

**EFFECT OF INTEREST CAPPING ON FINANCIAL PERFORMANCE OF
COMMERCIAL BANKS IN KENYA. A CASE OF TIER ONE COMMERCIAL
BANKS IN NAIROBI COUNTY**


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DECLARATION

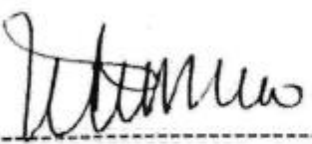
I declare that this applied research project is my original work and that it has not been presented in any other University for academic credit

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We have examined this document and the research has met or exceeded the requirement for the degree sought, in addition, the candidate has sufficiently defended the material presented to merit the awarding of the degree of Masters of Business Administration.

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DEDICATION

I record my dedication sincerely to my late Dad Peter Nyangau for his immeasurable support and steerage in my life. He taught me discipline that drives me to handle tasks with ardent spirit and determination. Without his undeserving and unmerited love, this far wouldn't have been made possible.

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ABSTRACT

The financial performance of commercial banks is partly obsessed with interest unfold, the distinction in interest rates charged on loans and what's paid to suppliers of funds. Charge per unit volatility includes a negative impact on the financial performance of commercial banks motility a challenge to banks managers in their core operations of credit management and profit. On the other hand, an increase in interest rates interprets to higher returns on new investments, exaggerated profit margins on loans, and improved earnings from trading. The purpose of the study was to assess the effect of interest rate capping on financial performance of tier one commercial banks in Kenya. It focused on credit supply, interest cost, interest rate spread and interest income and financial performance. The targeted population of the istudy was five hundred employees of tier one commercial banks in Kenya in the ranks of senior management, middle management and lower level management. Eighty (80) respondents were sampled using stratified sampling method. Primary data was collected with the help of self-administered questionnaires. The collected data was cleaned, edited and analyzed using SPSS statistical tool. To assess the effect of interest capping on the performance of the banks, descriptive statistics, Pearson's correlation and regression analysis were used. The multiple regression results revealed that the identified interest rate capping factors had a significant positive relationship with the performance of commercial banks ($R = 0.757$). The coefficient of determination (R^2) revealed that the identified interest rate capping factors collectively explained 57.4% on the performance of commercial banks, while 42.6% could be explained by other factors beyond the study. It was concluded that credit supply, cost of interest, interest rate spread and interest income influenced the financial performance of tier one commercial banks in Kenya. It was recommended that interest rate capping being a norm practiced all over world should be upheld to regulate the financial sector effectively so that people and companies can borrow and improve businesses which in effect grows the economy. Banks can benefit from growth on number and volume of borrowings thus making more profits.

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LIST OF ABBREVIATIONS

CEMAC	Central African Economic and Monetary Community
GIZ	Gesellschaft für Internationale Zusammenarbeit
NBFIs	Non-Bank Financial Institution
SSA	Sub-Saharan Africa
UK	United Kingdom
US	United State
USA	United State of America
WAEMU	West African and Monetary Union
CBR	Central Bank of Kenya Rate
APR	Annual Percentage Rate
ECA	Europe and Central Asia.
LAC	Latin America and the Caribbean.

OPERATIONAL DEFINITION OF TERMS

Financial performance – is an indicator of how profitable a company is relative to its total assets and is measured by return on assets (Kavwele, Ariemba, & Evusa, 2018).

Interest Rate Cap - this refers to a ceiling placed on interest rates. It dictates the maximum rate that a bank can charge its customers on loans (Mbengue, 2013).

Tier 1 banks - are Large banks (tier I banks) which had asset size of over 15 billion shillings (Central Bank of Kenya, 2018).

Supply of Funds –refers to volume of deposits in banks which has a significant impact on the volume of bank lending. A positive relationship is expected between this variable and level of credit in the bank (Olokoyo, 2011).

Credit Supply: is the trust which allows one party to provide money or resources to another party where that second party does not reimburse the first party immediately (Irungu 2013).

Interest Income: is the amount of interest that has been earned during a specific time period (Irungu 2013).

Interest Costs: is the cumulative amount of interest a borrower pays on a debt obligation over the life of the borrowing (IFF/ZEW 2010).

Interest Rate Spread: is the difference between the average yield a financial institution receives from loans, along with other **interest**-accruing activities; and the average **rate** it pays on deposits and borrowings (IFF/ZEW 2010)

CHAPTER ONE: INTRODUCTION AND BACKGROUND OF THE STUDY

1.1 Introduction

The purpose of this chapter is to assess the background of interest rate capping and the performance of tier one banks. The chapter will also focus on statement the problem, objectives, scope, significance, limitations and delimitations as well as the theoretical and conceptual framework governing the study.

1.2 Background of study

Interest rate caps are existing over the decades though with restricted use due to the perceived barriers that exist in the economy. The capping of interest rates implies that the rates will be modified however within limits. The Kenyan situation is that disposal rate of interests are set at most of four percent on top of the Regulator (Central Bank of Kenya) rates, whereas deposit rates are set at a minimum of 70% of CBK rates. Each government adopts different ways up to and as well as a completely rigid system or a versatile system wherever discrimination in capping rates on the type of loan and therefore the form of investors (Central Bank of Kenya, 2018).

Understanding the impact of capping on Commercial banks, requires an indepth iunderstanding of theiinterest rate composition. The banking interest rates are composed of 4 major parts such as bank profitablity, provision for non-performing loans, overheads and then the actual value of funds. Each institution exists to maximize wealth return for shareholders through profitableness,and for this to be achieved expenses ought to be met by the recipient. The borrowers additionally have to bear the number of loans that would be written off thanks to nonperformance.

Expenses be they fixed or variable and prices relating to those that banks incur in running their establishments, appropriate salaries, the value of their enlargement, loan process fees and technological prices (Central Bank of Kenya, 2018). Prices vary from bank to bank inflicting a monetary strain once caps are placed on the banks.

In the USA, the Reserve Bank controls banking establishments, wherever caps exist in some states, however, limits vary. Like Arkansas state and Connecticut have the lowest caps at 17%. (Maimbo & Gallegos, 2014). The UK has an absolute associate rate of interest ceiling of two percent monthly for credit unions, and Greece caps the credit rate of non-commercial banks at 6.75 % per annum (Iff/ZE, 2010). Western Europe nations, like Belgium use law, regulates interest rates consistent with the dimensions and compensation amount of the loan (Iff/ZEW, 2010). In the case of France, the rate of interest capping has been there since 1935. The ceiling presently, is at 133 % of the common APR, counting on the worth of the loan granted. Additionally, Germany contains has a Usury law commercial banks ate expected to compley with when lending loans. The Usury Law regulates the amount of interest that can be charged on a loan. The law stops loan interests from doubling the value of loans, the rate of interests in different sectors or average interest rate within the business by twelve percentage points in the banking industry (Lysenko, 2021). Ceilings, in this case, are applicable on banks and non-banking monetary sectors. In Italy the Usury law allows interest rates for loans to be below fifty percent of the APR applied by each bank and financial intermediaries.

In the Middle East and North Africa, six countries use rate of interest caps on loans. In Malta, interest rates caps started in 1868 civil code (Iff/ZEW, 2010). 14 Nations in Latin America and also in Caribbean , cap interest rates on loans, just like the ECA region, LCA countries the most interest rates that money establishments will charge are encoded in usury laws (Porteous, Collins & Abrams 2010).

In the case of Chile, the law that sets most interest rates on loans started in 1981 wherever banks cannot go on top of fifty percent the present interest rates set at the time of the convention (Flores, Morales, & Yáñez, 2005). In the case of Paraguay, since the 1995 rate of interest controls on many segments that can't go on top of 30% the mean of the most annual interest rates banks charge. Argentina in 1998 established most interest rates banks charge over credit cards not surpassing 25% (Capera, Murcia, & Estrada, 2011).

In addition, three South Asian countries that include India, Bangladesh, and Pakistan use rate of interest cappings. People's Republic of Bangladesh cap is twenty-seven percent for microcredit loans from 2011 (Economist Intelligence Unit, 2012). India controls the rate of interest since the year 2011 set at 26 percent. Pakistan has no law imposing ceilings on interest rates; they use on the side repress through government subsidies, which are thought-about an actual management regime. In 2004 the Pakistan government declared the associate annual rate of interest cap of 9.5% on agricultural loans (Maimbo, 2014).

Interest rate capping has also been partially applied in East Asia and Pacific where seven countries in East Asia and Pacific use interest cappings rates. Japan, has the oldest history from 1954 capped rates at 20%, (Porteous, Collins, & Abrams, 2010).

Thailand uses its civil code at the most rate of interest of 15% for loans granted by non-Government owned financial establishments (EIU, 2012; 2013). Myanmar applied controls on interest rates for microfinance and bank disposition and enforced a replacement law in 2011 that caps interest rates for microloans at 2.5% monthly or 30% annually (GIZ, property report 2013; Duflos et al., 2013).

In Sub Saharan Africa (SSA), interest rates are capped in twenty-four countries. The following eight countries within the West African Economic and financial Union (WAEMU) (IMF report, 2014) (Benin, Burkina Faso, Ivory Coast, Republic of Guinea-Bissau, Mali, Niger, Senegal, & Togo), others are African countries like, Ethiopia, Ghana, Guinea, Mauritania, Namibia, Nigeria, South Africa, and Sudan. Six countries in CEMAC and Republic of Zambia additionally apply the rate of interest caps. South Africa has created many changes in its rate of interest cappings. First, the authorities signed associate exemption within the usury law to get rid of small loans from the rate of interest ceilings in 1993. Then, after a decade with no cap on small loans, a National Credit Act went into place from 2007 that brought in a cap on microloans and introduced a cap of 5% per month on short-run loans as a part of an integrated credit framework. Besides, the act acknowledges seven credit subsectors with completely different most interest rates coupled to a benchmark rate set by the Central Bank. Bank fees also are capped (Porteous, Collins, & Abrams, 2010). The members of West African Economic and Monetary Union (WAEMU) established the rate of interest controls from 1997 and introduced their ceilings by three percent in 2013. Banks currently charge the most rate of interest of 15%, and the most rate of twenty-four percent for microfinance

establishments (MFIs) (Mbengue, 2013). In Egypt, civil and business transactions are subjected to a ceiling of seven percent. However, banks will confirm their interest rates freely (Allaire et al. 2009). Algeria, Libya, and Syria additionally manage interest rates on loans (Porteous, Collins, & Abrams, 2010). Tunisia has had a microcredit law from 1999 that sets a ceiling on interest rates on loans at 5 % as well as all commissions and charges, as a result the law applies solely to native associations, the cap isn't enforced on the international NGOs, ENDA-IA (Allaire et al. 2009; Khaled 2011).

The National bank of Ethiopia removed all rate of interest ceilings within the money sector in 1998. Nevertheless, even without the rate of interest ceilings the country has seen most microfinance establishments choose to take care of a lower rate of interest, primarily for political reasons. Continued with the trend of introducing a rate of interest controls in African countries, Central African Economic and financial Community (CEMAC) that has countries like Cameroon, the Central African Republic, Chad, Congo, Equatorial Guinea, and Gabon capped interest rates from 2012. The microfinances use price ceiling which is calculated using the average effective rate of interest charged by non-banking financial establishments throughout the previous six months and a margin of thirty-three percent. From 2013, Republic of Zambia introduced a cap on business disposition at nine percentage points over the policy rate (Musiitwa, 2018). It additionally introduced a ceiling on the effective annual rate of interest on loans charged by nonbanking financial institutions (NBFIs). The rate of interest ceiling is currently forty-two percent for NBFIs selected as

microfinance service suppliers by the Central Bank of the Republic of Zambia, whereas rates charged by alternative NBFIs are not to exceed thirty percent (Musitwa, 2018).

1.2.1 Banking Sector in Kenya

Kenya had a complete forty-two Commercial banks and one mortgage non-depository financial institution with two banks (Central Bank of Kenya, 2016). These Commercial Banks are classified into three completely different categories betting on the market share, asset base, advances, Client deposits and pre-tax profits by Central Bank of Kenya. According to (CBK, 2013). Giant banks (tier I banks) that had an asset base of over fifteen billion shillings, medium banks (tier II banks) that had five billion shillings whereas small banks (tier III banks) had a size of fewer than five billion shillings. Six banks were classified as Tier I banks, fifteen as tier II banks whereas twenty-three were tier III banks (CBK, 2013). Solely, nine Commercial banks were listed within the Capital stock market (Barclays Bank, CFC Stanbic Holdings, Diamond Trust Bank, Equity Bank, Kenya Commercial bank, Standard Chartered Bank of Kenya, NIC Bank, National Bank of Kenya and also the Co-operative Bank of Kenya). The primary functions of Commercial banks are to accept deposits from customers, facilitate the transfer of money, and also acting as an intermediary between savers and borrowers. In 2016, the Kenyan government assented to the Banking (Amendment) Act, 2015 that capped interest rates at four percent higher than the Central Bank of Kenya rate, which presently stands at a simple fraction. Before the law, banks were charging between eighteen and thirty percent for loans advanced to their customers reaping vast profit (Xinhua, 2017).

1.2.2 Tier 1 Commercial Banks

Central Bank of Republic of Kenya (2020) noted that the forty-two Banks were classified into 3 groups; Tier one, Tier two and Tier three. This can be supported through weighted index of all their assets, capital, and reserves, client deposits, range of loans and deposit accounts. Only eight banks were classified as tier one by the CBK with over fifteen billion plus asset base (bankingbanner, 2020). Tier one banks manage over 50% of the market and they include: Kenya Commercial Bank (KCB), Equity Bank, Co-operative Bank, Standard Chartered Bank, Barclays Bank, Stanbic Bank, Diamond Holding Trust and Commercial Bank of Africa. (CBA). Equity bank, Co-operative bank, Stanbic Bank, Diamond Trust Hplding Bank and CBA are non-public native banks whereas KCB is a native bank with government participation. Standard chartered Bank and Barclays Bank are foreign banks (Central Bank of Kenya, 2020). The Central Bank of Kenya (CBK) ranking of the Kenyan banking sector was done in December 2015. The classification is predicated on the performance of the banks and whether or not they are native banks, foreign banks or they're native banks with government participation. The tier system is simply a distinctive criterion and not a cause for bank instability (Ayugi, 2016).

1.3 Statement of the Problem

The financial performance of commercial banks is directly linked with its interest spread and the gap in interest rates charged on loans and what is paid to suppliers of funds. Charge per unit volatility contains a negative impact on the financial performance of business banks posing a challenge to business bank managers in their core operations of credit management and gain. On the other hand, a rise in interest rates interprets to higher returns on new investments, increased profit

margins on loans, and improved earnings from trading. However, with the interest capping that brought down the interest rates charged by banks from regarding twenty-five percent to fourteen percent lowers the profit margin on loans (Wambari & Mwangi, 2017).

Interest capping has had a significant negative impact on the performance of commercial banks according to Kavwele, Ariemba and Evusa (2018), who ascertained that a day after the assent of the interest capping bill, the Nairobi Securities Exchange (NSE) twenty Share Index nine financial institutions lost 152.92 points (4.4%) to hit 3,309.76. The biggest plunges were recorded and as a results the bank's stock performance in the market declined by 11% (Kavwele & Evusa, 2018). Therefore, this study investigated the consequences of interest rating capping on the financial performance of tier one commercial banks in Kenya.

1.4 Purpose of the Study

The core purpose of this study is to establish the effects of interest rate capping on financial performance of commercial banks in Kenya. A case of tier one commercial banks in Nairobi, County.

1.5 Objectives of the Study

1.5.1 General Objective

The objective of the study was to establish the effect of interest rate capping on financial performance of tier one commercial banks in Kenya.

1.5.2 Specific Objectives

- I. To examine the effect of credit supply on financial performance of tier 1 commercial banks in Kenya.

- II. To determine the effect of interest costs on financial performance of tier 1 commercial banks in Kenya.
- III. To evaluate the effect of interest rate spread on financial performance of tier 1 commercial banks in Kenya.
- IV. To assess the effect of interest income on financial performance of tier 1 commercial banks in Kenya.

1.6 Research Hypotheses

The study hypothesis are as listed below;

- I. Credit supply has no significant effect on financial performance of tier 1 commercial banks in Kenya.
- II. Interest cost has no significant effect on financial performance of tier 1 commercial banks in Kenya.
- III. Interest rate spread has no significant effect on financial performance of tier 1 commercial banks in Kenya.
- IV. Interest income has no significant effect on financial performance of tier 1 commercial banks in Kenya.

1.7 Significance of the Study

This study will be of importance to several groups of stakeholders. The study will be of great importance to the government officers who are policymakers. They will gain insights, and evaluate the effects of the capping law on the availability of credit in the economy and which areas of the economy is adversely affected by the law. It will go further to clearly show whether the law has achieved its primary purpose and if there is any need to review the law. Secondly, the study will be significant to the management of the

commercial banks will show how the interest capping influence the financial performance of tier 1 commercial banks. Thirdly, the shareholders will be able to get an understanding of how the decision to cap interest rates will actually affect their wealth and also assess whether it is still prudent to invest in the banking industry and whether to reduce or increase their investments. Besides, the study will also contribute to the addition of literature reviews and findings which will benefit the researchers and academicians.

1.8 Scope of the Study

The population for this study was all the commercial banks which operate under the banner of tier 1. The literature review focused on the study four variables; credit supply, interest cost, interest rate spread and interest income. The study was conducted within Nairobi County and was completed within a period of six months.

1.9 Limitations of the Study

One of the most critical limitations of the study was that of time. This is often as a result of rate capping began in 2016 in Kenya that indicates a brief moment, whereas interest capping influence could also be well known during a long time span. This was overcome by incorporating secondary information like financial statements by affected tier one commercial bank. The analysis was also done quarterly to make the data large enough for analysis. Lack of collaboration, another challenge and the researcher handled this by being persistent and consistent. In addition, it was also overcome by providing the introductory letter from faculty helping in building confidence from the .

1.10 Delimitations of the Study

The study did not specialize with tier two banks and Tier three. These are banks that had a lower weighted index on assets, capital, and reserves, client deposits, the range of loans and deposit accounts. The banks not studied had a lower market share with under fifty percent combined, thus, could not offer enough knowledge for the study.

1.11 Theoretical Review

The theoretical review consists of loanable funds theory, the theory of balanced portfolio, theory of liquidity preference and rational expectations theory as reviewed below.

1.11.1 Loanable Funds Theory

Mckinnon (1973) noted that the loanable fund's theory of rates of interest was originated by Ohlin. The opinion indicates that rates of interest are determined by the provision and demand for loanable funds. With this respect, this theory is broader and realistic than the normal theory of interest. In his argument, Ohlin tried to enhance on the quantity theory of interest by recognizing that currency play associate treater role in investment and saving processes, and this may cause disparities within the level of financial gain. Thus, he introduced the money approach to the traditional theory of interest.

The loanable fund's theory argues that rate is that the value equates the provision and demand for loanable funds. Therefore, the soundness purpose wherever provide equals demand for funds on the market for loans each borrower/investors and savers are satisfied with the result. However, variations either within the provider of funds or demand for loans on the market could cause fluctuations within the rate. (Turnovsky, 1985) Termed loanable funds as the sums of cash

equipped and demanded at any time within the securities industry. He aforementioned that the funds on the market for disposal and also the provision of credit would be subjective by the savings folks created and even the additions to the currency provided during a given amount. The demand facet of the loanable would be determined by the demand for cash and the need for investments. The Loanable fund theory contains a suggestion of banks borrowers and savers (Emmanuelle, 2003).

The theory is of excellent importance to the interest income and interest spread variables as credit provision is set by the quantity of savings that are deposited within the banks at intervals. Further , the higher the interest value, the higher the prices are going to be a financial gain to banks. Also, the interest financial gain is influenced by the interest within the market with the higher the rate, the more financial gain is received by the banks.

1.11.2 Theory of Balanced Portfolio

The portfolio theory approach plays a critical role in bank performance studies (Nzongang & Atemnkeng, 2006). Consistent with the Portfolio balance model of quality diversification, the optimum holding of every quality in a very wealth holder's portfolio may be an operation of policy selections determined by variety of things like the vector of rates of return on all assets within the portfolio, a vector of risks related to the possession of monetary assets and also the size of the portfolio. It implies portfolio diversification and even the desired portfolio composition of commercial banks are results of choices taken by the bank management. Further, the power to get most profits depends on the possible set of assets and liabilities determined by the administration and also the unit prices

incurred by the bank for manufacturing every part of assets (Nzongang & Atemnkeng, 2006).

According to Engelmann (2011), the danger of credit offer may be a crucial issue. Most of the recent bank failures were connected, in part, to banks holding risky loans that went into default. What is more, several of the banks were actively, and chop-chop is increasing their deposit bases to finance the risky loans. In essence, bank failures could appear no worse than alternative business failures. However, bank failures will do substantial injury by interrupting the profitable investment of bank customers. In handling the danger of loan portfolios, bank regulators have targeted on restrictions on bank behavior and careful observance of banks which are proof against introducing a risk adjustment to deposit insurance premiums. There are many sensible reasons why risk sensitive insurance premiums would be difficult to implement, particularly for the state. It's onerous to urge helpful information regarding the standard of these bank loans that there's no secondary market, not to mention objective information that might justify a governmental policy alternative (Engelmann, 2011).

Despite its theoretical importance, critics of BPT question whether or not it's a perfect investment tool as a result of its model of economic markets doesn't match the real world in some ways (Yilmaz, 2009). The risk, return, and correlation measures employed by BPT are supported by expected values, which implies that they're mathematical statements regarding the longer term (the first moment of returns is express within the on top of equations, and inexplicit the definitions of variance and covariance). I observe, investors should substitute predictions

supported actual measurements of quality come and volatility for these values within the equations. Reasonably often such expected values fail to require an account of recent circumstances that didn't exist once the historical information was generated. Additionally, basically, investors are cursed estimating crucial parameters from past market information as a result of BPT attempts to model risk concerning the chance of losses, however, says nothing regarding why those losses would possibly occur (Yilmaz, 2009).

The balance portfolio theory is important to the financial performance variable of the study because it involved with the employment of the varied bank's assets to maximize profits. Lower charge per unit indicates that the banks can receive higher deposits which can influence the monetary performance. Moreover, the interest price born by the Commercial banks can affect the financial performance of the banks.

1.11.3 Theory of Liquidity Preference

This theory was developed by John Keynes in 1936. This theory explains the concept of demand and supply of money in the financial system with the interest rates. The theory holds that, income and interest rates are the functions of the demand for money in an economy. This theory shows the interaction of demand and supply of funds where stock regulates the interest rate. Keynes (1936) stated the following motives when money is demand; speculative, transaction and precautionary motive. He also indicated that investors would be more inclined to choose short-term securities to long-term securities.

This is done by encouraging them to embrace long-term bonds, and hence higher interest is yielded by long-term securities than short-term bonds. Thus, the yield curve will at all times be upward sloping. This is based on, all other factors being equal, people choose to hold on to cash (liquidity) and that they will demand a premium for investing in non-liquid assets such as stocks, bonds, and real estate. The theory suggests that the term for getting the cash back increases as the premium demanded parting with cash raises.

Howels and Bain (2007), tell us an improved inclination for liquidity in the model is the same as to raise demand for money and hence the demand for money increases wherever a larger group of people think that the interest rates are likely to hike than believes they are likely to go down. Thus the study seeks to identify the effects of interest rate capping on the financial performance of tier 1 commercial banks. On the contrary, borrowers will only capitalize where the returns on their investment profile exceed the rates of borrowing.

The suggestion of the theory is that, different financial institutions have different liquidity, when the theory is applied, banks with huge liquidity should charge low-interest rate on lending in order to draw more borrowers and rate of interest on savings should be low in order to depress savings or if it charges the same rate as other financial institutions on cash borrowed then the rate of interest on saving should remain minimal. Thus, the spread of the rate of interest on banks which prefer liquidity should be relatively more than those that don't prefer cash (Barber & Odean, 2011).

The theory supports the study on the credit supply and credit income variable which is determined by the amount of savings that are deposited in the banks within a particular period will influence the financial performance of tier 1 commercial banks. Further, the higher the interest cost will be income to banks. Also, the interest income is influenced by the interest in the market with the higher the interest rate, the more revenue is received by the banks which affect the liquidity of the banks.

1.11.4 Rational Expectations Theory

The theory of rational expectations of interest rates is made on the assumptions that each one the knowledge that's on the market within the market is what's employed by folks to formulate expectations (Bekaert, 1998). The idea underscores that assessment for future rates of rates is that the changes in current interest rates that are chiefly caused by unforeseen data and shifts in economic factors. The rational expectations theory are often combined with the loanable fund's theory to grant higher thought to the prevailing information inside the economy.

Restraining factors of rational expectation theory are often joined to the struggle of assembling information and know-how of however uses of the general public gathered material to create their prospects (Caplan, 2000). So folks avoid borrowing if they expect that interest the speed can which can affect the bank's routine thanks to reduced earning on rates of interest. On the contrary, if folks are of the read that the rates of interest can drip they might be able to borrow. This will, as a result, improve banks performance thanks to growth in rate attained.

The rational expectation theory is anchored to the interest cost variable of the study in that interest rate capping influences financial performance of tier one business banks as credit provided is decided by the number of savings that are deposited within the banks inside a selected amount, so once customers avoid borrowing, then interest financial gain is affected. Further, the upper the interest value higher the prices are going to be that are financial gain to banks. Also, the interest financial gain is influenced by the interest within the market with the upper the rate; the additional revenue is received by the banks.

1.12 Conceptual Framework

The conceptual framework consists of the dependent variable that is the financial performance of tier 1 commercial banks. It also involves the independent variables which include: credit supply, cost of operations, interest rate spread and interest income as represented by figure 1.1 below.

Independent Variables

Dependent Variable

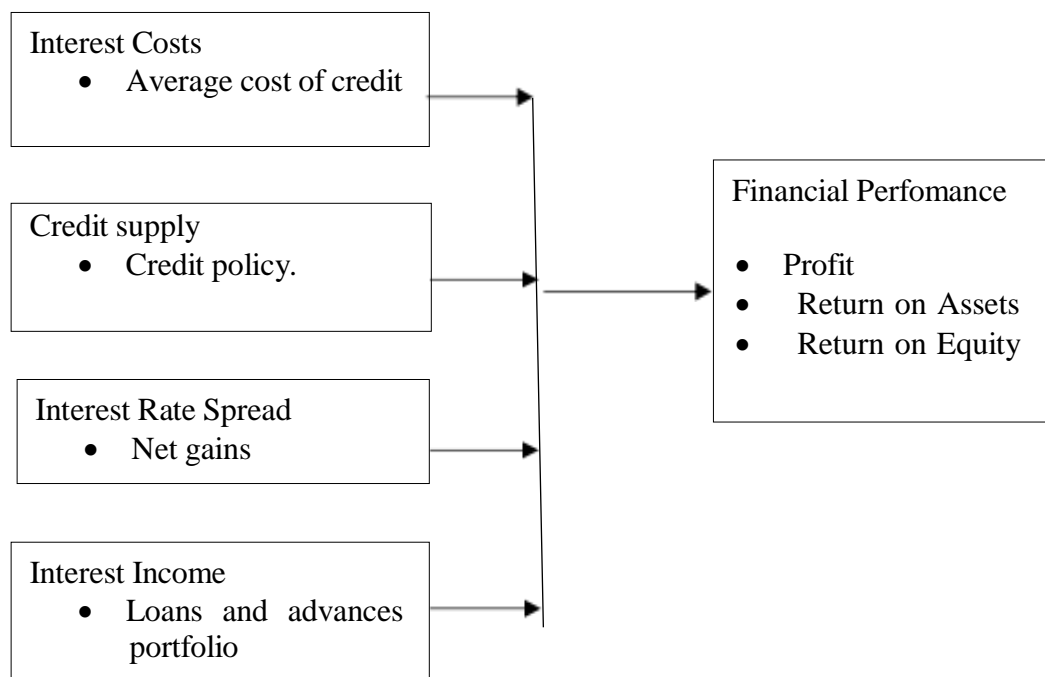


Figure 1. 1: Conceptual Framework

Source: Researcher (2021)

1.13 Assumptions of the study

The study assumes that the respondents will cooperate and will be able to get honest answers from the target audience since the questionnaires will be very open for them target audience to explain themselves exhaustively. Confidentiality of the information will also be highly guaranteed to allow the population to answer the questions with honesty. Additionally, the study assumes that the research will be completed in the given timeline.

CHAPTER TWO: LITERATURE REVIEW

2.1 Introduction

The purpose of this chapter is to review the literature related to the effects of interest rates capping on the financial performance of tier 1 commercial banks. It focused on review of the empirical literature with the aim of identifying and justifying the study gap from the summary of the review.

2.2 Empirical Review

The empirical review focused on the credit supply, cost of operations, interest rate spread and interest income and their influence on the performance of tier 1 banks as follows.

2.2.1 Credit Supply and Financial Performance

A study applied by (Wanja, Mwaura & Dorcas, 2013) geared toward work the results of credit policy used by business banks on their performance terminated that the nature terms and conditions connected to loan had a major impact on the aggressiveness of the bank and therefore the size of loan applications received by the bank on a small low extent. Finally, the study terminated that the majority monetary establishments to an outsized extent suppose the previous credit history of the recipient, his account movement and his behavior in award loans. The findings of the investigation portrayed that the status of the credit policies employed by the commercial banks dictates on the volumes of loans procured by commercial banks and thus bank's competitiveness in lending and performance in the industry.

Study on the link between the disposal and bank competition in Bangladesh (Miyachi, 2017) once rate caps found that bank branches that accustomed charge higher interests before the regulation reduced the rate a lot of once the second quarter. Also, banks that accustomed charge the next rate exaggerated the credit provide a lot of right once the introduction of the cap. The magnitude was important that's mathematical notation increase of the pre-regulation rate induced 17 percent increase of the outstanding quantity and 11percent increase of the number of loans in one year after the introduction of the cap. Besides, exaggerated credit provides failed to dissipate even once the cap was removed, implying the persistent impact of the cap on the credit provided.

In South Africa, some monetary establishments evaded caps by charging credit life assurance and alternative services that reduced the transparency of the whole value of the credit. In WAEMU countries, the imposition of rate caps on microfinance loans caused microfinance establishments to withdraw from poor and a lot of remote areas and to extend the common loan size to enhance potency and returns as a result of the rate ceiling was thought of too low (Helms and Reille 2004). As a result of lower caps on interest rates in Japan, the availability of credit seemed to contract, acceptance of loan applications fell, and ill-gotten disposal rose (Porteous, Collins & Abrams, 2010).

In Armenia, the dearth of clarity on the way to calculate the rate diode banks and microfinance establishments to impose fees and commissions, so avoiding the ceiling and reducing the transparency for shoppers (Helms & Reille 2004). In Poland, interest restrictions cut provision to credit and welfare. In France and

Germany, (Ellison & Forster, 2006) found that rate ceilings reduced the variety of product for low-income households. In France, lenders have used consumer credit to achieve lower-income families, whereas in Germany several low-income and insecure borrowers square measure excluded from credit.

2.2.2 Interest Cost and financial Performance

Interest prices are seen to influence industrial banks and specifically on the stock costs (Nyakio, 2017). There's a positive relationship between banks' rates of loaning and costs of stocks within the market. Capping of interest rates in Kenya crystal rectifier to a fall in costs within the stock exchange. The study showed that the surprising amendment in regulation although capping of interest rates influenced money flows offered for investment. (Nganga & Wanyoike, 2017) During a study on the impact of the rate of interest, controls on stock performance indicated that event analysis indicates vital impact. The study showed that there's a negative relationship between interest rates and also the performance of stocks within the market. This can be in support of empirical studies done indicating similar results. The analysis shows that dominate the interest rates are supposed to boost the economic performance of the country together with that of the securities market. (Nganga & Wanyoike, 2017) argue that the results are because of the reduced handiness of funds through loans and therefore very little cash for investment.

The work of (Capera, Murcia & Estrada, 2011) found a negative association between restrictive limits on the rate of interests and monetary depth in eighteen countries in Latin America for the amount between 1980 and 2008 and located that there have been increased prices related to interest rate caps. In Nicaragua,

parenthetically, the appliance of associate interest ceiling caused microfinance establishments to scale back loaning and prompted some such establishments to depart rural areas, because of high operational prices and risks. They additionally responded by adding fees and alternative charges to hide their prices, since these weren't capped (Helms & Reille 2004). In the case of Colombia, Delgado (2004) found that the rate of interest limits severely affected banks as a result of their higher dealing prices was because of reduced interest rates.

Report by CBK (2018) on the impact of the rate of interest caps indicated that the high value of credit culminated in the Banking modification Act 2016 was geared toward lowering the price of credit. Also, use of caps to support a particular trade or sector, defend customers from usury and exploitation, defend borrowers from predatory loaning and excessive interest rates, a variety of grant to specific teams, decrease the risk-taking behavior of credit suppliers, among others. Respondents from the banking system (83 percent) according to reduced loaning since the capping of interest rates. However, some respondents from tier one according to a rise in loans, whereas others in tier two and three according to that they weren't littered with the law.

Empirical proof on the consequences of the rate of interest caps on loans was found for a few countries. In most cases, the consequences were preponderantly negative; even if, within the case of the USA, some studies supported positive outcomes. Laeven (2003) did a study on the capping of interest rates within the USA and indicated that imposing liberal measures adore eliminating interest rates caps had a positive impact on the flexibility of tiny investors to access funding.

The study additionally according that investors tend to migrate to countries with fewer restrictions on interest rates. (Iff/ZEW, 2010) Did additional studies within the USA and located that access to credit by insecure borrowers is larger once interest rates caps are higher. However, accessing credit at high prices consequently ends up in high levels of default.

2.2.3 Interest Rate Spread and financial Performance

Research on the impact of the fluctuation of interest rates on financial performance (Lagat & Okendo, 2016) indicated that there's a positive relationship between interest rates and banks money performance. The study was through with a spotlight on coming back on Equity, Earnings per Share and come back on Capital Earnings. The study highlighted that banks ought to be ready to maintain a margin that enables them to create a profit to stay engaging to potential investors.

Capping of interest rates within the USA pushed down the gain of banks and so influencing their costs within the stock exchange. The move forced the banks within the region to hunt various investment ways to stay profitable (Irresberger, Mühlnickel, & Weiß, 2015). Money reforms through such ways as capping the interest rates were seen to extend capitalist confidence in countries admire Pakistan that consequently brought associate degree improvement within the valuation of shares within the country (Zaman et al., 2013).

A report by CBK (2018) examined the results of rate unfold and located that as a result of high interest spreads Kenya's banking sector remained extremely profitable compared to peers so agitative dialogue on rate capping within the

country. The gain ratios within the banking sector had remained high compared to different countries within the African region. Maybe, in 2016, the come back on assets (ROA) and come back on equity (ROE) in Kenya stood at 31% and 24.5% severally that was abundant higher compared to different countries within the region.

Also, the banking sector continuing to keep up the high price of credit with noticeable variations across bank tiers. The rate spreads remained high, with variations across bank tiers and loan sort. Whereas giant banks (Tier 1) systematically maintained higher rate spreads, on the average the little banks (Tiers 3) had all-time low and stable ranges, with medium-sized banks (Tier 2) falling intermediate. Concerning borrowers, company purchasers enjoyed lower disposition rates compared to non-public and business classes, with the latter attracting the very best rates. The variation in disposition rates mostly reflects variations in the rating of actual or perceived risks for various categories of borrowers, whereas variation across banks reflects the various funding constraints that characterize the bank tiers (CBK, 2018).

According to CBK (2018), a report examination of its peers, Kenya's banks maintained high-interest rate spreads. Demand capping interest rates were in the main anchor on the high spreads between disposition rates and deposit rates compared to different developing peer economies, and therefore the ensuing high gain within the sector. Though Kenya's average rate unfold that stood at 14.2% in the year 2000 had declined to nine.9 p.c by 2014; it had been still high

compared to Kenya's comparators admire Mauritius, Namibia and Republic of South Africa that had abundant lower rate spreads.

2.2.4 Interest Income and Financial Performance

Report by CBK (2018) found that the structure of deposits has shifted in favor of demand deposits as a result of interests capping law that has implications for the long-run funding of assets. There was a marked decline in time deposits (interest-earning accounts) vis-à-vis a rise in demand deposits (non-interest earning accounts). Besides, the interchange denominated deposits, which were on the decline within the amount before the rate of interest caps, began to increase. The shift in deposits in favor of demand deposits followed straightaway when the rate of interest capping law was enforced. The banking sector remains resilient despite interest rates caps. Banks stay adequately capitalized with core and total capital to risk-weighted assets averaging fifteen.8 p.c and eighteen.4 p.c on top of the restrictive needs of ten.5 p.c and fourteen.5 percent, severally. However, capital had declined since August 2015 sign either potency or overall erosion. The business, however, remains stable within the post – interest rates cap amount.

A study to investigate the impact of changes within the rate of interest on the profitability of 4 major industrial banks in West Pakistan mistreatment Pearson correlation technique (Khan & Sattar, 2014) discerned that rate of interest significantly affects the banks' interest financial gain. It so meant that banks' financial gain by interest is very regarding the rate of interests that show the bank's profitability depends on the financial policy tool is understood because of the interest rate. He counseled on the banking concern of West Pakistan to require a big role to manage the rate of interest unfolds within the country. (Tuyishime,

Memba & Mbera, 2015) Mistreatment each Pearson and Spearman correlation did a study on the results of deposit mobilization on the monetary performance of business banks in the Rwandese Republic whose findings indicate that a positive amendment in deposits rate of interest affect the number of deposits received and shortly the profitability of the bank. This study recommends banks to style innovative {ways|ways that|ways in that} to extend the number of inexpensive deposits which area unit competitive to balance with interest paid on them.

Interest rates have an instantaneous result on the activities of business banks owing to the firm belief that they affect the monetary performance banks (Priti, 2016). The valuation of bank assets is that the most important issue once it involves the assessment of bank stocks followed by the increase and fall of interest rates (Rosenbaum, 2015). Historically, retail banks create cash by wishing on the connection between interest rates, deposits and also the loans issued to purchasers. Therefore, it is smart for monetary analysts to concentrate on bank stocks because the interest rates rise or fall. Various bank failures were recorded within the USA throughout the Nineteen Seventies and Eighties are owing to high-interest rates and also the sensitivity of rate of interest (Priti, 2016). Associate degree examination on the mean and volatility spillovers (Priti, 2016) area unit caused by short-run interest rates and exchange rates, and long-run interest rates and exchange rates. It's a vital issue for investors and bankers owing to the impact it has on the valuation of bank stocks. Also, it defines the number of risks that the bank is facing. A comprehensive understanding of them, however, the rate of

interest affects the valuation of bank stocks, and also the overall charge per unit is prime once one considers that some banks have foreign operations (Zaman et al., 2013). The distinction between the short-run interests paid to deposits and savers and also the longer-term interests paid by borrowers is that the interest earned by banks. A steep yield curve suggests that the industrial bank's area unit is generating high advantages (Tran, 2013).

2.2.5 Financial Performance

A study was done on India's banks on the effect that asset quality has on the profitability in the periods between 2006 and 2011 using the Return On Assets (ROA) ratio. It was evident that there is a negative relationship between the financial performance of the bank and asset ratio (Khalid, 2012). Studies on performance of banks in Nigeria indicated that poor asset quality posed a risk to the performance of the bank and recommended adoption of policies that encourage diversification of products and minimization of credit risk (Abata, 2014).

According to a report by CBK (2018), it found that ROE and ROA of the banking sector continued to decline since late 2016. The return on equity (ROE) touched the lowest level of 19.8 percent in February 2017 with return on assets (ROA) reaching the lowest level of 2.3 percent in January 2017. The decline in earnings over time may pose risks to financial stability through increased balance sheet risks. Also reduces the buildup of capital buffers to absorb any shocks. Profitability was the most affected by this interest rates capping law, although the decline started earlier in 2016 (Kipngetich, 2011) examined the effect on interest rates on the performance of commercial banks in Kenya. The study used published

incomes statement of commercial banks between 2006 and 2010 to model the relationship between interest rates and financial performance. The study concluded that in the short term, interest rates did not have a significant effect on the profitability of commercial banks. The study recommended the application of diversification strategies to enhance the performance of commercial banks.

2.3 Summary of the Reviewed Literature

This chapter has mentioned the theories of interest rates and implications of interest rates capping within the banking sector and financial performance of tier one commercial banks. Arguments reviewed shows that provision and demand of funds are the determinants of interest rates. However, the expectation of the two parties features a role they play in the business. Literature is split with the arguments for and against interest capping. Counter-arguments concerning the imperative for interest capping offer, conflicting proof that interest capping results in credit constraints and the contrary. In spite of this lack of consistent proof, many recommendations are on the liberalization of interest rates so that demand and supply become main determinants. A number of these recommendations embody active superintendence of commercial banks, value stability, business enterprise discipline that's increased by domestic property borrowing, truthful competition by commercial banks in very increasing surroundings, institutional development, economic science stability and a nondiscriminatory legal system on money intermediaries.

2.4 Knowledge Gap

Some studies have been undertaken by scholars to try and handle the subject of interest rate capping in Kenya. For instance, (Gichuki 2017) looked at strategic responses of banks after the law capping interest rates leaving out the issue of performance before and after the introduction of interest rate capping. Wambari and Mwangi (2017) did a journal on effects of interest rates on financial performance of commercial banks in Kenya which did not specifically take care of tier one commercial banks which according to central Bank report 2017 have a customer and asset base of over 50 percent. Majority of the studies done have focused on effects of interest rate capping on the economic growth. The introduction of interest rate capping is new in Kenya thus there is a gap as some people think capping is only applicable in Kenya while it's world wide. The capping should be researched to show how it affects both the banks and the citizens of the country especially on credit consumption. So the study seeks to assess the result of interest rate capping on the financial performance of tier one Commercial banks. Majority of the studies have focused on all commercial banks and therefore this study sought to bridge the gap by examine the specific influence of interest rate capping on Tier 1 commercial banks.

CHAPTER THREE: RESEARCH DESIGN AND METHODOLOGY

3.1 Introduction

This chapter focuses on the methodology utilized during this study. It explains the research design utilized in the study, the target population, sample size and sampling techniques, data collection methods and procedure as well as data analysis and ethical considerations during the study process.

3.2 Research Design

Durcevic (2019) describe analysis style as a method, structure, and arrangement formed to get solutions to the varied analysis issues. It provides a framework for coming up with and conducting a study. A research design discloses the research question and also the strategy for the investigation to be accustomed acquire first-hand proof on matters of the expressed drawback (Cooper & Schindler, 2003). This study used descriptive research design. The descriptive design is suitable for this study as it focuses on giving descriptive observations of the variables without altering their natural existence (Babbie 2011).

3.3 Research Site and Rationale

The study was conducted in Nairobi County focusing on the Tier one commercial banks. They included Kenya Commercial Bank (KCB), Equity Bank, Co-operative Bank, Standard Chartered Bank, Barclays Bank, Diamond Holding Ltd, Stanbic Bank and Commercial Bank of Africa (CBA). Equity bank, Co-operative bank, and CBA are private native banks whereas KCB is a native bank with government participation. Standard Chartered and Barclays Bank are foreign banks. The choice

of Nairobi county was because it the only county that houses the Head Offices of all the tier 1 Banks in Kenya.

3.4 Target Population

Babbie (2011) described population to be the assortment of elements to that the research worker desires to extend some reasoning. The target population that's of interest during this study entailed all the 6 tier one commercial bank in Nairobi County. The target population was five hundred (500) managerial level staff members from the six tier 1 Commercial Banks in Nairobi county (Central Bank report, 2017).

3.5 Sampling Procedure

Bhattacharjee (2012) noted that sampling is a systematic process of selecting the number of individual cases or units to provide information needed for the study. Thus, sampling is important in research due to the limitations in studying the whole population and reduction of both costs and time required since a small number of units have to be investigated. The study will use stratified sampling in the selection of respondents who will form strata that is top management, middle management, lower management, and employees. The use of stratified sampling is better than other methods since the respondents were categorized in accordance to the three levels of management

3.6 Sample Size

Kumar, Talib and Ramayah (2013) noted that sampling design is the rationale to be used in determining who and the number of individuals to survey, how many and what events to take note of or how many and what records to scrutinize.

The basic idea of sampling is picking out the part of the component in the population. The eventual sample's test of a sample design is how good it characterizes the features of the population from which it was drawn from. Also, a good sample should be acceptable by being accurate and precise. Kothari (2004)

formula was used to determine the sample size of 80 respondents.

$$n = \frac{Z^2 pqN}{e^2(N-1) + Z^2 pq}$$

Where: n: is the sample size for a finite population

N: size of population which is the number of households

p: population reliability (or frequency estimated for a sample of size n), where p is 0.5 which is taken for all developing countries population and p + q = 1

e: margin of error considered is 10% for this study.

$$Z_{\alpha/2}: \text{normal reduced variable at 0.05 level of significance } z \text{ is } 1.96$$

$$\frac{1.96^2 \times 0.5 \times 0.5 \times 500}{0.1^2(500-1) + 1.96^2 \times 0.5 \times 0.5} = \frac{480.2}{4.99 + 0.9604} = \frac{480.2}{5.9504} = 80$$

To determine the respondents in each category the following formula was used as a sampling frame on table 3.1 below

Top Management $85/500 \times 80 = 14$ respondents

Middle Management $180/500 \times 80 = 29$ respondents

Lower Management $235/500 \times 80 = 37$ respondents

Thus, table 3.1 will show how the sample size:

Table 3.1 Sample Size

Respondents	Target size	Sample size
Top Management	85	14
Middle management	180	29
Lower Management	235	37
Total	500	80

3.7 Data Collection Procedure

Cooper and Schindler (2014) describe data collection as the process of taking first-hand evidence with the aim of gaining insights about a particular situation as well as answering questions of the research. Primary data can be defined as the first-hand information given by the respondent (DeVos *et al.*, 2011). The primary data was gathered using a self-administered questionnaire with established scales. The research instrument was administered through the drop and pick method to the sampled respondents. Secondary data was obtained from the financial statements of the selected banks.

3.8 Research Instruments

This study used self-administered questionnaires to collect primary data. The questionnaires were administered both physically and also sent via the e-mails. This is because questionnaires can be carried out in a short period and are relatively cost-effective way compared to other data collection tool and also they can be used to compare and construct other research (Babbie, 2011). The questionnaires were

developed with questions based on the variables of the study. Secondary data was collected to compare performance of each of the six banks especially before and after the introduction of interest rate caps.

3.8.1 Piloting of Research Instruments

A pilot study was carried out to determine whether the questionnaire contains some errors. This was done by issuing 5 questionnaires to the managers of tier 1 banks that were not part of the sampled respondents to ascertain that the questionnaires are free from any errors. Five questionnaires were issued due to time limitations and also the need for having a thorough review on the research instruments

3.8.2 Validity of Findings

According to Kumar et al. (2013), validity is outlined as the level to which an accurate look lives to what it's alleged to measure. This may additionally facilitate in making certain the judgment and accuracy of the tool, and thence any errors are corrected before the particular survey. To make sure the validity of the instrument, internal and external validity tests are going to be meted out. Face validity is going to be assessed by sorting out the convenience with that the respondents answer the analysis queries (Cooper & Schindler, 2003). Content validity offers an adequate investigation of the study queries. The questionnaire was given to the supervisors for review and their input on the constructs of the analysis was used to improve.

3.8.3 Reliability of Research Instruments

Kumar et al. (2013) notes that reliability is concerned with the degree to which the instrument produces the same results on repeated trials. The tendency toward consistency found in repeated trials is referred to as reliability. A Cronbach's test

was used to test reliability, where an alpha coefficient of 0.7 was considered the minimum measure of reliability acceptable (Bhattacharjee, 2012).

3.9 Data Analysis and Presentation

Data analysis can be defined as the process through which structure, order, and meaning are obtained from the mass information collected (Bhattacharjee, 2012). First, the data was cleaned, sorted, collated and analysed with the help of SPSS. Descriptive statistics including mean, frequency and standard deviation were used to describe the data.. Pearson Product-Moment Correlation and Regression analysis was used to show and measure the relationship between interest rates capping and the financial performance of tier 1 commercial banks. The following regression equation was used to guide the analysis .

$$Y = a + B_1X_1 + B_2X_2 + B_3X_3 + B_4X_4 + E$$

Where;

y = Financial performance, x_1 = Credit supply, x_2 = Interest cost, x_3 = interest rate spread

x_4 = Interest income, e = error term

The regression model was used to predict the values of α and β_i (where $i = 1, 2$ and 3), which explains the relationship between the dependent and independent variables. This method is preferred due to its predictive power of multivariate association β , estimated coefficient of correlation R . The coefficient of determination R^2 was utilized to explain the association amid the dependent with

the independent variable; the T-test assessed the significance of individual betas and standard b-coefficients.

3.10 Ethical Considerations

Privacy and confidentiality are the major ethical considerations in any research study. Caution was taken against source bias (conditions or circumstances which affect the external validity of statistical results), errors in methodology, interpretation of results and their application to real-world issues (Kombo and Tromp, 2006). Ethical issues in data collection was adhered to specifically in the following areas: Confidentiality was maintained at all times by making sure that only individuals concerned with the study understand the identity of the participants (Kombo and Tromp, 2006). The researchers are chargeable for the conduct of the analysis and therefore the consequences of that analysis. Therefore the investigator can settle for individual responsibility for the whole method. Consent was obtained from subjects who can participate in the study, and it made sure that all subjects are collaborating voluntarily. The reason is the key to gaining consent from the participants. Informing the participants regarding the results of the study engineered trust and even the study of the participants. The results of the study and therefore the recommendations that will be projected will impact the participants' future actions and perceptions.

CHAPTER FOUR: DATA ANALYSIS AND PRESENTATION OF FINDINGS

4.1 Introduction

This chapter analyses the findings, interprets and presents the data in line with objectives of the study. The data analysis was based on the research objectives and questionnaire items, which were analyzed using statistical tools like pie charts, frequency distribution, tables and graphs and the results of the analysis presented

4.2 Response Rate

The questionnaires were issued to the respondents of the banks. A total of eighty (80) questionnaires were administered and seventy-seven (77) were received as indicated in the figure 4.1.

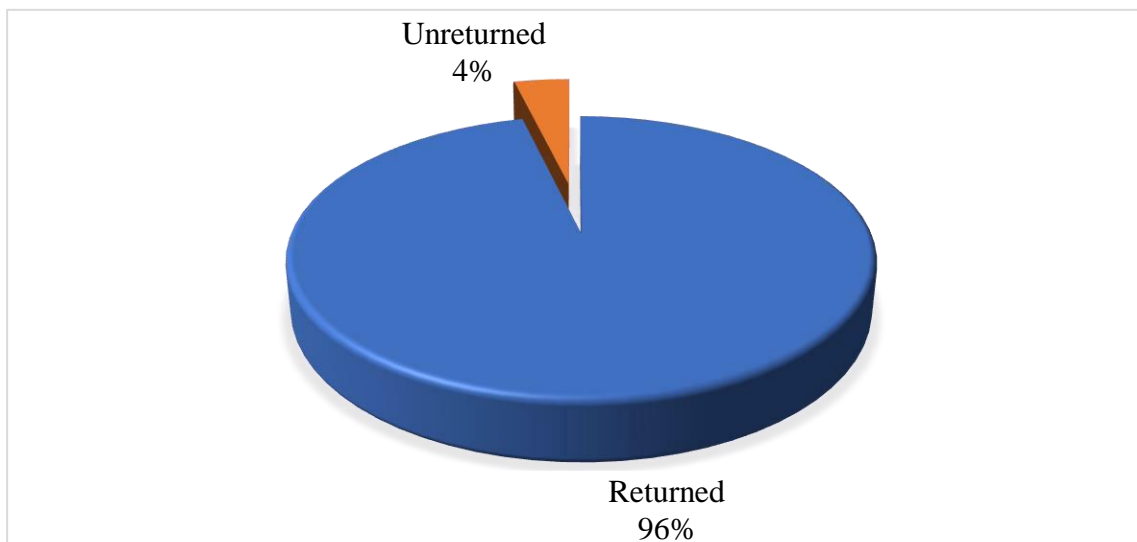


Figure 4.1 Response Rate

As clearly illustrated in figure 4.1 above, the total number of questionnaires that was distributed to the field were 80 where 96.3% were successfully completed while 3.8% were not returned. Based on the analysis, it can be concluded that the response rate was high

4.3 Demographic Characteristics

The demographics information of the study involved gender, age, education level, working experience and position held in the banks. The analyses were as follows.

4.3.1 Gender Analyses

The gender analyses of those respondents who participated in the study about effects of interest rate capping on financial performance of tier 1 commercial banks Kenya were done. The results were summarized in the figure 4.2

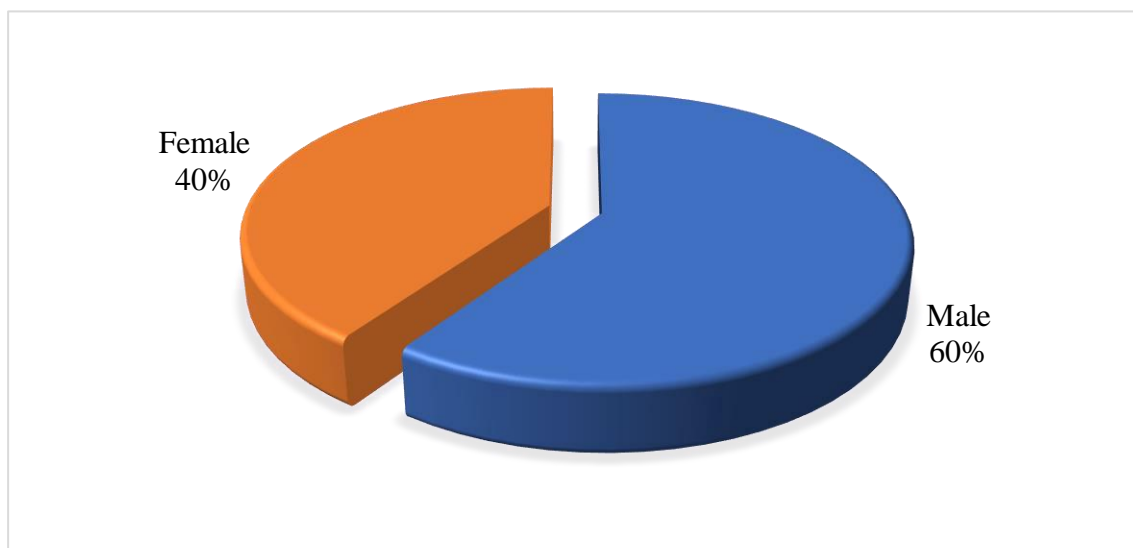


Figure 4.2 Gender Analyses

According to the figure 4.2 above the total number of males who responded were 59.7% while females were 40.3%. From the study it can be concluded that the number of males who responded were slightly higher than the number of female on the study about effects of interest rate capping on financial performance of tier 1 commercial banks in Kenya.

4.3.2 Age of the Respondents

The age analyses of those respondents who participated on the study about effects of interest rate capping on financial performance of tier 1 commercial banks were done. The results were summarized in the figure 4.3

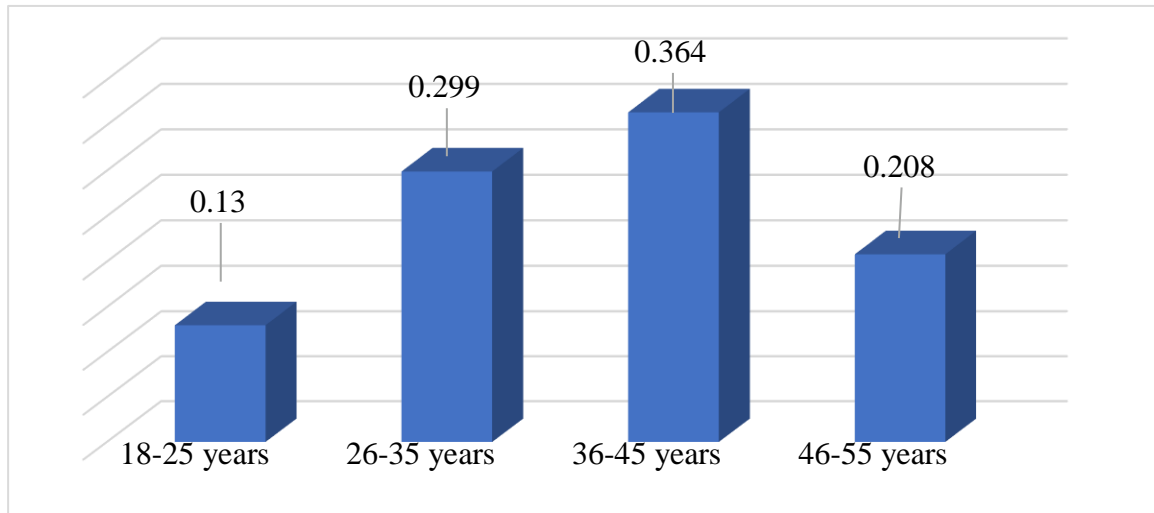


Figure 4.3 Age of the Respondents

According to the figure 4.3 above, 14% of the respondents were between the ages of 18-25, 29.9% were between the ages of 26-35, while 36.4% were between the age of 36-40 and 20.8% were 50 and above. Based on the analysis, it can be inferred that the majority of the respondents were between the ages of 36-45 on the study about effects of interest rate capping on financial performance of tier 1 commercial banks in Kenya.

4.3.3 Education of the Respondents

The education level analysis of those respondents who participated on the study about effects of interest rate capping on financial performance of tier 1 commercial banks were done. The results were summarized in the figure 4.4

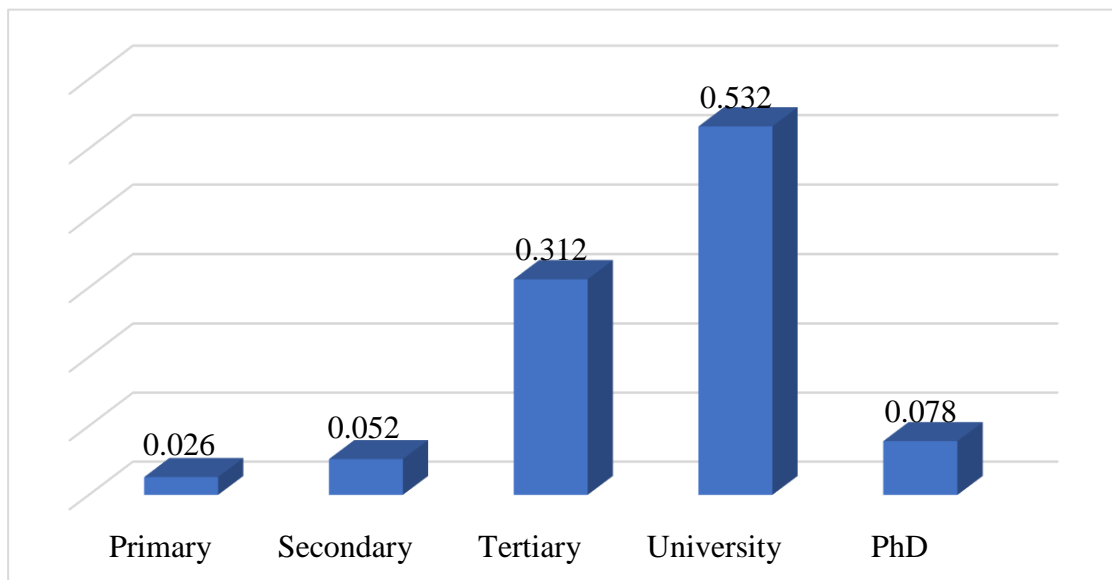


Figure 4.4 Education of the Respondents

The figure 4.4 above shows the level of education of various respondents. According to the figure, most of the respondents had university level education with a percentage of 53.2% while 31.2% had tertiary education level, 7.8% had attained PhD education level, 5.2% had secondary level and 2.6% has reached primary level. From the study it can be concluded that the majority of the respondents had university level of education who participated on the study of effects of interest rate capping on financial performance of tier 1 commercial banks in Kenya.

4.3.4 Working Experience of the Respondents

The working experience analysis of those respondents who participated on the study about effects of interest rate capping on financial performance of tier 1 commercial banks in Kenya were done. The results were summarized in the figure 4.5

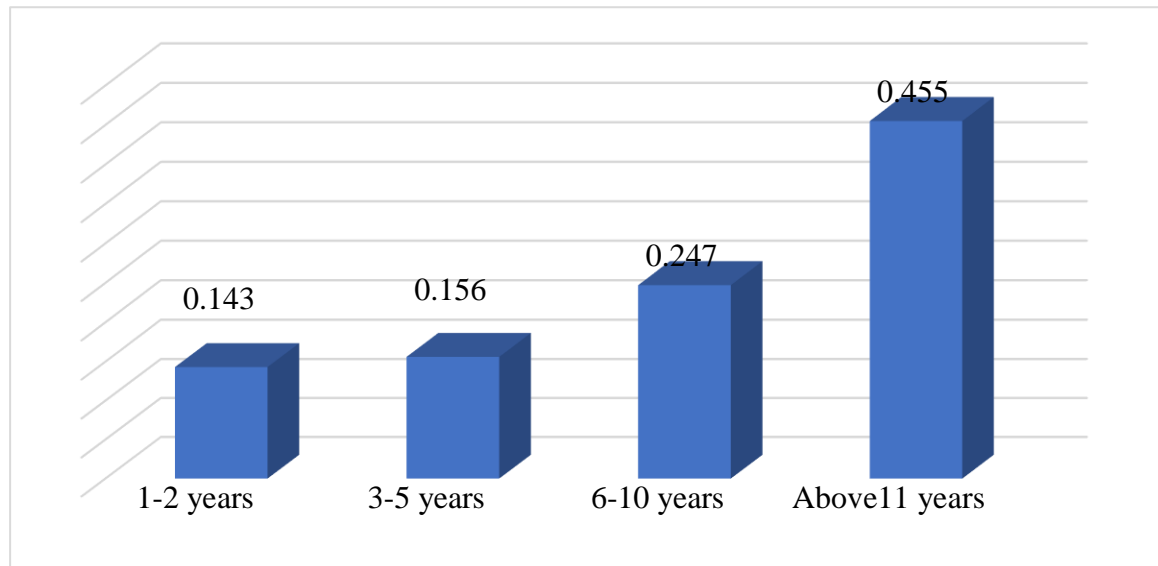


Figure 4. 5 Working Experience of the Respondents

Figure 4.5 above presents the level in which working experience was carried out. According to the figure, most of the respondents have attained above 11 years of service represented by 45.5% those who had 1-2 years was 14.3% while those with 3-5 years was 15.6%, lastly those above 6 to 10 years were only 24.7%. It was concluded that the majority of the respondents was of those with above 11 years of the respondents who took part on effects of interest rate capping on financial performance of tier 1 commercial banks in Kenya.

4.3.5 Position Held by the Respondents in Banks

The position held by respondents in banks analyses were done on the study about effects of interest rate capping on financial performance of tier 1 commercial banks. The results were summarized in the figure 4.5

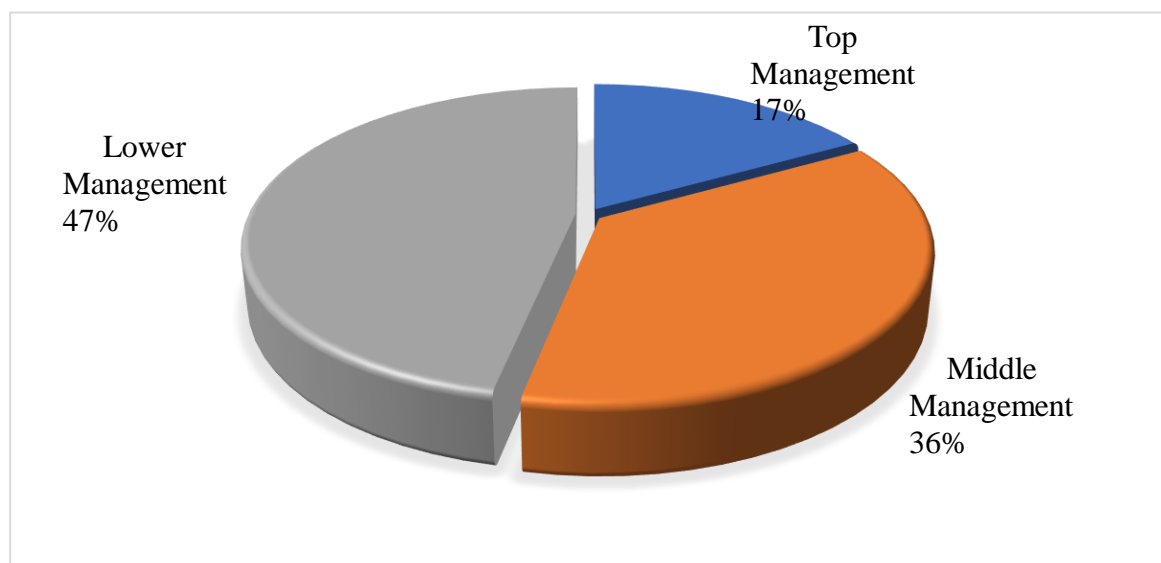


Figure 4. 6 Position held by the Respondents in Banks

Figure 4.7 above shows the majority of the employees at tier 1 commercial banks, the lower management has a percentage of 46.8%. They are followed by the middle management employees with a percentage of 36.4% and finally the top management with 16.9% of the total respondents who participated on the study

about effects of interest rate capping on financial performance of tier 1 commercial banks.

4.4 Effect of interest Rate Capping on Financial Performance

The analysis on effect of interest rate capping on financial performance of tier 1 commercial banks. The analyses involved the credit supply, interest costs, interest rate spread, interest income and financial performance.

4.4.1 Credit Supply and Financial Performance

The study determined the effects of credit supply on financial performance of the tier 1 commercial banks. The results were indicated in the table 4.1.

Table 4.1 Effects of Credit Supply on financial performance of the commercial banks

	Strongly Disagree %	Disagree %	Neutral %	Agree %	Strongly Agree %
Nature terms and conditions attached to loan had a large effect on the competitiveness of the bank and the size of loan applications received by the bank	7.0	11.3	29.3	33.7	
Banks which used to charge higher interest rate increased the credit supply	6.5	7.8	19.5	33.8	32.8

more right after the introduction of the cap					
Supply of credit appeared to contract, acceptance of loan applications fell, and illegal lending rose	5.2	6.5	27.3	28.6	32.5
Interest restrictions reduced both supply to credit and welfare	7.8	5.2	26.0	29.9	31.2
Lenders have used revolving credit to reach lower-income households	2.6	15.6	20.8	27.3	33.8

The table 4.1 shows the response of the respondents on effects of credit supply on financial performance of the tier 1 commercial banks. According to the study 37.7% of the respondents strongly agreed that the nature, terms and conditions attached to loan had a large effect on the competitiveness of the banks and the size of loan applications received by the bank. While the rest indicated that they strongly disagree, disagree, neutral and agree with 7.8%, 13.0%, 14.3% and 27.3% respectively. It can be deduced that from the analysis that 65.0% who were majority of the respondents indicated that nature terms and conditions attached to loan had a large effect on the competitiveness of the bank and the size of loan applications received by the bank.

More analyses indicated that 33.8% of the respondents agreed that banks which used to charge higher interest rate increased the credit supply more right after the

introduction of the cap. While the rest of the respondents indicated strongly disagree, disagree, neutral and strongly agree with 6.5%, 7.8%, 19.5% and 32.8% respectively. It can be deduced that 66.6% of the respondents indicated that banks which used to charge higher interest rate increased the credit supply more right after the introduction of the cap.

In addition, 32.5% of the respondents indicated that supply of credit appeared to contract, acceptance of loan applications fell, and illegal lending rose. Moreover, those who strongly disagreed with 5.2%, disagreed with 6.5%, neutral with 27.3% and agreed with 28.6%. From the analyses above it can be deduced that 61.1% of the respondents indicated that supply of credit appeared to contract, acceptance of loan applications fell, and illegal lending rose.

Further analyses indicated that 31.2% of the respondents strongly agreed that interest restrictions reduced both supply to credit and welfare. While the rest strongly disagreed, disagreed, neutral and agreed with 7.8%, 5.2%, 26.0% and 29.9% respectively. It can be deduced that 61.1% of the respondents indicated interest restrictions reduced both supply to credit and welfare.

Final analyses on the effects of credit supply indicated that 33.8% of the respondents strongly agreed that lenders have used revolving credit to reach lower-income households. While the rest of the respondents strongly disagreed, disagreed, neutral and agreed with 2.6%, 15.6%, 20.8% and 27.3% respectively. It can be deduced that 61.1% of the respondents indicated that lenders have used revolving credit to reach lower-income households.

4.4.2 Interest Costs and Financial Performance

The study determined the effects of interest costs on financial performance of the tier 1 commercial banks. The results were indicated in the table 4.2.

Table 4.2 Effects of Interest Costs on financial performance of the commercial banks

	Strongly Disagree %	Disagree %	Neutral %	Agree %	Strongly Agree %
Capping of interest rates have increased interest costs	19.1	9.1	21.8	33.8	33.1
Interest rates has affected performance of stocks in the market	9.1	10.4	18.2	22.1	40.3
Increased costs associated with interest rate caps	13.0	9.1	22.1	23.4	32.5
Interest rate caps has influence high cost of credit	6.5	10.4	15.6	29.9	37.7
Interest cost has decrease the risk-taking behavior of credit providers	3.9	14.3	20.8	26.0	35.1

Table 4.2 presented that analyses of effects of interest costs on financial performance of the tier 1 commercial banks. According to the analyses 35.1% of the respondents strongly agreed that capping of interest rates have increased

interest costs. While rest of respondents indicated strongly disagreed, disagreed, neutral and agreed with 1.3%, 9.1%, 20.8% and 35.1% respectively. It can be deduced that 68.9% of the respondents indicated that capping of interest rates had increased interest costs.

Further, 40.3% of the respondents strongly agreed that interest rates had affected performance of stocks in the market. While the rest of the respondents indicated strongly disagreed, disagreed, neutral and agreed with 9.1%, 10.4%, 18.2% and 22.1% respectively. It can be deduced 62.4% of the respondents indicated that interest rates had affected performance of stocks in the market.

Also, the analyses of the study indicated that 32.5% of the respondents strongly agreed that increased costs were associated with interest rate caps. While the rest of the respondents indicated strongly disagreed, disagreed, neutral and agreed with 13.0%, 9.1%, 22.1% and 23.4% respectively. It can be deduced that 55.4% of the respondents indicated that increased costs were associated with interest rate caps.

Moreover, analyses indicated that 37.7% of the respondents strongly agreed that interest rate caps had influence high cost of credit. While the rest of the respondents strongly disagreed, disagreed, neutral and agreed with 6.5%, 10.4%, 15.6%, and 29.9% respectively. It can be deduced that 67.6% of the respondents indicated that interest rate caps had influence high cost of credit.

Finally, 35.1% of the respondents strongly agreed that interest cost had decrease the risk-taking behavior of credit providers. While the rest of the respondents strongly disagreed, disagreed, neutral and agreed with 3.9%, 14.3%, 20.8% and

26.0% respectively. It can be deduced that 61.1% of the respondents indicated that interest cost had decrease the risk-taking behavior of credit providers.

4.4.3 Interest Rate Spread and Financial Performance

The study determined the effects of interest rate spread on financial performance of the tier 1 commercial banks. The results were indicated in the table 4.3.

Table 4. 3 Effects of Interest Rate Spread on Financial Performance of the Commercial Banks

	Strongly Disagree %	Disagree %	Neutral %	Agree %	Strongly Agree %
High interest spreads in banking sector has remained highly profitable compared to peers thus provoking debate on interest rate capping in the country	1.1	3.3	21.0	33.2	31.7
Higher interest rate spreads, on average has affected the performance of the banks	6.5	7.8	15.6	18.2	51.9
Capping interest rates were mainly anchored on the high spreads between lending rates and deposit	3.9	9.1	18.2	26.0	42.9

rates compared to other developing peer economies, and the resulting high profitability in the sector					
The variation in lending rates largely reflects variations in pricing of actual or perceived risks for different categories of borrowers, while variation across banks reflects the different funding constraints that characterize the bank tiers	6.5	9.1	14.3	24.7	45.5
Interest rate Spread influence the financial performance of commercial banks	7.8	9.1	19.5	27.3	36.4

Table 4.3 shows the analyses of effects of Interest Rate Spread on financial performance of the commercial banks. According to the analyses 37.7% of the respondent strongly agreed that even with high interest spreads in banking sector had remained highly profitable compared to peers thus provoking debate on interest rate capping in the country. While the rest of the respondents indicated that they strongly disagreed with 1.3%, those who disagreed with 3.9%, those who were neutral with 26.0% and those who agreed with 31.2%. It can be deduced that 68.9% of the respondents indicated that even with high interest spreads in

banking sector had remained highly profitable compared to peers thus provoking debate on interest rate capping in the country.

In addition, 51.9% of the respondents strongly agreed that higher interest rate spreads, on average had affected the performance of the banks. While the rest of the respondents strongly disagreed, disagreed, neutral and agreed 6.5%, 7.8%, 15.6% and 18.2% respectively. It can be deduced that 70.1% of the respondents indicated that that higher interest rate spreads, on average had affected the performance of the banks.

Moreover, 42.9% of the respondents strongly agreed that capping interest rates were mainly anchored on the high spreads between lending rates and deposit rates compared to other developing peer economies, and the resulting high profitability in the sector. While the rest of the respondents strongly disagreed, disagreed, neutral and agreed 3.9%, 9.1%, 18.2% and 26.0% respectively. It can be deduced that 68.9% of the respondents indicated that capping interest rates were mainly anchored on the high spreads between lending rates and deposit rates compared to other developing peer economies, and the resulting high profitability in the sector.

Further, 45.5% of the respondents indicated strongly agreed that the variation in lending rates largely reflects variations in pricing of actual or perceived risks for different categories of borrowers, while variation across banks reflects the different funding constraints that characterize the bank tiers. While the rest of the respondents strongly disagreed, disagreed, neutral and agreed with 6.5%, 9.1%, 14.3% and 24.7% respectively. It can be deduced that 70.2% indicated that

variation in lending rates largely reflects variations in pricing of actual or perceived risks for different categories of borrowers, while variation across banks reflects the different funding constraints that characterize the bank tiers.

Finally, 36.4% of the respondents indicated strongly agree that interest rate spread influence the financial performance of commercial banks. While the rest of the respondents indicated strongly disagreed, disagreed, neutral and agreed with 7.8%, 9.1%, 19.5% and 27.3% respectively. It can be deduced that 63.7% of the respondents indicated that interest rate spread influence the financial performance of commercial banks.

4.4.4 Interest Income and Financial Performance

The study determined the effects of interest income on financial performance of the tier 1 commercial banks. The results were indicated in the table 4.4.

Table 4.4 Effects of Interest Income on Financial Performance of the Commercial Banks

	Strongly Disagree %	Disagree %	Neutral %	Agree %	Strongly Agree %
Interest rate capping has affected long term deposits in the banks	26.6	6.1	20.8	32.5	37.7
There is a marked decline in time deposits (interest earning accounts) vis-à-vis an increase in demand	7.8	9.1	22.1	28.6	32.5

deposits (non-interest earning accounts)					
The shift in deposits in favour of demand deposits followed immediately after the interest rate capping law was implemented. Banking sector remains resilient despite interest rates caps.	3.9	11.7	19.5	31.8	33.8
Banks remain adequately capitalized with core and total capital to risk weighted assets averaging	5.2	13.0	24.7	27.3	29.9
Banks' income by interest is extremely related to interest rates that show the bank's profitability is dependent on the monetary policy tool known as interest rate	3.9	6.5	26.0	27.3	36.4

Table 4.4 shows the analyses of effects of Interest income on financial performance of the commercial banks. According to the analyses 37.7% of the respondents strongly agreed that interest rate capping had affected long term deposits in the banks. While the rest of the respondents strongly disagreed, disagreed, neutral and agreed with 2.6%, 6.5%, 20.8% and 32.5% respectively. It

can be deduced that 70.2% of the indicated that interest rate capping had affected long term deposits in the banks.

Moreover, 32.5% of the respondents indicated strongly agreed that there was a marked decline in time deposits (interest earning accounts) vis-à-vis an increase in demand deposits (non-interest earning accounts). While the rest of the respondents strongly disagreed, disagreed, neutral and agreed with 7.8%, 9.1%, 22.1% and 28.6% respectively. It can be deduced that 61.1% of the respondents indicated that that there was a marked decline in time deposits (interest earning accounts) vis-à-vis an increase in demand deposits (non-interest earning accounts).

In addition, 33.8% of the respondents indicated strongly agreed that the shift in deposits in favour of demand deposits followed immediately after the interest rate capping law was implemented. Banking sector remains resilient despite interest rates caps. While the rest of the respondents indicated that strongly disagreed, disagreed, neutral and agreed with 3.9%, 11.7%, 19.5%, and 31.8% respectively. It can be deduced that 65.8% that respondents indicated that that the shift in deposits in favour of demand deposits followed immediately after the interest rate capping law was implemented

Also, 29.9% of the respondents indicated strongly agreed that banks remain adequately capitalized with core and total capital to risk weighted assets averaging. While the rest of the respondents indicated strongly disagreed, disagreed, neutral and agreed with 5.2%, 13.0%, 24.7% and 27.3% respectively. It can be deduced that 57.2% indicated that banks remain adequately capitalized with core and total capital to risk weighted assets averaging.

Finally, 36.4% of the respondents strongly agreed that banks' income by interest is extremely related to interest rates that show the bank's profitability is dependent on the monetary policy tool known as interest rate. While the rest of the respondents strongly disagreed, disagreed, neutral and agreed with 3.9%, 6.5%, 26.0% and 27.3% respectively. It can be deduced that 63.4% of the respondents indicated that banks' income by interest is extremely related to interest rates that show the bank's profitability is dependent on the monetary policy tool known as interest rate.

4.4.5 Financial Performance of the Commercial Banks

The study determined the financial performance of the tier 1 commercial banks.

The results were indicated in the table 4.5.

Table 4. 5 Financial Performance of the Tier 1 Commercial Banks

	Strongly Disagree %	Disagree %	Neutral %	Agree %	Strongly Agree %
Interest rate capping affects return on assets of banks	2.7	7.8	26.0	31.2	32.5
Interest rate capping affects return on equity of banks	5.2	7.8	22.1	29.9	35.1
Interest rate capping affect asset quality that is a risk to the performance of the bank	3.9	10.4	15.6	20.8	49.4

Decline in earnings over time may pose risks to financial stability through increased balance sheet risks	6.5	13.0	18.2	29.9	32.5
Short term, interest rates have a significant effect on the profitability of commercial banks	2.6	11.7	19.5	26.0	40.3

Table 4.5 shows the analyses financial performance of the commercial banks in relation to the interest rate capping. According to the analyses 49.4% of the respondents strongly agreed that interest rate capping affected return on assets of banks. While the rest of the respondents indicated strongly disagreed, disagreed, neutral and agreed with 2.6%, 7.8%, 26.0% and 31.2% respectively. It can be deduced that 63.7% of the respondents indicated that interest rate capping affected return on assets of banks.

Further analyses indicated that 35.1% of the respondents strongly agreed that interest rate capping affected return on equity of banks. While the rest of the respondents strongly disagreed, disagreed, neutral and agreed with 5.2%, 7.8%, 22.1% and 29.9 % respectively. It can be deduced that 65.0% of the respondents indicated that interest rate capping affected return on equity of banks.

More analyses indicated that 49.4% of the respondents strongly agreed that interest rate capping affected asset quality that is a risk to the performance of the bank.

While the of the respondents strongly disagreed, disagreed, neutral and agreed with 3.9%, 10.4%, 15.6% and 20.8% respectively. It can be deduced that 70.2% indicated that interest rate capping affected asset quality that is a risk to the performance of the bank.

Also analyses indicated that 32.5% of the respondents strongly agreed that decline in earnings over time posed risks to financial stability through increased balance sheet risks. While the rest of the respondents strongly disagreed, disagreed, neutral and agreed with 6.5%, 13.0%, 18.2% and 29.9% respectively. It can be deduced that 63.1% indicated that decline in earnings over time posed risks to financial stability through increased balance sheet risks.

Finally, 40.3% of the respondents indicated that they strongly agreed that short term, interest rates had a significant effect on the profitability of commercial banks. While the rest of the respondents strongly disagreed, disagreed, neutral and agreed 2.6%, 11.7%, 19.5% and 26.0% respectively. It can be deduced that 66.3% of the respondents indicated that short term, interest rates had a significant effect on the profitability of commercial banks.

4.5 Correlation of effect of interest rating capping on financial performance

The table 4.6 shows the correlation of the effect of interest rating capping on financial performance. The correlation of the variables which were under study involved the independent variables; Credit supply (CS), interest costs (IC), interest rate spread (IRS) and interest income (II) and financial performance (FP) as dependent variable analysis involved the bivariate correlation. The Pearson

correlation (R) was determined, the significance level was measured against the P <0.00, and labeled as (sig.) as indicated in table 4.6.

Table 4. 6 Correlation of Effect of Interest Rate Capping on Financial Performance

Correlations		FP	CS	IC	IRS	II
FP	Pearson Correlation	1				
	Sig. (2-tailed)					
CS	Pearson Correlation	.505**	1			
	Sig. (2-tailed)	.000				
IC	Pearson Correlation	.625**	.559**	1		
	Sig. (2-tailed)	.000	.000			
IRS	Pearson Correlation	.685**	.464**	.697**	1	
	Sig. (2-tailed)	.000	.000	.000		
II	Pearson Correlation	.715**	.563**	.712**	.772**	1
	Sig. (2-tailed)	.000	.000	.000	.000	

** . Correlation is significant at the 0.01 level (2-tailed).

Table 4.6 shows the correlation analyses of effect of interest rating capping on financial performance in tier 1 commercial banks and indicates that all the

variables had a positive correlation. It can be deduced that credit supply had a weak positive correlation with financial performance, which was statistically significant ($r = .505$, $P = 0.00$). Also, interest cost variable with positive Pearson correlation (R) of 0.625 which was significant since the $P = 0.00$. Interest rate spread variable with a Pearson correlation (R) of 0.685 which was significant since the $P = 0.00$. The last variable was that of interest income factor with positive Pearson correlation (R) of 0.715 which was significant since the $P = 0.00$.

4.6 Multiple Regression Analysis for effect of interest rating capping on financial performance

In this study, a multiple regression analysis was conducted to test relationship among variables on effect of interest rating capping on financial performance of tier 1 commercial banks.

4.6.1 Model Summary of effect of interest rating capping on financial performance

The model summary of the multiple regression on effect of interest rating capping on financial performance in tier 1 commercial banks was presented on table 4.7.

Table 4. 7 Model Summary of Effect of Interest Rate Capping on Financial Performance

Model	R	R Square	Adjusted Square	R	Std. Error of the Estimate
<hr/>					

1	.757 ^a	.574	.550	.53643
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a. Predictors: (Constant), Interest Income, Credit Supply, Interest Costs, Interest Rate Spread

Table 4.7 shows that the four independent variables that were studied, explain 75.7% on the effect of interest rating capping on financial performance in tier 1 commercial banks as indicated by the adjusted R squared of 0.574. This means that 57.4% change in the performance of the commercial banks can be attributed to the interest rate capping.

4.7.2 ANOVA of the Effect of interest Rrating capping on financial performance

The study also determined the analysis of variance (ANOVA) on effect of interest rating capping on financial performance of tier 1 commercial banks as presented on table 4.8

Table 4. 8 ANOVA of the Effect of Interest Rating Capping on Financial Performance

Model		Sum of Squares	Df	Mean Square	F	Sig.
1	Regression	27.893	4	6.973	24.233	.000 ^b

Residual	20.718	72	.288
Total	48.611	76	

a. Dependent Variable: Financial Performance

b. Predictors: (Constant), Interest Income,

Credit Supply, Interest Costs,

Interest Rate Spread

From table 4.8 shows that the multiple regression model was significance because P -value is 0.00, which is, less than 0.05 thus the model is statistically significant in predicting effect of interest rating capping on financial performance of tier 1 commercial banks. The $F = 24.233$ critical at 5% level was significant, since $p < 0.05$ this shows that the overall model was significant.

4.8.3 Regression Coefficients of effect of interest rating capping on financial performance

Multiple regression analysis was conducted in order to determine the effect of interest rating capping on financial performance of tier 1 commercial banks. The results were indicated in table 4.9.

Table 4. 9 Regression Coefficients of Effect of Interest Rate Capping on Financial Performance

Model		Unstandardized		Standardized		
		Coefficients		Coefficients		
		B	Std. Error	Beta	T	Sig.
1	(Constant)	.556	.296		1.879	.000
	Credit Supply	.107	.094	.111	1.149	.000
	Interest Costs	.101	.106	.116	.960	.000
	Interest Rate Spread	.296	.137	.278	2.171	.003
	Interest Income	.373	.142	.356	2.625	.001

a. Dependent Variable: Financial Performance of tier 1 commercial banks

From table 4.9 the mode formulates the following equation

$$Y = 0.556 + 0.107X_1 + 0.101X_2 + 0.296X_3 + 0.373X_4$$

We can deduce from the coefficient table that when the unstandardized coefficient of credit supply is .107 that means holding all the other variables, constant one unit change in credit supply leads to 10.7% change in financial performance. Similarly one unit change in the cost of credit was attributed to cause 10.1% change in the performance of the commercial bank. In addition, the effects of interest cost was found to significantly affect financial performance of tier 1

commercial banks with a P-value = 0.000, similarly, the effect of interest rate spread was found to significantly affect financial performance of tier 1 commercial banks (P Value = 0.003), with a unit change in interest spread contributing to 29.6% change in financial performance. Finally, the effects of interest income was found to have the highest contribution to the change in financial performance where a unit change in interest income was associated with 37.3% change in the level of financial performance of tier 1 commercial banks (P Value = 0.001).

CHAPTER FIVE: SUMMARY OF FINDINGS, CONCLUSION AND RECOMMENDATIONS

5.1 Introduction

This chapter is going to present the summary, which is drawn from the research data which was analyzed, discussion of the study and conclusion about the study. Finally, the research is going to give recommendation on the effects of interest rate capping on financial performance of tier 1 commercial banks.

5.2 Discussions

The core purpose of this study was to determine the effect of interest rating capping on financial performance of tier one commercial banks in Kenya. The study findings revealed that credit supply, cost of interest, interest rate spread and interested income profitability, size of the firm, cash reserve ratio and cash flow had positive effects on the financial performance of tier one commercial banks in Kenya.

5.2.1 Credit supply and Financial performance

The correlation analysis revealed that credit supply had a significant positive Pearson correlation ($R= 0.505$, $p = 0.000$) with the financial performance of tier one commercial banks. The findings of the study indicated that credit supply has effect on the financial performance of tier 1 commercial banks. This concurs with the study of Wanja et al. (2013) which found that credit policy used by business banks on their performance terminated that the nature terms and conditions connected to loan had a major impact on the aggressiveness of the bank and therefore the size of loan applications received by the bank on a small low extent.

This was also supported by the study of Miyauchi (2017) which indicated that rate caps found that bank branches that accustomed charge higher interests before the regulation reduced the rate a lot of once the second quarter.

The study however contradicts with a number of studies that argues that interest capping reduces loan appetite and applications. For instance, according to (Okwany, 2017) interest vapping reduces the number of people taking loans in a given period. In addition, Neil 2015 also argues that interest capping reduces the number of new borrowers in the bank. This study clearly indicates that interest capping have played a great role in increasing the number of potential investors who uses loans from the banks for investment purposes. Furthermore, the research shows a great increase of debtors and loaners even with the introduction of interest capping. Interest capping have created a better environment for people to borrow money from the banks. Nevertheless, the central bank of kenya should ensure that the number of collateral for acquiring loans is reduced to ensure that even small borrowers can access this loans.

5.2.2 Interest Cost and Financial performance

The second of objective of this study was to determine the effect of interest costs on financial performance of tier 1 commercial banks in Kenya. Table 4.6 revealed that interest cost variable had with positive correlation coefficient of 0.625 which was significant since the $P = 0.000$. The study found that interest costs affect the performance of tier 1 commercial banks. The study of Nyakio (2017) agrees with the findings that interest prices are seen to influence industrial banks and specifically on the stock costs. There's a positive relationship between banks' rates

of loaning and costs of stocks within the market. Also, the study of Nganga et al. (2017) is in line with the findings that amendment in regulation although capping of interest rates influenced money flows offered for investment. On the contrary the findings of Capera et al. (2011) that found a negative association between restrictive limits on the rate of interests and monetary depth in eighteen countries in Latin America for the amount between 1980 and 2008 and located that there have been increased prices related to interest rate caps. In summary, it is clear to say that interest cost has a direct correlation with the financial performance of a bank. The interest rate may in one way or the other discourage borrowing from the borrowers, however if an enabling environment is created, the bank investors can borrow the loans without fear of high interest rates.

5.2.3 Interest rate and Financial performance

The third objective was to find out the effect of interest rate spread on financial performance of tier 1 commercial banks in Kenya. Correlation analysis revealed that interest rate spread had a significant positive influence of 0.685 with the financial performance of tier 1 commercial banks in Kenya. The study found that interest spread had a positive effect on the financial performance of tier 1 commercial banks. This is in line with the findings of Lagat (2016) that found that there was a positive relationship between interest rates and banks money performance. In addition, this is in line with the study of Irresberger (2015) that found that Capping of interest rates within the USA pushed down the gain of banks and so influencing their costs within the stock exchange.

5.2.4 Interest income and Financial performance

The last objective of this study was to assess the effect of interest income on the financial performance of tier 1 commercial banks in Kenya. Correlational analysis revealed that interest income had a significant positive effect on $(R= 0.715)$, $(p=0.000)$ on the financial performance of tier 1 commercial banks in Kenya. The study has found that there was a positive effect on interest income and financial performance of tier 1 commercial banks. These findings were in line with the findings of Khan and Sattar (2014) who found that the rate of interest significantly affects the banks' interest financial gain. It so means that banks' financial gain by interest is very much regarding the rate of interest that shows the bank's profitability depends on the financial policy tool used because of the interest rate. He counseled on the banking concern of West Pakistan to require a big role to manage the rate of interest within the country. (Tuyishime, Mumba & Mbera, 2015) Mistreatment each Pearson and Spearman correlation did a study on the results of deposit mobilization on the monetary performance of business banks in the Rwandese Republic whose findings indicate that a positive amendment in deposits rate of interest affects the number of deposits received and shortly the profitability of the bank.

5.3 Summary of Major Findings

On credit supply majority of the respondents (65.0%) indicated that the nature of terms and conditions attached to loans had a large effect on the competitiveness of the bank and the size of loan applications received by the bank. Further, 66.6% of the respondents indicated that banks which used to charge higher interest rates increased the credit supply more right after the introduction of the cap. The

correlation analysis revealed that credit supply had a significant positive Pearson correlation ($R= 0.505$, $p = 0.000$) with the financial performance of tier one commercial banks.

On the interest it was deduced that 68.9% of the respondents indicated that capping of interest rates had increased interest costs. Further, 62.4% of the respondents indicated that interest rates had affected performance of stocks in the market. Besides, 67.6% of the respondents indicated that interest rate caps had influence high cost of credit. Correlation analysis revealed that interest rate spread had a significant positive influence of 0.685 with the financial performance of tier 1 commercial banks in Kenya.

On interest rate spread was deduced that 68.9% of the respondents indicated that even with high interest spreads in banking sector had remained highly profitable compared to peers thus provoking debate on interest rate capping in the country. It was also deduced that 70.1% of the respondents indicated that that higher interest rate spreads, on average had affected the performance of the banks. Further, it can be deduced that 68.9% of the respondents indicated that capping interest rates were mainly anchored on the high spreads between lending rates and deposit rates compared to other developing peer economies, and the resulting high profitability in the sector. Correlation analysis revealed that interest rate spread variable had a positive significant ($R=0.685$, $p=0.000$) with the financial performance of tier one banks in Kenya.

Lastly, on interest income it was deduced that 70.2% of the majority indicated that interest rate capping had affected long term deposits in the banks. Further, it was

deduced that 61.1% of the respondents indicated that there was a marked decline in time deposits while 65.8% of the respondents indicated that the shift in deposits in favour of demand deposits followed immediately after the interest rate capping law was implemented. Correlational analysis revealed that interest income had a significant positive effect on ($R= 0.715$, $p=0.000$) on the financial performance of tier 1 commercial banks in Kenya.

5.4 Conclusion

The general objective of the study was to determine the effect of interest rate capping on financial performance of tier one commercial banks in Kenya. Based on the study findings it was revealed that credit supply, cost of interest, interest rate spread and interest income had a positive significant relationship with financial performance of tier one commercial banks in Kenya. It was concluded that credit supply, cost of interest, interest rate spread and interest income influenced the financial performance of tier one commercial banks in Kenya.

5.5 Recommendations

The following recommendations can be observed as from the study on effects of interest capping on financial performance of tier 1 commercial banks.

First, on credit supply, the banks should change the nature of terms and conditions attached to loan so as to be competitiveness enough. If the security and the requirements of acquiring a loan are reduced, more potential customers will be attracted. The banks should also increase the credit supply despite the change on interest rate so as maintain their clients by having less stringent policies attached to their loans.

Also, it is recommended that on interest costs, the central banks should ensure that interest rate caps should not influence the cost of credit.

Further, on interest rate spread the banks should avoid anchoring on the high spreads between lending rates and deposit rates compared to other developing peer economies, and the resulting high profitability in the sector.

5.6 Areas for Further Research

The study was about the effect of interest rate capping on financial performance of tier 1 commercial banks, Further study researchers may focus on still determining the whether the Central Bank of Kenya should repeal the interest rate capping as it is affecting the small business. Additionally, due to the fact that interest capping is a new phenomenon in East Africa further reaserch should be undertaken on other East African countries which have different banking system with Kenya, to evaluate the effect of interest capping on their performance and market generally. Finally, further research may also be done using regional percepectives using extended time periods to establish the effect of interest capping in diffent regions in the country. Extended time periods will help establish the effect of interest capping without being affected by the country economic cycles. In conclusion, this further recommended research will enable comparability of studies and enhance knowledge in regard to interest capping.

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APPENDICES

APPENDIX I: LETTER OF INTRODUCTION

Dear Sir,

This letter is to introduce Mr. Evans Nyakundi who is an MBA student in the School of Business at Africa Nazarene University. He will produce his student card, which carries a photograph, as proof of identity.

He is undertaking research leading to the production of a thesis or other publications on the subject of "Effects of interest rate capping on the financial performance of banks in Kenya. A case study of tier one commercial banks."

He would like to invite you to assist in this project, by granting an interview which covers certain aspects of this topic. Be assured that any information provided will be treated in the strictest confidence and none of the participants will be individually identifiable in the resulting thesis, report or other publications. You are entirely free to discontinue your participation at any time or to decline to answer particular questions. He has a questionnaire that is a guide on the kind of answers he expects to be able to complete this assignment.

Any inquiries you may have concerning this project should be directed to me at the address given above or by telephone on 0703970520/5 by email (info@anu.ac.ke).

Thank you for your attention and assistance.

Yours sincerely

Dr. Kimani

MBA Coordinator School of Business

APPENDIX II: QUESTIONNAIRE

I am a Master of Business Administration student carrying out a research on effects of interest rate capping on financial performance of tier 1 commercial banks”.

Section A: Background Information

1. Gender

a) Male b) Female

Indicate your age

a) 18-25 b) 26-35 c) 36-45

d) 46-55 e) >55

Level of education

a) Primary b) Secondary c) Tertiary

d) University e) PhD

How long have you be working in the banking sector?

a) 1-2 b) 3-5 c) 6-10 d) >10

What is your position in the bank

a) Top Management b) Middle management c) low management

d) Other Staff

Section B: Credit Supply

What are the effects of credit supply on financial performance of the commercial banks?

where; strongly disagree =1, disagree=2, neutral=3, agree=4 and strongly agree=5.

	1	2	3	4	5
Nature terms and conditions attached to loan had a large effect on the competitiveness of the bank and the size of loan applications received by the bank					
Banks which used to charge higher interest rate increased the credit supply more right after the introduction of the cap					
Supply of credit appeared to contract, acceptance of loan applications fell, and illegal lending rose					
Interest restrictions reduced both supply to credit and welfare					
Lenders have used revolving credit to reach lower-income households					

Other comments on (specify)

.....

Section C: Interest Costs

What are the effects of interest costs on financial performance of the commercial banks?

where; strongly disagree =1, disagree=2, neutral=3, agree=4 and strongly agree=5.

	1	2	3	4	5

Capping of interest rates have increased interest costs					
Interest rates has affected performance of stocks in the market					
Increased costs associated with interest rate caps					
Interest rate caps has influence high cost of credit					
Interest cost has decrease the risk-taking behavior of credit providers					

Other comments (specify)

.....

Section D: Interest Rate Spread

What are the effects of interest rate spread on financial performance of the commercial banks? where; strongly disagree =1, disagree=2, neutral=3, agree=4 and strongly agree=5.

	1	2	3	4	5
High interest spreads in banking sector has remained highly profitable compared to peers thus provoking debate on interest rate capping in the country					
Higher interest rate spreads, on average has affected the performance of the banks					
Capping interest rates were mainly anchored on the high spreads between lending rates and deposit rates compared					

.....

to other developing peer economies, and the resulting high profitability in the sector					
The variation in lending rates largely reflects variations in pricing of actual or perceived risks for different categories of borrowers, while variation across banks reflects the different funding constraints that characterize the bank tiers					
Interest rate Spread influence the financial performance of commercial banks					

Other comments (specify)

.....

Section E: Interest Income

What are the effects of Interest Income on financial performance of the commercial banks?

where; strongly disagree =1, disagree=2, neutral=3, agree=4 and strongly agree=5.

	1	2	3	4	5
Interest rate capping has affected long term deposits in the banks					

.....

There is a marked decline in time deposits (interest earning accounts) vis-à-vis an increase in demand deposits (non-interest earning accounts)					
The shift in deposits in favour of demand deposits followed immediately after the interest rate capping law was implemented. Banking sector remains resilient despite interest rates caps.					
Banks remain adequately capitalized with core and total capital to risk weighted assets averaging					
Banks' income by interest is extremely related to interest rates that show the bank's profitability is dependent on the monetary policy tool known as interest rate					

Other comments on (specify)

.....

Section F: Financial Performance

What are the effects of Interest rate cap on financial performance of the commercial banks?

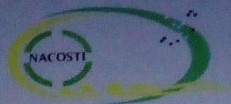
where; strongly disagree =1, disagree=2, neutral=3, agree=4 and strongly agree=5.

	1	2	3	4	5
Interest rate capping affects return on assets of banks					
Interest rate capping affects return on equity of banks					

Interest rate capping affect asset quality that is a risk to the performance of the bank					
Decline in earnings over time may pose risks to financial stability through increased balance sheet risks					
Short term, interest rates have a significant effect on the profitability of commercial banks					

Other comments on (specify)

.....



**NATIONAL COMMISSION FOR SCIENCE,
TECHNOLOGY AND INNOVATION**

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Date: **15th January, 2019**

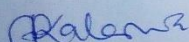
Evans Nyakundi Nyangau
Africa Nazarene University
P.O BOX 53067-00200
NAIROBI.

RE: RESEARCH AUTHORIZATION

Following your application for authority to carry out research on *“Effect of interest rate capping on financial performance of Commercial Banks in Kenya. Acase of Tier One Commercial Bank”* I am pleased to inform you that you have been authorized to undertake research in **Nairobi County** for the period ending **15th January, 2020.**

You are advised to report to **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.


GODFREY P. KALERWA MSc. MBA MKIM
FOR: DIRECTOR-GENERAL/CEO

Copy to:

The County Commissioner
Nairobi County.

The County Director of Education
Nairobi County.

Permit No : **NACOSTI/P/19/39922/26995**
 Date Of Issue : **15th January, 2019**
 Fee Received : **Ksh 1000**

THIS IS TO CERTIFY THAT:
MR. EVANS NYAKUNDI NYANGAU
of AFRICA NAZARENE UNIVERSITY,
579-300 Nairobi, has been permitted to
conduct research in Nairobi County
on the topic: EFFECT OF INTEREST RATE
CAPPING ON FINANCIAL PERFORMANCE
OF COMMERCIAL BANKS IN KENYA. A
CASE OF TIER ONE COMMERCIAL BANKS

for the period ending:
15th January, 2020

[Signature]
 Applicant's
 Signature

[Signature]
 Director General
 National Commission for Science,
 Technology & Innovation



**THE SCIENCE, TECHNOLOGY AND
INNOVATION ACT, 2013**

The Grant of Research Licenses is guided by the Science,
Technology and Innovation (Research Licensing) Regulations, 2014.

CONDITIONS

1. The License is valid for the proposed research, location and specified period.
2. The License and any rights thereunder are non-transferable.
3. The Licensee shall inform the County Governor before commencement of the research.
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REPUBLIC OF KENYA



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CONDITIONS: see back page



AFRICA NAZARENE
UNIVERSITY

E-mail: researchwriting.mba.anu@gmail.com

Our Ref: 15S03EMBA016

The Director,
National Commission for Science,
Technology and Innovation (NACOSTI),
P. O. Box 30623, 00100
Nairobi. Kenya

Dear Sir/Madam:

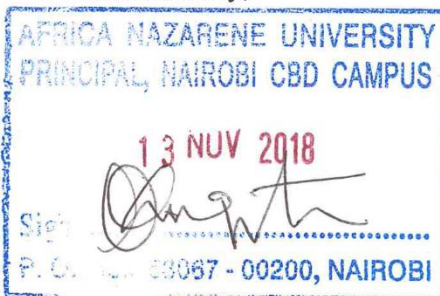
RE: RESEARCH AUTHORIZATION FOR: MR. EVANS

Mr. Nyakundi is a postgraduate student of Africa Nazarene Business Administration (MBA) program.

In order to complete his program, Mr. Nyakundi is conducting **of Interest Rate Capping on Financial Performance of Co A case of Tier One Commercial Banks”**

Any assistance offered to him will be highly appreciated.

Yours Faithfully,



PROF. ORPHA ONG'ITI,
PRINCIPAL: NAIROBI CBD CAMPUS.



Google map of banks in ...

LIST

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