-term rate, banks commonly swing to the national bank, instead of each other, to acquire stores. Accordingly, the rebate rate can possibly drive the medium-term rate up or down.

As the bank rate has such a solid impact on the medium-term rate, it likewise influences buyer loaning rates. Banks charge their best, most trustworthy clients a rate that is near the medium-term rate, and they charge their different clients a rate that is somewhat higher. For instance, if the bank rate is 0.75%, banks are probably going to charge their clients generally low loan costs. Interestingly, if the markdown rate is 12% or a likewise high rate, banks will charge borrowers similarly higher financing costs.

The greatest cost of credits stays unaltered after the Central Bank of Kenya (CBK) on Monday held the base loaning rate as banks kept on shying from loaning because of the lawful tops on obtaining rates. The Monetary Policy Committee (MPC) kept up the benchmark rate at 10 for every penny in spite of expansion hitting a five-year high, saying the current financial strategy position had lessened the risk of cash driven swelling. Kenya is attempting to contain high swelling, caused for the most part by higher sustenance costs, which is outside the money related control.

Kenya's swelling rose to a yearly 11.48 for each penny in April, up from 10.28 for every penny in March and the most astounding since May 2012 which is past Treasury favored a furthest point of confinement of 7.5 for every penny. Board of trustees executive and CBK representative
has demonstrated a stable forex showcase, a smaller current record shortage and trade saves are "at unsurpassed abnormal states" which keep on cushioning the economy from unanticipated stuns as the explanations behind holding the base rate unaltered. The MPC, in this way, chose to hold the Central Bank Rate (CBR) at 10 for every penny. The advisory group will keep on closely screen advancements in the household and worldwide economies, and stands prepared to take extra measures as vital. The administration topped loaning rates last September at four rate focuses over the Central Bank Rate, saying they were too high and banks had more than once neglected to bring down them. The Central Bank has shown that because of the tops, the quantity of credit applications has expanded by 23.4 for every penny between August 2016 and April 2017. The estimation of the credits connected for fell by 18.3 for each penny amongst August and April, recommending endorsement of littler advances. Anyway the log jam in private part credit development, which was to a great extent because of elements in exchange, fabricating, land, and private family units, the board noticed that credit to private families, assembling, and land had grabbed in March and April 2017 in spite of the enthusiasm topping.

2.3.3 Bank lending rate and performance of commercial banks

As indicated by Jones (2010) the bank loaning rate is the financing cost that business banks charge their most credit-commendable clients. For the most part, a bank’s best clients comprise of extensive enterprises. The bank financing cost, or prime loaning rate, is generally dictated by the Central bank rate (CBR), which is the medium-term rate that banks use to loan to each other; the prime rate is likewise imperative for singular borrowers, as the prime rate straightforwardly influences the loaning rates accessible for a home loan, private venture advance or individual advance.

Using explanatory research design and multiple regression model analysis, Wamabir and
Mwangi (2017) investigated on impacts of interest rates on commercial bank’s financial performance. All 42 commercial banks in Kenya were used in the study. This study concluded that lending rate ration has a positive influence on commercial banks performance while deposits interest ratio impacts negatively. Financial performance management and asset quality were concluded as having positive and negative impact on commercial banks performance respectively. As a recommendation from the study, commercial banks in Kenya need to carefully monitor their deposit and lending interest rates and deposit interest rate.

Default chance is the principle determiner of the financing cost a bank charges a borrower. Since a bank's best clients have minimal possibility of defaulting, the bank can charge them a rate that is lower than the rate charged to a client who has a higher probability of defaulting on a credit. The prime rate fills in as a premise, or perspective, for deciding most other loan fees moneylenders make accessible to borrowers, despite the fact that it won't not be particularly recorded as a segment of the rate at last charged. Loan costs fill in as pay for the hazard gone up against by the moneylender in view of the borrower's record and other budgetary points of interest, and give an approach to take care of expenses related with loaning (Federal Reserve Bank, 2012).

In instances of variable loan fees, for example, those utilized on certain Mastercards, the card's financing cost might be communicated as the prime rate in addition to a set rate. This implies the rate rises and falls with the prime rate however dependably remains a settled rate over the prime rate consistently. The bank loaning rate isn't set by a specific lawful element, and the prime rate utilized by one organization might be unique in relation to the prime rate being used by another. While changes to the Federal Reserve's or Central Bank's prime rate are regularly noted by
different U.S. or then again other nations' establishments, and might be utilized to legitimize changes in the foundation's prime rate, it's anything but a necessity for the organization to raise its prime rate as needs be (Wall Street Journal, 2016).

By and large, the prime rate is saved for just the most qualified clients, decided as the individuals who represent minimal measure of danger of default. Prime rates may not be accessible to singular borrowers as frequently as to bigger substances, for example, especially stable organizations. Regardless of whether the bank loaning rate is set at a specific rate, for example, 5%, that does not mean a moneylender can't offer rates underneath that add up to very much qualified clients. The prime rate is viewed as a benchmark just, and however it is probably going to be the least declared rate accessible, it ought not be viewed as an obligatory minimum (Morgan, 2015).

Bank Lending Rate in Kenya expanded to 13.71 percent in May from 13.61 percent in April of 2017. Bank Lending Rate in Kenya arrived at the midpoint of 16.35 percent from 1971 until 2017, achieving an untouched high of 32.28 percent in April of 1994 and a record low of 9 percent in January of 1972. In Kenya, the bank loaning rate is the upper rate of premium charged on unsecured advances by business banks to private people and organizations (CBK, 2017).

According to World Bank statistics, the Commercial bank prime lending rate of Kenya is 17.1 (%) with a global rank of 26. Commercial bank prime lending rate of Kenya is similar to that of Venezuela, Mauritania, Honduras, Turkmenistan, Mongolia, Jamaica, Azerbaijan, Armenia, Argentina, Rwanda with a respective Commercial bank prime lending rate of 18.0, 18.0, 17.8, 17.5, 17.5, 17.0, 16.5, 16.4, 16.3 (%) and a global rank of 21, 22, 23, 24, 25, 27, 28, 29, 30, 31. Last 5 years average. Kenya had an average Commercial bank prime lending rate of 12.6 (%)
in the last 5 years from (2008 to 2013). Kenya's Commercial bank prime lending rate had a positive growth of 15.5% since the end of the Great Recession

2.3.4 Bank deposit rates and performance of commercial banks in Kenya

Deposit interest rate (%) in Kenya was accounted for at 8.6901% in 2016, as indicated by the World Bank accumulation of improvement pointers, incorporated from formally perceived sources. Deposit interest rate is the rate paid by business or comparative banks for request, time, or reserve funds stores.

Interest rate directly affects the exercises of business banks due to the solid conviction that they influence the money related execution banks (Priti, 2016). The valuation of bank resources is the most imperative factor with regards to the valuation of bank stocks took after by the ascent and fall of loan costs (Rosenbaum, 2015). Customarily, retail banks profit by depending on the connection between financing costs, stores and the advances issued to customers. Along these lines, it bodes well for monetary experts to center around bank stocks as the loan fees rise or fall. Various bank disappointments were recorded in the United States amid the 1980s in light of high-loan costs and the affectability of interest cost (Priti, 2016).

Priti (2016) examined the mean and volatility spill overs caused by short-term interest rates and exchange rates, and long-term interest rates and exchange rates. It is an important factor for investors and bankers because of the impact it has on the overall valuation of bank stocks. In addition, it defines the level of risks that the bank is facing. A comprehensive understanding of how interest rate affects the valuation of bank stocks and the overall exchange rate is very important when one considers that some banks have foreign operations (Zaman, et al., 2013). The difference between the short-term interests paid to deposits and savers and the longer-term
interests paid by borrowers is the interest earned by banks. A steep yield curve means the commercial banks are generating high interests (Tran, 2013). Currently, the United States of America has kept the long term and short term interest rates very low, which means the amount of interest generated by commercial banks is limited (Rosenbaum, 2015; Priti, 2016).

Zaman et al. (2013) conducted a study to determine the impact on interest rate on the profitability of commercial banks in Pakistan. A sample of 20 banks operating in Pakistan and listed in Karachi Stock formed the study. The study design was cross-sectional, and the data sources included the indexed Karachi stocks based on return, audited financial reports of the banks, publications of the State Bank of Pakistan, Press publications, and media reports. The outcome of the study confirmed that interest rate, deposit with the other banks, investment, and loans. It was established the interest rate (a key tool of monetary policy) has a significant impact on the profitability of banks. An increase in interest rates causes a higher lending rate more than the deposit rate, which results in profit because the bank spread is high. A reduction in the interest rate causes the deposit rate to move faster than the lending rate, which keeps the bank spread low.

The cash flow discounting model used by commercial banks calculates the value of stocks by discounting the cash flow in the future at the present discount rate. The discount rate depends on the prevailing market interest rates, which means a small change in the interest rates has a major impact on the banks stock valuation (Kozak, 2016; Koch, 2015). Furthermore, high-interest rates limit borrowing, which limits the cash flow to firms. The ultimate effect has reduced the profitability of firms, which affects the attractiveness and value of stocks.
According to KBA (2017), if one wants to save your money in Kenyan banks, the best type of account to open is a fixed deposit account. With this account, one will get the best interest rates on your deposits but only occurs if you save with the right bank. The first thing to consider before a customer can decide to save money in a bank is the stability of the bank. In Kenya, these are the banks with the most attractive interest rates on fixed deposit accounts.

2.4 Summary of Literature review and Research Gaps

A study by Folawewo and Tennant (2008), Beck and Hesse (2006), Aboagye et al (2008), Ikhide (2009) on interest rate spread with respect to African countries were too general and the scope was in Africa. A study by Folawewol and Tennant (2008) on the determinants of interest rate spread in 33 Sub-Saharan African (SSA) countries focusing on macroeconomic variables was too general and was conducted in developed countries compared to Kenya. Nduwayo (2015) examined effect of loan management on the financial performance of commercial bank using the case of Bank of Kigali. Nsambu (2015) examined factors affecting performance of commercial banks in Uganda using a case for domestic commercial banks.

Were and Wambua (2014) examined factors that drive interest rate spread of commercial banks using empirical evidence from Kenya. Langa (2014) examined effect of interest rates spread on the performance of banking industry in Kenya. Mang'eli (2012) utilizing descriptive research design in his study of relationship between interest rate spread and financial performance of commercial banks brings up that interest rate spread influence the execution of commercial banks, as it increment the cost of advances charged on the borrowers, controls on loan fees have broad consequences for execution of business since they decide the loan cost spread in banks and furthermore help alleviate moral dangers coincidental to execution of commercial banks, credit hazard administration system remotely influences the estimation of a bank's loan cost spread
financing costs are benchmarked against the related NPLs and NPLs is inferable from surprising cost of loans.

It can be concluded from the empirical evidence that most of the studies carried out focused on different aspects and countries which are more developed compared to Kenya which is a developing country. The study therefore seeks to find out the influence of interest rate capping on the financial performance of commercial banks in Kenya.

Table 2.1 Research Gaps

<table>
<thead>
<tr>
<th>Author/Year</th>
<th>Title</th>
<th>Findings</th>
<th>Gap</th>
</tr>
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<tbody>
<tr>
<td>Folawewo and Tennant (2008)</td>
<td>Interest rate spread in Africa</td>
<td>Interest rates affected significantly the performance of banks</td>
<td>The conclusions were too general for African countries and did not focus on interest rate capping</td>
</tr>
<tr>
<td>Nyakio Mbua (2017)</td>
<td>Effect of interest rate capping by the CBK on the banks listed on the NSE</td>
<td>Interest capping reduced returns to banks leading to poor performance</td>
<td>The study only confined to banks listed with NSE leaving out a majority</td>
</tr>
<tr>
<td>Nduwayo (2015)</td>
<td>Effect of loan management on performance of commercial banks; case of Bank of Kigali</td>
<td>Poor loan management rendered most banks insolvent</td>
<td>The study only focussed on loan management while our study is based on interest rate capping</td>
</tr>
<tr>
<td>Were and Wambua (2014)</td>
<td>Factors that drive interest rate spread of commercial banks using empirical evidence from Kenya</td>
<td>Client risk, government regulations and CBR</td>
<td>The study only focussed on interest rate spread which tags on risk management</td>
</tr>
<tr>
<td>Langa (2014)</td>
<td>Effect of interest rates spread on the performance of banking industry in Kenya</td>
<td>NPL rate dictates the spread of interest rates to cushion against loss</td>
<td>The findings were limited to non-performing loans and spread of interest rates</td>
</tr>
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2.5 Conceptual framework
A conceptual framework as a written or visual presentation that explains either graphically, or in narrative form, the main things to be studied, the key factors, concepts or variables and the presumed relationship among them. This study adopts the conceptual framework illustrated in the figure below;

![Conceptual Framework Diagram]

**Independent Variables**
- Central Bank Rate
  - Percentage
  - Volume
- Bank Prime lending rate
  - Percentage
  - Volume
- Deposit interest rates
  - Percentage
  - Volume

**Dependent Variables**
- Financial Performance of Banks
  - ROA
  - ROI
  - Market share

*Figure 2.1 Conceptual framework*

*Source: Author (2017)*
CHAPTER THREE
RESEARCH METHODOLOGY

3.1 Introduction

This chapter described the methodology that was used for collecting and analyzing the data in the study. It described the research design, population, and sampling technique, instruments for data collection and procedures, reliability and validity of the study. It also described how data was processed and analysed and ethical considerations to achieve the stated objectives.

3.2 Research Design

This study adopted a descriptive research design. Descriptive design is appropriate in social event information whose aim is to depict the idea of the current condition. It endeavors to depict attributes of subjects, conclusions, states of mind, inclinations and view of people important to the analyst (Orodho 2005). Descriptive research design is reasonable for this examination since it is typically the best techniques for gathering data that will show connections. In this study the researcher sought to establish the effects of interest rate capping on performance of commercial banks in Kenya. As per Mugenda and Mugenda (1999) the reason for spellbinding examination is to decide and report the way things are and it helps in building up the present status of the populace under investigation and is valuable for depicting, clarifying or investigating the current status of two or more variables.

3.3 Target Population

According to Ngechu (2004) a population is defined as a combination of people, animal and plants from which data can be collected. It is a large collection of individuals, objects or organizations that form the main focus of a scientific query. According to Coopers and Schindler
(2008), a population is also defined as the total collection of elements about which the researcher wishes to make inferences for the research. The target population was 42 commercial banks regulated and registered by the Central Bank of Kenya (Nairobi Securities Exchange, 2016).

3.4 Sampling Design

The researcher employed purposive sampling technique to select the sample for the population. Sampling technique refers to the process through which a sample size that is adequate and justified is selected for use. In this study all the commercial banks in the country were included in the study. Ryman and Bell (2011) noted that there are various ways that a researcher can use to get a sample size this includes probability and non-probability based sampling techniques. Furthermore, Bryman and Bell (2011) note that for small populations it is justified to include all the elements in the sampling frame as this reduces the sampling error. Since the sampling for this study was small, then a census survey was conducted. A census study involves the inclusion of all the elements in a sampling frame or population in a study (Bryman & Bell, 2011).

3.5 Data Collection Instruments and Procedures

The study relied on secondary data from the financial statements of the banks, CBK and KBA. Secondary data was obtained from the finance, operations and administration departments. A data collection sheet was availed to the management who filled it and share with the researcher upon completion.
3.6 Data Analysis and Presentation

All data was scrutinized to check for any inadequate or out rightly irrelevant responses. A Statistical Package for the Social Science (SPSS) was used to analyze quantitative data for means, standard deviation, inferential and regression analysis.

A regression model was applied for independent and dependent variables as follows;

\[ Y = \beta_0 + \beta_1 x_1 + \beta_2 x_2 + \beta_3 x_3 + e, \text{ Where,} \]

\[ Y = \text{Performance of commercial banks in Kenya} \]
\[ x_1 = \text{Central Bank Rate} \]
\[ x_2 = \text{Bank lending rate} \]
\[ x_3 = \text{Deposit rate} \]
\[ \beta_0 = \text{Constant} \]
\[ \beta_1, \beta_2 \text{ and } \beta_3 = \text{Coefficients} \]
\[ e = \text{Error term} \]
The Table 3.1 shows the operationalization and measurement of study variables.

**Table 3.1 Operationalization and measurement of variables**

<table>
<thead>
<tr>
<th>Objectives</th>
<th>Study variables</th>
<th>Measurement</th>
<th>Presentation</th>
</tr>
</thead>
<tbody>
<tr>
<td>To establish the effect of central bank rate on financial performance of commercial banks in Kenya</td>
<td>Central bank rate</td>
<td>Ordinal</td>
<td>Pearson correlation, regression model, ANOVA and regression coefficients</td>
</tr>
<tr>
<td>To analyse the relationship between banking lending rates on the financial performance of commercial banks in Kenya</td>
<td>Banking lending rate</td>
<td>Ordinal</td>
<td>Pearson correlation, regression model, ANOVA and regression coefficients</td>
</tr>
<tr>
<td>To assess the effect of deposit interest rates on financial performance of commercial banks in Kenya</td>
<td>Deposit interest rate</td>
<td>Ordinal</td>
<td>Pearson correlation, regression model, ANOVA and regression coefficients</td>
</tr>
</tbody>
</table>

**3.7 Ethical consideration**

A study permit was obtained from Kenyatta University before the study is conducted. Prior consent was sought from the commercial banks management as well as the consent from the selected respondents. During and after the study, confidentiality of the information received from the respondents shall be observed. All documents and source documents referred to were acknowledgement.
CHAPTER FOUR

RESEARCH FINDINGS AND DISCUSSION

4.1 Introduction

This chapter discusses data analysis, presentations and interpretation of the research findings. The chapter gives detailed explanation of the processes, techniques and procedures applied to analyze and present data acquired using questionnaires.

4.2 Response Rate

The study targeted the 42 banks listed at the NSE and data was obtained for all the Banks. This therefore created a response rate of 100%. According to Mugenda and Mugenda (2003), a 50% response rate is adequate, 60% is good and above 70% is rated very good. This also collaborate with Bailey’s (2000) findings assertion that a response rate of 50% is adequate, while a response rate greater than 70% is very goo

4.3 Descriptive Results

To establish the nature of association between the independent variables (central bank rate, lending bank rate and deposit interest rates) and dependent variable, a Pearson Correlation was performed. The study tested the correlation between the dependent (Financial performance) variable and the independent variables (central bank rate, lending bank rate and deposit interest rates). The main purpose was to determine the nature and strength of association between each of the independent variables and the dependent variable.
Table 4.1 Descriptive Statistics

<table>
<thead>
<tr>
<th></th>
<th>Mean</th>
<th>Std. Deviation</th>
<th>N</th>
</tr>
</thead>
<tbody>
<tr>
<td>Central bank rate</td>
<td>12.17</td>
<td>.0805</td>
<td>42</td>
</tr>
<tr>
<td>Lending bank rate</td>
<td>11.56</td>
<td>.1595</td>
<td>42</td>
</tr>
<tr>
<td>Deposit bank rate</td>
<td>32.46</td>
<td>.0258</td>
<td>42</td>
</tr>
</tbody>
</table>

The result in Table 4.1 revealed that the deposit bank rate spread has low standard deviation from the mean meaning that the data from the banks is closely related to each other. The lowest standard deviation was seen on the deposit bank rate 2.58%. However, the lending bank rate has a higher standard deviation meaning that it is widely spread from the mean. There was 15.95% standard deviation from the mean. The banks have different lending rate which depends on operating efficiencies depending on the level of technology, the size and economic of scale.

Table 4.2 Pearson Correlation

<table>
<thead>
<tr>
<th>Pearson Correlation</th>
<th>Performance of commercial bank</th>
<th>Central bank rate</th>
<th>Lending bank rate</th>
<th>Bank deposit rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Performance of bank</td>
<td>1.00</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Central bank rate</td>
<td>0.913</td>
<td>1.00</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Lending bank rate</td>
<td>0.819</td>
<td>0.901</td>
<td>1.00</td>
<td></td>
</tr>
<tr>
<td>Bank deposit rate</td>
<td>0.551</td>
<td>0.614</td>
<td>0.556</td>
<td>1.00</td>
</tr>
</tbody>
</table>

*. Correlation is significant at the 0.05 level (2-tailed).

Source: Researcher, 2019
4.3.1 Central bank lending rate and financial performance of commercial banks in Kenya

The result showed that there was a strong positive correlation between each of the independent variables and the dependent variable. Central bank rate scored a positive correlation coefficient (r = 0.913) with financial performance of commercial banks in Kenya, meaning that this variable is very important to commercial banks performance. Based on the findings it was evident that the performance of commercial banks in Kenya was significantly affected by the central bank rate. In addition central bank lending has a very crucial role of regulatory help to troubled financial institutions for a long past (Mwega, 2000).

The money that commercial banks lend to their borrowers earns income which is known as interest income. It is from this income that they get profit and also get money to fund their daily bank operations. This interest income however depends on the interest rate charged to the borrower. The introduction of interest rate capping law in Kenya controlled this interest rate at base rate of 4%. This has accordingly affected the performance of commercial banks in Kenya because they are unable to set their own interest of high profit margin. It is evident that this lowered the rate at which commercial banks lend money therefore gaining very little and more so suffering from a high level of non-performing loans. The findings collaborate with Jagongo et al. (2017) Effects of lowering Central Bank Rate on Bank’s Prime rate.

4.3.2 Bank lending rate and performance of commercial banks

Lending bank rate had a strong positive correlation with financial performance of commercial banks, (r = 0.819). The study showed that the existing bank lending rate can adversely affect the amount of money credit supply to commercial banks in Kenya where an increase in lending rate would increase to an increase in amounts available for credit and vice versa.
According to Irving Fisher’s theory of interest the real interest is the interest rate that lenders must have to be willing to loan out their funds. The study showed that banks were seen to have reduced the amount of credit to its borrowers as they feared to give loans to people due to the many risks involved. In addition, being that the lending rate had reduced as banks had to comply with introduction of the capping law, yields from interest rate lowered the banks profit margin as banks were not to give loans above the capped interest rate. This is contrary to the introduction of the interest capping rate where previously banks were able to give loans to up to 25% making high profit margins translating to commendable financial performance. The findings collaborate with Mwangi (2017) lending rate ration has a positive influence on commercial banks performance while deposits interest ratio impacts negatively.

4.3.3 Bank deposit rates and performance of commercial banks in Kenya

Deposit interest rates as well got a strong significant correlation with financial performance of commercial banks (r=0.551). Commercial banks pay out interest on deposits they hold, this interest is known as the interest expense. The study showed that the interest rate capping law affected the interest expense element of performance of commercial banks in Kenya as it affected the interest rate paid on deposits to customers. This was as a result of narrowed interest rate spread hence banks gaining very little from interest income. The results concur with Zaman et al. (2013) interest rate, deposit with the other banks, investment, and loans. It was established the interest rate (a key tool of monetary policy) has a significant impact on the profitability of banks. An increase in interest rates causes a higher lending rate more than the deposit rate, which results in profit because the bank spread is high. A reduction in the interest rate causes the deposit rate to move faster than the lending rate, which keeps the bank spread low.
4.4 Regression analysis

The study was done through the secondary collection of data that was available through the financial statements of banks that are readily available to the public. The analysis of the data was done to establish the relationship between the interest rate capping and commercial banks performance in Kenya. The performance was measured for the period between 2015-2017 financial years.

Table 4.3 Model Summary

<table>
<thead>
<tr>
<th>Model</th>
<th>R</th>
<th>R Square</th>
<th>Adjusted R Square</th>
<th>Std. Error of the Estimate</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>0.923</td>
<td>0.915</td>
<td>0.716</td>
<td>0.327</td>
</tr>
</tbody>
</table>

Source: Field data, 2018

The Table 4.3 above indicates the model summary. From the findings, R was 0.923, adjusted R square was 0.716 and R squared was 0.915. An R square of 0.915 implies that 91.5% of changes on performance of commercial banks are explained by the independent variables of the study. There are however other factors that influence performance of commercial banks are not included in the model which account for 8.5%. An R of 0.923 on the other hand signifies strong positive correlation between the variables of the study.

Table 4.4 ANOVA

<table>
<thead>
<tr>
<th>Model</th>
<th>SS</th>
<th>df</th>
<th>MS</th>
<th>F</th>
<th>Significance</th>
</tr>
</thead>
<tbody>
<tr>
<td>Regression</td>
<td>457.14</td>
<td>5</td>
<td>470.4</td>
<td>3.884</td>
<td>0.009</td>
</tr>
<tr>
<td>Residual</td>
<td>251.40</td>
<td>37</td>
<td>0.950</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>708.54</td>
<td>42</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: Researcher, 2019
From the ANOVA Table 4.4 above, the study was done at 5% significance level which is 0.05. The study provided a P-Value of 0.00 which is lower than the significance level of 0.05, thus interest capping rate has impact on performance of commercial banks. The overall regression model was significant and therefore a reliable indicator of the study findings. In terms of p values, the study indicated 0.000 which is less than 0.05 and therefore statistically significant.

Table 4.5 Regression Coefficients

<table>
<thead>
<tr>
<th>Variables</th>
<th>Unstandardized Coefficients</th>
<th>Standardized Coefficients</th>
<th>t</th>
<th>Sig.</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>B</td>
<td>Std. Error</td>
<td>Beta</td>
<td></td>
</tr>
<tr>
<td>(Constant)</td>
<td>1.454</td>
<td>0.311</td>
<td>5.720</td>
<td>.0000</td>
</tr>
<tr>
<td>Central bank rate</td>
<td>0.346</td>
<td>0.164</td>
<td>0.193</td>
<td>2.150</td>
</tr>
<tr>
<td>Bank lending rate</td>
<td>0.305</td>
<td>0.0481</td>
<td>0.0327</td>
<td>3.534</td>
</tr>
<tr>
<td>Deposit rate</td>
<td>0.251</td>
<td>0.0714</td>
<td>0.2325</td>
<td>3.626</td>
</tr>
</tbody>
</table>

Source: Researcher, 2018

In addition, the researcher conducted a multiple regression analysis so as to determine the relationship between performances of commercial banks and the three variables.

The regression model in Table 4.5 above also revealed that holding all the three factors, (central bank rate, bank lending rate and deposit rate) constant, financial performance of commercial banks in Kenya would be achieved at unit of 1.454. A unit increase in central bank rate would cause an increase in development of financial performance of commercial banks by a factor of 0.346, a unit increase in bank lending rate would cause an increase in financial performance of commercial banks in Kenya by a factor of 0.305 and a unit increase in deposit rate would cause an increase in financial performance of commercial banks in Kenya by a factor of 0.251.
Also, from the regression model in Table 4.5, the findings indicated that loan interest rate capping had (At 95% confidence level, \( P = 0.05 \)) a \( P = \text{Value} \ 0.000 \), a value less than the significance level of 0.05. This shows a strong relationship between loan interest rate capping as a factor influencing financial performance.

Secondly, central bank rate interest rate capping had a \( P = \text{Value} \ 0.006 \), connoting a strong relationship between central bank rate and the financial performance. Bank lending rate capping as a factor influencing financial performance scored a \( P = \text{Value} \ 0.007 \), which again indicating a strong relationship between bank lending rate capping and the financial performance. Finally, deposit rate capping as a factor influencing financial performance scored a \( P = \text{Value} \ 0.009 \). This is a clear indication that the entire three factors central rate capping, bank lending rate and deposit interest rate strongly influence financial performance of commercial banks in Kenya.
CHAPTER FIVE

SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

5.1 Introduction

This chapter highlights summary of the study, interpretation of the findings, conclusions and recommendations based study findings.

5.2 Summary of the study findings

The main aim of the study was to establish the effects of interest rate capping on the financial performance of commercial banks in Kenya. Commercial banks play a very key role in financial services in Kenya and consequently any failure in the sector would adversely affect the country’s economy. Interest rate capping is a relatively new law in Kenya as compared to other countries in the world. It is a law that has a heavy weight as it is an effective determinant of how commercial banks would lend and borrow money from their customers. Previously, bank interest rates were determined by market forces of demand and supply and banks would set their own interest rates. Being that interest rate is the key role of determining financial performance of commercial banks, this study was done to establish how the new interest rate capping had affected the performance of commercial banks in Kenya.

The study findings indicate all the factors had a significant influence on the financial performance of the commercial banks in Kenya. The findings indicate interest rate caps on r=0.761 and p=0.008 influence this means there is a significant and strong positive correlation between the loan interest rate and the commercial bank financial performance.

Therefore we can see there were a significant influence and a positive relationship between the interest rate caps on loans and the financial performance of the commercial banks in Kenya.
The results indicate there is a significant and positive relationship between the interest rate capping on the deposit and the financial performance of commercial banks of Kenya. The interest rate on deposit had $p=0.009$ which indicates significant and strong positive relationship between interest rate capping on deposit and financial performance of commercial banks.

The findings central bank rate interest rate capping had a $P=\text{Value } 0.006$, connoting a strong relationship between central bank rate and the financial performance. Bank lending rate capping as a factor influencing financial performance scored a $P=\text{Value } 0.007$, which again indicating a strong relationship between bank lending rate capping and the financial performance. Finally, deposit rate capping as a factor influencing financial performance scored a $P=\text{Value } 0.009$. This is a clear indication that the entire three factors central rate capping, bank lending rate and deposit interest rate strongly influence financial performance of commercial banks in Kenya.

### 5.3 Conclusions

From the study findings; the study concluded that all the variables tested in the study have a significant influence on the financial performance of the commercial banks in the Kenya. The introduction of interest capping had a negative impact on the financial performance of commercial banks as there was a narrowed interest spread leading to a reduction of lenders. There was an increase on non-interest income after the introduction of interest rate capping law even though the income was not sufficient to cover up the declined interest income.

The capping of the interest rate is expected to continue having adverse effect in the near future on the commercial banks in Kenya and the country’s economy as bank’s profit reserves would continue depleting. The banks on the other hand will tend to source for other ways of generating income for example introduction of new and hidden charges that were not there previously. This
would mean that borrowers who were meant to be favoured by the law would no longer be willing to work with commercial banks instead they would opt for other ways of acquiring loans.

Lastly capping the interest rates would mean that there will be limited access to credit as very few commercial banks will be willing to lend money especially to the private sector due to the high risk of default rate and non-performing loans. Further, it will be hard for the private sector to raise collateral required by these banks. This means some investment areas in the economy will be adversely affected due to very slow investment projects and very limited jobs opportunities. The country’s economy will as well slag.

5.4.1 Recommendation

The researcher recommends that the commercial banks’ management should be innovative to do product and service diversification to other non-intermediation roles relevant to the financial industry so as to achieve year by year growth in profits and achieve targets without proportionate increase in capital. This will also guarantee capital flow to the industry and especially for the listed banks as the share prices to a large extend mirror the performance of the company.

Banks management should ensure that central bank rate capping, bank lending rate and deposit interest rate are improved and maintained for an increased and sustainable financial performance of commercial banks. Banks managers in Kenya are encouraged to improve on these factors because they can add an immense value to the development of these institutions.

The banks should encourage customers towards mobile banking services because this will not only bring in income from interest on loans but there will also be a reduction on operation costs that are catered for via use of mobile services. Additionally, due to increased technology, it is
advisable for the bank to close off some of their branches that are in close proximity to one another and especially those with lower income to mitigate on costs.

The interest capping rate was imposed by central bank of Kenya to protect borrowers against exorbitant borrowing rates imposed by various banks. However, this has not worked since its imposition. Central Bank of Kenya should find new policies of protecting the borrower without slowing down the economic performance.

It is also recommended that commercial banks need to loosen on the restrictions on those that are borrowing from them. As much as interest charged is main source of the bank income there is a need for a favourable lending environment. The more customers borrow the more income the banks makes money from the interest rate and other charges. Further, the bank should carefully monitor and evaluate the customer before giving them the loan or can introduce effective measures to appraise a client’s worthiness.

5.4.2 Limitations of the study

One of the constraints of the study was the challenge of inadequacy of funds to meet all the financial obligations sufficiently. Anyway the researcher optimized accessible resources in the prevailing circumstances. Unwillingness of respondents to participate in giving required data is was a challenge. The issue was curbed by guaranteeing respondents that the investigation is just scholastic and their data was taken care of with privacy. The study findings might not apply to other sector players hence results may not be generalized. However, the examination focused on general effect of interest rate capping across all commercial banks in Kenya.
5.4.3 Recommendation for Further Research

This study focused on the banking sector listed at Nairobi Securities Exchange. There is therefore need for research in the other sectors so as to see the full impact on the NSE of the capping of interest rates. Further studies on the effect of the interest rate capping on the general economy can be done to establish whether there could be any noted effect in the economy such growth in the uptake of loans to fund businesses that is attributable to cheap credit or growth in bank deposits.
REFERENCES


52


Mang'eli, V. (2012). Making hydrochemical model of the shallow subsurface (with focus on nutrients) [A case of cross section in Lubigi Catchment, Kampala, Uganda].


APPENDICES

APPENDIX I: INTRODUCTION LETTER

Wangari Jane

Kenyatta University,

P.O. Box 702 – 60100,

NAIROBI.

RE: Request to fill in the Data collection sheet

Dear Respondent,

I am a graduate student at Kenyatta University, carrying out research on the influence of interest rate capping on financial performance of commercial banks in Kenya. This is in partial fulfillment of the requirement of the Master of Business Administration degree program at the Kenya University.

You have been randomly selected among many to participate in this study. It is estimated that it will take less than twenty (20) minutes of your time to complete the attached data collection sheet. Please respond as honestly and objectively as possible. Your participation is very essential for the accomplishment of this study and it will be highly appreciated. I guarantee that the information that you will provide will be treated with the utmost confidentiality and will be used only for academic purposes.

This is an academic research and confidentiality is strictly emphasized, your name will not appear anywhere in the report. Kindly spare some time to complete the questionnaire attached.

Thank you.

Yours faithfully,

Jane Wangari
**APENDIX II: DATA COLLECTION SHEET**

I am a student at Kenyatta University taking an MBA course. As part of my academic requirements I am carrying out a study on “Interest rate capping and financial performance of commercial banks in Kenya”. Please assist in filling this data collection sheet for the four quarters in the financial year 2016/2017 to enable me complete writing this research. Thank you.

<table>
<thead>
<tr>
<th>Item</th>
<th>1st quarter</th>
<th>2nd quarter</th>
<th>3rd quarter</th>
<th>Last quarter</th>
</tr>
</thead>
<tbody>
<tr>
<td>Central Bank Rate</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Bank prime lending rate</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Deposit interest rate</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Return on Assets</td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>Return on Investments</td>
<td></td>
<td></td>
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</tr>
<tr>
<td>Market share (%)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Customer numbers</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Volume of credit</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>NPLs</td>
<td></td>
<td></td>
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</tbody>
</table>
### APPENDIX II: LIST OF COMMERCIAL BANKS

<table>
<thead>
<tr>
<th>List of Commercial Banks</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. African Banking Corporation Ltd</td>
</tr>
<tr>
<td>2. Bank of Africa Kenya Ltd</td>
</tr>
<tr>
<td>3. Bank of Baroda (K) Ltd</td>
</tr>
<tr>
<td>4. Bank of India</td>
</tr>
<tr>
<td>5. Barclays Bank of Kenya Ltd</td>
</tr>
<tr>
<td>6. Stanbic Bank Ltd</td>
</tr>
<tr>
<td>7. Charterhouse Bank Ltd</td>
</tr>
<tr>
<td>8. Chase Bank (K) Ltd-In Receivership</td>
</tr>
<tr>
<td>9. Citibank N.A. Kenya</td>
</tr>
<tr>
<td>10. Commercial Bank of Africa Ltd</td>
</tr>
<tr>
<td>11. Consolidated Bank of Kenya Ltd</td>
</tr>
<tr>
<td>12. Co-operative Bank of Kenya Ltd</td>
</tr>
<tr>
<td>13. Credit Bank Ltd</td>
</tr>
<tr>
<td>15. Diamond Trust Bank Kenya Ltd</td>
</tr>
<tr>
<td>16. Dubai Bank Ltd-In liquidation</td>
</tr>
<tr>
<td>17. Ecobank Kenya Ltd</td>
</tr>
<tr>
<td>18. Equatorial Commercial Bank Ltd</td>
</tr>
<tr>
<td>19. Equity Bank Ltd</td>
</tr>
<tr>
<td>20. Family Bank Ltd</td>
</tr>
<tr>
<td>21. Fidelity Commercial Bank Ltd</td>
</tr>
<tr>
<td>22. Guaranty Trust Bank (Kenya) Ltd</td>
</tr>
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<td></td>
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<tr>
<td>---</td>
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<tr>
<td>23</td>
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<td>41</td>
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<tr>
<td>42</td>
</tr>
<tr>
<td>43</td>
</tr>
</tbody>
</table>

Source: CBK (2015)
APPENDIX III: APPROVAL OF RESEARCH PROPOSAL

KENYATTA UNIVERSITY
GRADUATE SCHOOL

P.O. Box 43844, 00100
NAIROBI, KENYA
Tel. 810901 Ext. 4150

Internal Memo

FROM: Dean, Graduate School
TO: Mweresa Wangari Jane
     C/o Accounting and Finance Dept.

DATE: 31st August, 2018
REF: D53/OL/CTY/26917/2015

SUBJECT: APPROVAL OF RESEARCH PROJECT PROPOSAL

This is to inform you that Graduate School Board at its meeting of 22nd August, 2018 approved your Research Project Proposal for the M.B.A Degree Entitled, “Interest Rate Capping and Financial Performance of Commercial Banks in Kenya”.

You may now proceed with your Data Collection, Subject to Clearance with Director General, National Commission for Science, Technology and Innovation.

As you embark on your data collection, please note that you will be required to submit to Graduate School completed Supervision Tracking Forms per semester. The form has been developed to replace the Progress Report Forms. The Supervision Tracking Forms are available at the University’s Website under Graduate School webpage downloads.

Thank you.

HARRIET ISABOKE
FOR: DEAN, GRADUATE SCHOOL

C.c. Chairman, Accounting and Finance.

Supervisors:

1. Dr. Fredrick Ndede
   C/o Department of Accounting and Finance
   Kenyatta University
APPENDIX IV: KENYATTA UNIVERSITY RESEARCH AUTHORIZATION LETTER

KENYATTA UNIVERSITY
GRADUATE SCHOOL

E-mail: dean-graduate@ku.ac.ke
Website: www.ku.ac.ke

P.O. Box 43844, 00100
NAIROBI, KENYA
Tel: 8710901 Ext. 57530

Car Ref. DEE-OL/CTY/26917/2015

DNR: 374 August, 2013

Director General,
National Commission for Science, Technology
and Innovation
P.O. Box 30623-00100
NAIROBI

Dear Sir/Madam,

RE: RESEARCH AUTHORIZATION FOR MWERESA WANGARI JANE – REG. NO.
D53/OL/CTY/26917/2015.

I write to introduce Mweresa Wangari Jane who is a Postgraduate Student of this University.
The student is registered for M.B.A degree programme in the Department of Accounting and
Finance.

Mweresa intends to conduct research for a M.B.A Project Proposal entitled, “Interest Rate
Capping and Financial Performance of Commercial Banks in Kenya”.

Any assistance given will be highly appreciated.

Yours faithfully,

PROF. PAUL OKEMO
FOR: DEAN, GRADUATE SCHOOL
APPENDIX V: NACOSTI RESEARCH AUTHORIZATION LETTER

NATIONAL COMMISSION FOR SCIENCE, TECHNOLOGY AND INNOVATION

Ref: No. NACOSTI/P/18/57156/25870
Date: 13th October, 2018

Jane Wangari Mwereza
Kenyatta University
P.O. Box 43844-00100
NAIROBI.

RE: RESEARCH AUTHORIZATION

Following your application for authority to carry out research on “Interest rate capping and financial performance of Commercial Banks in Kenya” I am pleased to inform you that you have been authorized to undertake research in Nairobi County for the period ending 12th October, 2019.

You are advised to report to the Chief Executive Officers of selected Commercial Banks, the County Commissioner and the County Director of Education, Nairobi County before embarking on the research project.

Kindly note that, as an applicant who has been licensed under the Science, Technology and Innovation Act, 2013 to conduct research in Kenya, you shall deposit a copy of the final research report to the Commission within one year of completion. The soft copy of the same should be submitted through the Online Research Information System.

BONIFACE WANYAMA
FOR: DIRECTOR-GENERAL/CEO

Copy to:

The Chief Executive Officers
Selected Commercial Banks.

The County Commissioner
Nairobi County.