STRATEGIC RESPONSES TO INTEREST RATE CAPPING BY COMMERCIAL BANKS IN KENYA

BY

MULWA JUDITH MUTINDI

A RESEARCH PROJECT SUBMITTED IN PARTIAL FULFILLMENT OF THE REQUIREMENTS FOR AWARD OF THE MASTER OF BUSINESS ADMINISTRATION DEGREE, SCHOOL OF BUSINESS, UNIVERSITY OF NAIROBI

DECEMBER, 2017

DECLARATION

I declare that this research project is my original work and has not been presented for degree in any other university.

Sign: ……………………………………….. Date: …………………………..

MULWA JUDITH MUTINDI

D61/79331/2015

This research project has been submitted for examination with my approval as university supervisor

Sign: …………………………………… Date: ……………………………

DR. J. KAGWE,

SCHOOL OF BUSINESS,

UNIVERSITY OF NAIROBI

ACKNOWLEDGEMENTS

I first thank the God Almighty for the gift of life and protection. I hereby wish to thank my supervisor Dr. J. Kagwe for his support and guidance on this research project.

I also acknowledge the support of the lecturers in the School of Business, University of Nairobi, fellow classmates, the administration staff and the whole University fraternity who have always been positive and supportive.

Special thanks go to my family members who realized the course of my study and gave me the moral support to complete my studies. I owe my success to their sacrifices.

DEDICATION

I dedicate this research project to my dear family; my husband Samson K. Mbaluka for his love, selfless support, patience and encouragement throughout my study.

To my daughter Olivia Nduku, you inspired me to work harder. You are my world.

ABSTRACT

The capping of commercial banks' interest rates have changed the business environment forcing the financial institutions to align their operations to the changed environment. The objective of the study was to determine the strategic responses employed by commercial banks in Kenya to cope with interest rate capping. The study was guided by Open Systems Theory, Dynamic Capability Theory and Institutional Theory. The study adopted a cross-sectional descriptive research design. The target population was the 42 commercial banks registered with Central Bank of Kenya(CBK) as at December 31st 2016. Therefore this was a census study. The respondents were the management staff in the commercial banks. The study collected primary data through use of a questionnaire. The data collected was edited, coded, entered into SPSS which also aided in data analysis. The data was analyzed using descriptive statistics which included frequency distribution tables, mean and standard deviation. The analyzed data was presented using tables, charts and graphs. The study found out that interest rates capping had narrowed the pricing gap of the banks and had removed banks' ability to price risk. Interest rates capping had not helped to achieve consumer protection from exorbitant interest rates as it was intended. The study found out that interest rate caps had reduced the supply of credit to the borrowers to a great extent especially the risky borrowers and low income borrowers. It had also increased the operational costs and risks to the bank to a great extent. To cope with interest rate capping, commercial banks were adopting modern technology in bank operations to enhance efficiency and expanding into new markets. The banks were also innovating new products and services, diversifying into other products offerings as well as cutting on staff expenses and benefits. The study concludes that interest rate capping has an effect on the commercial banks efficiency, stability and performance. The move did not account for several factors that might affect the banks' decision to opt for certain spreads. Introduction of interest rate caps has weakened bank's balance sheets and posed a risk to financial efficiency and stability and therefore banks are adopting these strategies as a way to maintain their performance and competitive edge in the market. The study recommends that CBK should review or remove the interest rate cap to allow forces of demand and supply to set prices of the interest rates charged. The study also recommends for realignment especially of the small banks through mergers and acquisition so that they are able to compete with their larger counterparts.

TABLE OF CONTENTS

LIST OF TABLES

LIST OF FIGURES

LIST OF ABBREVIATIONS AND ACRONYMS

CBK	Central Bank of Kenya
IAF	International Award Foundation
IMF	International Monetary Fund
NPLs	Non-Performing Loans

CHAPTER ONE: INTRODUCTION

1.1 Background of the Study

The recent introduction of lending rate caps for banks and other financial institutions has reopened an old debate over the appropriateness of regulatory intervention to limit the charging of rates that are deemed, by policymakers, to be excessively high (Maimbo & Gallegos, 2014). Move to cap commercial banks' interest rates have changed the business environment forcing the financial institutions to align their operations to the changed environment (Xinhua, 2017). The general idea is that interest rate ceilings limit the tendency of some financial service providers to increase their interest yields especially in markets with a combination of no transparency, limited disclosure requirements and low levels of financial literacy (Maimbo & Gallegos, 2014). Capping of interest rates has a tendency to distort the market and cause adverse biases, which in turn leads to inefficiencies in the financial intermediation process (Ramsey, 2013).

This study is guided by Open Systems theory, Dynamic Capability theory and Institutional theory. According to open systems theory, an organisation is an open system that needs to put environmental factors into account when making decisions or efforts to achieve their purposes. No such organisation can prosper and excel without paying attention to its environment (Duffy, 2008). On Dynamic capability theory, the underlying assumption is that firms which are able to reconfigure their resources and capabilities, in line with recognized opportunities and environmental change, can create and sustain a competitive advantage (Breznik & Lahovnik, 2016) Institutional theory is built on the argument that the institutionalized rules and norms of society intrude on the internal structure of organizations. The core idea is that organizations are deeply embedded in an expansive environment and consequently become influenced by the pressures and constraints of this environment (Scott, 2008).

Kenyan banks have in the past 20 years been enjoying interest rate spreads of about 11.4% on average, way above the world average of 6.6% (Cytonn Research, 2016). In 2016, the Kenyan government assented to the Banking (Amendment) Act, 2015. The Act states that interest rate charged by banks will not exceed four per cent above the base rate set by Central Bank of Kenya (Banking Amendment Act, 2015). However, the new legislation has drawn mixed reactions from the various stakeholders. The move to cap commercial banks' interest rates in Kenya has taken a toll on the financial institutions, forcing many of them to align their operations to the changed environment. The banks have responded to the new interest rate regime in varied ways (Xinhua, 2017).

1.1.1 Strategic Responses

Response strategies are ways an organization ensures a fit into the changing environment. Strategic response is the set of decisions and actions that results in the formalization and implementation of plans designed to achieve a firm's objectives (Pearce & Robinson, 2010). Changing business environments alter the way organizations fundamentally conduct business. Such adaptations made to suit the firm may be referred to strategic response. Strategic management literature suggests that a successful firm's strategy must be favourably aligned with the external environment (Ndung'u *et al.*, 2014).

Strategic responses require organization to change their strategy to match the environment and to redesign their internal capability to match this strategy (Grant, 2011). If an organization's strategy is not matched to its environment, then a strategy gap arises. The degrees to which response are viable will also vary considerably depending onq the region or country involved. The implications of specific response will depend on its social, environmental, and economic contextv(Grant, 2011). For effective strategic responses continuous scanning of both internal and external environment is a prerequisite so as it keeps abreast of all environmental variables underpinning current and future business operations of the firm (Thompson & Strickland, 2003).

Response strategies may include: response which are beneficial and justifiable in their own right; economically efficient and cost effective, in particular those that use market-based mechanisms; able to serve multiple social, economic, and environmental changes. According to Smith (2002), good strategies define one or more target markets each of which is homogeneous in terms of the benefits it seeks; they differ from those of the competition; and minimise risk by avoiding unnecessary diversification in markets or products. Good strategies also leverage distinctive competencies against market opportunities and minimise relative weaknesses in the face of threats and recognise the implications of macro-environmental changes.

1.1.2 Interest Rate Capping

Interest rates capping has been one of the common forms of government financial control that is widely used in both developed and developing countries. Several political and economic reasons motivate the use of interest rate caps, for example, to support a specific industry or sector of the economy where a market failure exists or where a greater concentration of financial resources is needed (Maimbo & Gallegos, 2014). Those market failures result from information asymmetries and the inability of financial institutions to differentiate between risky and safe clients, from adverse selection, and from moral hazard. Thus interest rate caps may be a useful mechanism for providing short-term credit to a strategic industry or for supporting a sector until it is sustainable by itself (Miller, 2013).

It is also often argued that interest rate ceilings can be justified on the basis that financial institutions are making excessive profits by charging exorbitant interest rates to clients. In implementing a cap, government is aiming to incentivise lenders to push out the supply curve and increase access to credit while bringing down lending rates. However, such thinking ignores the actions of the banks operating under asymmetric information. The imposition of a maximum price of loans magnifies the problem of adverse selection as the consumer surplus that it creates is a larger pool of willing borrowers with unidentifiable creditworthiness. Faced with this problem, lenders have three options: increase lending, which will mean lending to more bad clients and pushing up NPLs; increase investment in processing systems in orde to better identify good clients, which will increase overheads; increase investment in outreach to clients that can be identified as having good repayment potential, which will increase overheads. All of these options will increase costs and force the supply curve back to the left, which is detrimental to financial outreach (quantity of credit falls) (Miller, 2013).

Moreover, banks essentially make money from the difference between the rate which they pay depositors and the rate which they charge borrowers. These rates are determined by market forces, that is, demand and supply, but also several other factors come into play. And in this regard, commercial banks felt that placing a cap on interest rates would have an effect on the industry's efficiency as it doesn't account for several factors such as market factors, that might affect the banks' decision to opt for certain spreads. The major argument used against the capping of interest rates is that they distort the market and prevent financial institutions from offering loan products to those at the lower end of the market that have no alternative access to credit (Agolla, 2016). Many countries in Africa have established interest rate ceilings to protect consumers from high interest rates charged by lenders. Such ceilings are often the response of governments facing political or cultural pressure to keep interest rates low (Mbengue, 2013).

1.1.3 The Banking Industry in Kenya

In Kenya, the Banking Sector is composed of the Central Bank of Kenya, as the regulatory authority and the regulated; Commercial Banks, Non-Bank Financial Institutions and Forex Bureaus. The banking sector in Kenya has reported massive growth and development in recent years. This is attributable to the effective regulation and reforms effected by the central bank after many banks went into bankruptcy in the 1990s. Much of the growth in the banking sector has been witnessed in branch network expansion, growth in capitalization and asset base, the expansion of some of the banks regionally and automation of their functions to give their customers good service (CBK, 2011).

Over the last few years, the Banking sector in Kenya has continued to grow in assets deposits, profitability and products offering, leveraging on diversification to alternative channels, supported by favourable macroeconomic environment. The growth has been mainly underpinned by an industry with branch network expansion strategy both in Kenya and in the East African community region, automation of a large number of services and a move towards emphasis on the complex customer needs rather than traditional 'off-the-shelf' banking products. Players in this sector have experienced increased competition over the last few years resulting to increased innovations among the player and new entrants into the market (CBK, 2015).

1.1.4 Commercial Banks in Kenya

As at December 2016, Kenya had a total of 42 commercial banks and 1 mortgage finance company with two banks; Chase bank and Imperial bank in receivership (CBK, 2016). Commercial banks are regulated by the Central Bank of Kenya which also acts as a banker's bank. The main functions of commercial banks include: provide a safe place for clients to keep their money, facilitate transfer of money, offer lending services, offer foreign exchange services, offer investment services and financial advice and also act as trustees.

In 2016, the Kenyan government assented to the Banking (Amendment) Act, 2015 which capped interest rates at four percent above the Central Bank rate, which currently stands at ten percent. Before the law, banks were charging between 18 and 30 percent for loans advanced to their customers reaping huge profit (Xinhua, 2017). Therefore, this aimed at protecting the consumers from exorbitant rates. The introduction of capping of interest rates in commercial banks in Kenya has been criticised by various stakeholders. It has been argued that capping interests would make it harder for lenders to price risk, encouraging them to shun riskier borrowers. Banks could also introduce new fees and charges to maintain their profits (IMF, 2017). Implementation of the interest rates caps has had an impact on commercial banks bottom lines. In this regard, it is necessary to examine ways in which commercial banks are coping with this business environment challenge to protect their bottom lines and remain competitive.

Commercial banks play an important position in the country's economy. They play a decisive role in the development of the industry and trade. They act not only as the custodian of the wealth of the country but also as resources of the country, which are necessary for the economic development of a nation (Ongeri, 2013).

1.2 Research Problem

The environment that organizations exist encapsulates many different influences. The mov to cap commercial banks' interest rates has changed the business environment forcing the financial institutions to align their operations. According to Ndung'u *et al.* (2014) all firms need to have a clear understanding of both the external economic trends that directly or indirectly affect their industry because ultimately they will affect consumption patterns. As the environment changes firms must change their strategies so as to survive. In turbulent environment, strategic thinking enables organizations to be flexible enough to change accordingly (Thompson *et al.*, 2010).

The capping of interest rates in 2016 has been criticised by a number of players in the financial sector. For instance, the Kenya Bankers Association criticised the move and analysts described it as "populist" and "retrograde" and cited that it would affect lending. The Central Bank through the Governor, Dr. Patrick Njoroge is on record acknowledging that even though the interest rates offered were too high, the CBK did not advocate for an interest rate peg as it would bring about rigidity in the financial system and may introduce a lot of shadow banking and shylocks as people who can't access credit from the banks due to their low credit quality are priced out of the market (Cytonn Research, 2016). The International Monetary

Fund (2017) also asked the Treasury to remove bank interest rate caps, giving Kenyan banks support in their war against the controls. The report claims that the controls posed a risk to financial stability (IMF, 2017). A move to cap commercial banks' interest rates in Kenya has taken a toll on the financial institutions, forcing many of them to align their operations to the changed environment. With the new law, banks have to employ techniques to survive and protect their bottom lines (Xinhua, 2017).

A review of the existing literature shows that Nitu (2015) did a research on response strategies of SMEs in Hungary to environment changes. The findings revealed that the strategies of SMEs in Hungary were not independent, but mostly adaptive, reflecting current changing global strategies and opportunities. The strategy to be adopted differed from firm to firm, depending on a variety of factors. Shehada (2010) also investigated the strategic organizational responses to environmental pressures in Palestinian non-governmental organizations. The study revealed that organizations have at their disposal a wide range of active choice behaviours that vary from passivity to positivity. An organization’s choices are predictable largely in terms of their political power and the nature of the institutional pressures enacted on them.

A review of the local studies shows that Ndung’u *et al.* (2014) conducted a study on response strategies by commercial banks to economic changes in Kenya. The authors revealed that external economic trends such as change in interest rates puts banks under pressure which demands them to change their strategies so as to survive. Kamwere (2016) also explored the strategic responses to environmental challenges facing Faulu

Bank in Kenya. The identified environmental challenges that faced Faulu bank were; competition, obsolete technology, evolving customer needs, complying with regulatory requirements and political instability. The bank responded to these challenges through use of modern technologies, product and service innovation, product differentiation, investing in research and development programmes as well as through talent management, training and development programme. This study sought to examine how commercial banks in Kenya are coping to a regulatory change, that is, interest rate cap.

There was limited empirical evidences on interest rate caps and the coping mechanisms in commercial banks in Kenya. This is the gap that this study sought to fill. What are strategic responses being adopted by commercial banks in Kenya to cope with interest rate capping?

1.3 Research Objective

The objective of the study was to determine the strategic responses employed by commercial banks in Kenya to cope with interest rate capping.

1.4 Value of the Study

The study may be of value to the management and the staff of commercial banks in Kenya since this study will highlight the strategic responses that other competitors are employing to mitigate the interest rate capping. The findings would therefore enlighten and give insights to the top management in the banks hence inform their future decisions on some of the best strategies they can employ to cope with interest rate capping in a bid to remain competitive in the market.

The study may also be of significance to the Central bank of Kenya as a regulator and a policy maker. The mandate of CBK is to promote and maintain financial stability through regulation and supervision. CBK have acknowledged that interest rate capping would bring about rigidity in the financial system limiting consumers' access to credit from the banks. The findings of this study may therefore inform or trigger future policy in regard to interest rate capping in financial institutions.

The study would also benefit researchers and scholars as it would add value to the existing body of knowledge in the area of interest rate capping in financial institutions. The study would also act a source of reference for further research on the same area. The gaps identified from this study may also be the basis for future research in the area of interest rate capping in financial institutions.

The increasing aspect of 'institutional complexity' has been a recent resurgence of interest in how organizations respond strategically to organizational demands/challenges. This study would add knowledge to the institutional theory by advancing the understanding of how organizations experience and respond to institutional complexity.

CHAPTER TWO: LITERATURE REVIEW

2.1 Introduction

This chapter covers the various theories that guide the study and the empirical review on strategic responses to environmental challenges. The chapter ends with a section on knowledge gaps identified from the literature and the conceptual framework.

2.2 Theoretical Foundation

This section presents the theories that inform the study. The study was guided by Open Systems Theory, Dynamic Capability Theory and Institutional Theory.

2.2.1 Open Systems Theory

Open Systems theory refers simply to the concept that organizations are strongly influenced by their environment. The environment consists of other organizations that exert various forces of economic, political, or social nature. The environment also provides key resources that sustain the organization and lead to change and survival (Bastedo, 2006). Organisation as an open system has several attributes or characteristics. Organisational theorists such as Duffy (2008) argue that open system in an organisation needs to have the following attributes namely boundary, purpose, inputs, throughput (transformation process), outputs, feedback and environment. Open systems theory proposes that an organisation transforms inputs into outputs within the environment (both internal and external) upon which it is dependent (Katz & Kahn, 1971).

As portrayed by the theory, it is apparent that as the environment in which organizations operate has become more complex and turbulent; organizations can no longer ignore the impact of changes in the business on organizational function. In the context of this study, it can be said that commercial banks are embedded in their environment, importing resources from the environment and exporting products and services to the environment. Commercial banks have to pay emphasis on how interest rate capping has impacted on their business and respond to these changes for them to prosper.

In open systems, any change in any elements of the system causes changes in other elements. Organizations are not able to internally generate all the resources required to maintain themselves and therefore must enter into exchange transactions with elements in the environment to ensure a stable flow of resources (Stewart & Ayres, 2001). However, according to Yoon and Kuchinke (2005), the systems theory does not specify when and how collaboration with the organization needs to take place, nor what to do when the analysis suggests that there are existing or potential conflicts between the organizational environment, work environment, work, and the structure of the organization.

2.2.2 Dynamic Capability Theory

Dynamic capability means the firm's ability to adapt, integrate, build and reconfigure internal and external competences to address rapidly changing environments. The term 'dynamic' refers to the capacity to renew competences so as to achieve congruence with the changing business environment. The rate of change of the business environment is rapid, and the nature of future competition and markets is difficult to determine hence, certain innovative responses are required and timing is critical. The term 'capabilities' refers to an organization demonstrated and potential ability to accomplish against the opposition of circumstances or competition, whatever it sets out to do. The fundamental question is how firms achieve and sustain competitive advantage (Teece, Pisano & Shuen, 1997).

Dynamic capabilities theory is being used in this study to explain how firms respond to the dynamic business environments, focusing on the capabilities that firms employ to reach competitive advantage. The theory will inform this study on how commercial banks in Kenya are developing and building their capability to adapt and even capitalize on rapidly changing environment as a result of interest rate capping. Commercial banks that can demonstrate timely responsiveness to interest rate capping, coupled with effective capabilities management (internal and external competences) will continuously remain competitive.

The notion of dynamic capabilities complements the premise of the resource-based view of the firm, and has injected new vigour in empirical research in the recent past. Nonetheless, several issues surrounding its conceptualisation remain ambivalent (Wang & Ahmed, 2007). Eisenhardt and Martin (2000) reckon that dynamic capabilities cannot be a source of sustained competitive advantage; the only way that they can be a source of competitive advantage is if they are applied 'sooner' more astutely, and more fortuitously' than competition to create resource configurations. The authors further argue that, dynamic capabilities are just another type of capability and become irrelevant over time.

2.2.3 Institutional Theory

Institutional Theory is based on set of assumptions that centre on the concept of social construction, that is, the external and internal world of organisations is that which is subjectively understood or perceived by people in those organisations. Institutional theory views organizations as social entities that seek approval for their performances in socially constructed environments. Organizations conform to gain legitimacy and acceptance, which facilitate survival (Scott, 2008). Internally, institutionalization arises out of formalized structures and processes, technological factors as well as informal or emergent group and organization processes. Forces in the external environment include those related to the state (e.g. laws and regulations), the professions (e.g. licensure and certification), and other organizations – especially those within the same industrial sector (DiMaggio & Powell, 1983).

The purpose of this study is to identify the different strategic responses that organizations enact as a result of the institutional pressure toward conformity that are exerted on them. The study will specifically be seeking to establish the strategic responses employed by commercial banks in Kenya to cope with interest rate capping. The capping of interest rates was effected by the government for consumer protection and economic reasons. There was a feeling that commercial banks were charging exorbitant interest rates to clients.

In organizational studies, particularly in institutional theory, there has been a growing interest in the strategic responses of organizations to institutional demands, especially those of a conflicting nature such as Scott (2005); Seo and Creed (2002), which are broadening the limits of attention on the part of institutional theorists, which was hitherto focused on the effects of the institutional environment on structural conformity and isomorphism effects (Rincón, 2014). The institutional perspective has been increasingly criticised for its lack of attention to the organizational self-interests and active agency in organizational responses to institutional pressures and expectations (Oliver, 1991).

2.3 Organizations and their External Environment

The external environment of an organization comprises of all the entities that exist outside its boundary, but have significant influence on its growth and survival. An organization has little or no control over its environment but needs to constantly monitor and adapt to these external changes, a proactive or reactive response leads to significantly different outcome. The common external factors that influence the organization are competition, customers, resources, technology and laws and regulations (Voiculet *et al.*, 2010). The opportunities and threats that a company confronts with may exist or may develop in the next points: the own company industry where structural changes may be produced; the market place, which can be deteriorated by economical and social factors; competitiveness, where new dangers and opportunities may appear; new technologies that may cause fundamental chances of products, processes etc (Gasparotti, 2009).

In order to survive and prosper, the organization has to adapt itself to the ecological system that surrounds itself. It is important to utilize the environmental intelligence to determine the uncertainty and take appropriate actions for the well being of the organization. Organizations can adapt to external environment by forecasting and planning, organization design or reorganization and reduce resource dependence (Fereidouni *et al.*, 2010). In the process of formulating policy options, the organization must take account of external environmental opportunities and threats, present and future but internal potential, the forces and weaknesses of the organization, competitive advantage over competitors. Organizations need to achieve harmony between the organization's external environment and internal environment (Voiculet *et al.*, 2010).

Dynamic external environment changes impact on organizations goals and objectives and this makes it difficult for organizations to remain viable. To be able therefore to stay ahead of competition, it’s imperative for the organizations to continually scan the environment so that the organizations adjust their strategic responses to accommodate the demands of the environment (Ndung’u, Machuki & Murerwa, 2014). In view of the highly competitive market, companies must quickly grasp opportunities, respond to threats and outmanoeuvre their rivals to endure and succeed (Thompson, Strickland & Gamble, 2010).

2.4 Strategic Responses to Environmental Challenges

Pearce and Robinson (2011) posits that the factors that influence a firm's operations can be divided into three interrelated subcategories; factors in the remote environment, factors in the industry environment, and factors in the operating environment. Factorsq in the remote environment are political, economic, social or technological. Political factors include government regulations and legal issues and define both formal and informal rules under which the firm must operate. These include tax policy, employment laws, environmental regulations, trade restrictions and tariffs and political stability. Economic factors affect the purchasing power of potential customers and the firm's cost of capital. These include economic growth, interest rates and inflation rate. Social factors include demographic and cultural aspects of external environment. Technological factors can lower barriers to entry, reduce minimum efficient production levels and influence outsourcing decisions.

2.4.1 Economic Challenges

A review of the existing literature shows that Gichuki (2013) conducted a study to establish the strategic responses adopted by multinational companies in the cosmetics industry in Kenya to the changes in the environment. The study found out that there was high level of rivalry among cosmetic companies as each company struggles to outperform its competitors. Internal factors like management style and level of capital affected changes that took place in the companies. Cosmetic companies adopted different strategies in response to changes in their operating environment which ranged from outsourcing, retrenchment, product diversification, innovation, cost leadership, target marketing and enhanced customer care.

Macharia (2014) carried out a study to examine how Alliance Ginneries Company in Tanzania is strategically responding to challenges posed by the competitive environment. The study found out that the operating environment in the cotton industry is very dynamic and volatile. The study further concludes that Alliance Ginneries had adopted various strategies to respond to the environmental changes such as expansion into new regions, operation cost reduction, restructuring and outsourcing of non-core activities.

2.4.2 Technological Challenges

Pogutz and Tyteca (2010) reviewed the dimensions of technological innovation as related to environmental pressures. The study indicated environmental challenges can be taken, in various ways, as the central focus on which business strategies can be elaborated. The study cited that environmental pressures can be addressed through various forms of environment-friendly innovations at three different levels, that is., the process, the product, and the system. It was concluded that in many instances, technological innovation induced by environmental issues not only yields advantages from an ecological standpoint, but also from an economic and strategic point of view.

Matabishi (2015) conducted a study to determine the response strategies to environmental changes by International Award Foundation in Kenya. The study established thatq the changes in IAF environment include economic, technological, legal and social changes. In order to respond to the changes in the environment, IAF adopted information technology, organizational restructuring, differentiation strategy, strategic partnership, innovation strategy, organizational structure, resource mobilization, leadership and culture, and change management. The study recommended that IAF continually monitor its environment and swiftly modify its strategy in response to changes in the external environment.

2.4.3 Regulatory Changes and Political Instability

In another study, Wasike (2015) investigated the strategic responses to the business environment and performance of Old Mutual Kenya. The study established that Old Mutual Kenya Limited has adopted strategies similar to those adopted by other players in the financial services sector although it has been more aggressive in some aspects. Changes in business environment that affect the operation of the organization were traditional and non-traditional competition, political instability, economic changes, technological changes, regulatory changes, changing customer needs, talent flight due to changing employees expectations, industry's poor reputation resulting in low penetration and changing customer needs. The study revealed that Old Mutual Kenya responded to the business environment through mergers and acquisitions, product development and differentiation, aggressive brand campaigns, technology advancements and infrastructure refresh, business process automation, branch network and distribution expansion. The study also confirmed that the strategies adopted were effective and resulted in improved financial performance, enhanced brand visibility, better customer retention and diversified product offering.

Kamwere (2016) conducted a study on strategic responses to environmental challenges facing Faulu Bank in Kenya. The study found that the environmental challenges that faced Faulu bank were competition, obsolete technology, evolving customer needs, complying with regulatory requirements and political instability. It was observed that these challenges hindered Faulu bank's survival in environment and thus necessitated the bank to find strategies to deal with the situation. It was further found out that the main strategic responses adopted by Faulu bank to deal with environmental challenges included the adoption of product and service innovation, use of modern technologies, product differentiation, investing in research and development programmes, strategic talent management programme and training and development programme.

Moreover, Koech (2012) examined the strategic responses adopted by the commercial banks, and the intensity of the competitive forces to the banks operation. The findings revealed commercial banks in Kenya faced a number of challenges which includes high expectations from customers, high rate of competition, government rules, bureaucracy, marketing and high cost of operation. The study found out that commercial banks responded strategically to the competitive challenging environment through product differentiation, cost leadership and management, investment in technology, focus strategy and customer focus strategy. The study showed that there is a positive relationship between the competitive environment determined by the Porters five force and the strategies the commercial banks adopted to respond to the competitive environment.

2.5 Summary of Knowledge Gaps

This section presents the summary and the knowledge gaps identified from critique of the existing literature relevant to the study. The table below highlights the knowledge gaps identified between what has been written and the interest of this study.

Study	Objective	Methodology	Findings	Gap
Gichuki (2013)	Strategic responses to environmental challenges adopted by multinational companies in the cosmetics industry in Kenya	• Descriptive research design. • Targeted 5 multinational companies in the cosmetics industry, operating in Kenya. • Primary data through a questionnaire. • Descriptive analysis.	• High level of rivalry among cosmetic companies • Response strategies: outsourcing, retrenchment, product diversification, innovation, cost leadership, target marketing and enhanced customer care	Study was limited to strategic responses to environmental challenges in multinational companies and not in the banking sector.
Matabishi (2015)	Strategic responses to environmental challenges by international award foundation in Kenya	• Case Study (IAF). • Primary data through interview Guide. • Content analysis	Strategic responses: • Information technology, • organizational restructuring • differentiation • strategic partnership, • Innovation • Leadership and culture change	The study only concentrated on strategic responses to environmental challenges in IAF. Could not be generalised to banking sector.
Kamwere (2016)	Strategic Responses to Environmental Challenges Facing Faulu Bank in Kenya.	• Case Study (Faulu Bank). • Primary data. • Interview Guide. • Content analysis	- Environmental challenges: • Competition, • Obsolete technology, • Evolving customer needs, • Complying	This study was limited to strategic responses to environmental challenges, with a focus on only one bank - Faulu bank. The study looked at

			with regulatory requirements • Political instability. - Various Strategic Responses were adopted.	regulatory challenge.
Macharia (2014)	Strategic responses to environmental challenges by alliance ginneries ltd in Tanzania	• Case Study (Alliance Ginneries Ltd). • Primary data. • Interview Guide • Content analysis.	Strategic Responses to environmental challenges: • Expansion into new regions, • Operation cost reduction, • Restructuring and • Outsourcing of non-core activities.	The study was limited to environmental challenges in Alliance Ginneries Ltd, Tanzania. The study looked at strategic responses to a regulatory challenge in the banking sector in Kenya.
Wasike (2015)	Investigated the strategic responses to the business environment an d performance of Old Mutual Kenya.	• Case study • Primary and secondary data • Interview Guide • Content analysis technique.	Environment challenges: • Competition. • Political instability. • Economic changes. • Technological changes. • Regulatory changes. • Changing customer needs.	Study limited to strategic responses to the business environment in insurance industry. The study looked at strategic responses to interest rate capping - a regulatory change.
Koech (2012)	Strategies adopted by local commercial banks in response to the competitive environment.	• Descriptive survey design. • Primary data through Questionnaire • Descriptive and inferential statistics.	- Environmental challenges: • Customers expectations • High competition • Government rules • High cost of	Study was conducted on response to the competitive environment in banking industry. The study looked at strategic responses to interest rate capping –

			operations. - Strategic responses: • Product differentiation, cost leadership • Investment in technology • focus strategy • customer focus strategy	regulatory change.

CHAPTER THREE: RESEARCH METHODOLOGY

3.1 Introduction

This chapter sets out various stages and phases that were followed in completing the study. It outlines a blueprint for the collection, measurement and analysis of data. It covers the research design, study population, data collection and data analysis.

3.2 Research Design

Research design refers to how the researcher put a research study together to answer a set of questions. Research design works as a systematic plan outlining the study, the researchers' methods of compilation, details on how the study will arrive at its conclusions and the limitations of the research (McLaughlin, 2012). The study adopted a cross-sectional descriptive design. A descriptive design is a research technique in which data are gathered by asking questions to respondents. It is one of the best methods for conductingq research in human contexts because of portraying accurate current facts through data collection for answering questions to conclude the study (Williams, 2007).

The cross-sectional descriptive design incorporates both quantitative and qualitative analysis. It was therefore appropriate for this study since it helped in collecting data through a questionnaire in order to answer the question of the current status and describe theq nature of existing conditions of the subject under study.

3.3 Population of the Study

A population is defined as a complete set of individuals, case or objects with some common observable characteristic (Bryman, 2008). The study population was the senior management staff in all the 42 commercial banks registered with CBK as at December 31st 2016 (CBK, 2016) (see Appendix II). The study picked one manager in each bank to give a population size of 42 management staff in all the commercial banks in Kenya.

A census study was adopted whereby the entire population was considered for the study. According to Cooper and Schindler (2011) a census is feasible when the population is small and necessary when the elements are quite different from each other. When the population is small and variable, any sample drawn may not be representative of the population from which it is drawn. A census study was deemed be appropriate for study since the sampling frame is small; thus the entire population of 42 banks were considered for the study.

3.4 Data Collection

The study collected primary data through use of a questionnaire. The questionnaire had both closed and open ended questions. It was divided into four sections. Section one gathered information on demographic information of the respondents, section two collected information on commercial banks, section three covered questions on effects of interest rate capping to the banks while section four covered questions on strategic responses by banks to interest rate capping. The data was collected from the management staff in the commercial banks since they involved in developing and overseeing the implementation of the strategic responses and they are deemed informed to give reliable information on the research problem. The researcher administered the questionnaire through drop and pick later method.

The questionnaire was considered as the appropriate data collection instrument for this study since they provide a high degree of data standardization, they are relatively quick to collect information from people in a non-threatening way and they are cheap to administer. Questionnaires are also able to give a detailed answer to complex problems (Kombo & Tromp, 2009).

3.5 Data Analysis

The data collected through the questionnaire was edited, coded, entered into Statistical Package for Social Sciences (SPSS) Version 21, which also aided in data analysis. The data was analyzed using descriptive statistics to enable the researcher to summarize and organize data in an effective and meaningful way. The descriptive statistics included frequency distribution tables and the mean, standard deviation and measures of relative frequencies. The quantitative data was presented using tables, charts and graphs. The qualitative data was categorized in themes in accordance with research objectives and reported in narrative form along with quantitative presentation.

CHAPTER FOUR: DATA ANALYSIS, RESULTS AND DISCUSSION

4.1 Introduction

This chapter presents the study data analysis, interpretation and discussion of the results. The objective of the study was to determine the strategic responses employed by commercial banks in Kenya to cope with interest rate capping. The findings were presented in tables and charts.

The study targeted 42 managers from the entire population of forty two banks in Kenya who were issued with questionnaires. Out of targeted sample size, 38 respondents successfully filled the questionnaires in time for analysis, which translate to a response rate of 90.5%. The response was appropriate for the study to continue and provide reliable results that could help make inference on the study. According to Mugenda and Mugenda (2003) fifty percent response rate is adequate, sixty percent is good and above seventy percent is rated very well.

4.2 Demographic Information

The section presents the demographic information of the respondents and the commercial banks who formed the population the study. This information was important in understanding and classifying the different responses according to the respondents' demographics and the banks' profile. The information captured includes: designation in the bank, number of years worked in the respective position and in the bank, market share of the bank, duration the bank has been in existence operation in Kenya and form of ownership of the bank.

4.2.1 Designation in the Bank

The respondents were asked to indicate their position in the bank. This was important as this study was limited to the management staff in the bank. The findings are presented in Table 4.1.

Table 4.1: Designation in the Bank

Designation	Frequency	Percent
Credit Manager	8	21.1
Relationship Manager	16	42.1
Branch Manager	14	36.8
Total	**38**	**100.0**

Source: Research Data (2017)

The study results in Table 4.1 show that 42.1% of the respondents who took part in the study were relationship managers while 36.8% were branch managers. On the other hand, 21.1% of the respondents were credit managers. The study targeted the management staff since they were in a position to give reliable information on the strategic responses employed by their banks to manage interest rate capping.

4.2.2 Duration Worked in the Current Position

The study sought to establish the number of years the respondents had worked in the above mentioned position. This was important in order to show the respondents experience in the position they held. The findings are presented in Table 4.2.

Table 4.2: Duration Worked in the Current Position

Duration (in Years)	Frequency	Percent
1-5 years	9	23.7
6-10 years	22	57.9
Over 10 years	7	18.4
Total	**38**	**100.0**

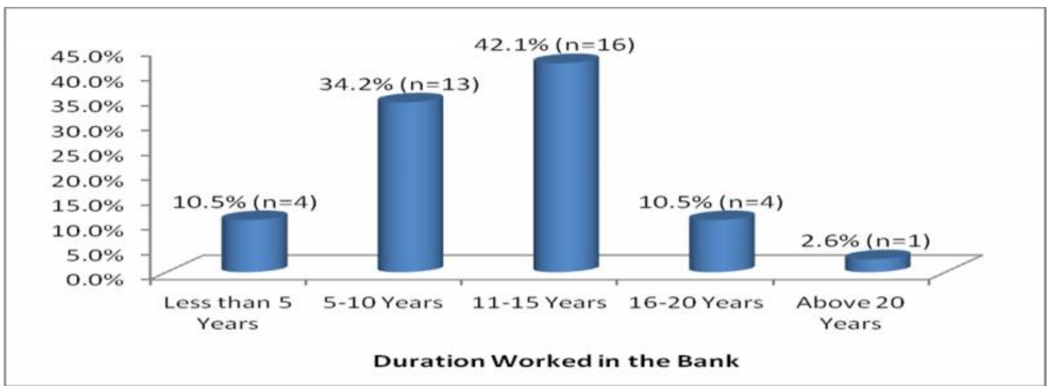
Source: Research Data (2017)

The study results show that majority of the respondents (57.9%) had worked in their current position for 6-10 years while 18.4% had worked in their current position more than 10 years. Majority of the respondents fell in these two categories which shows that the respondents had held the position for over five years, which is substantial time for one to understand the strategic responses employed by their institutions; hence it improves the reliability of the information given by the respondents.

4.2.3 Number of Years Worked in the Bank

The respondents were asked to indicate the number of years they had worked in the respective banks. The findings are presented in Figure 4.1.

Figure 4.1: Number of Years Worked in the Bank

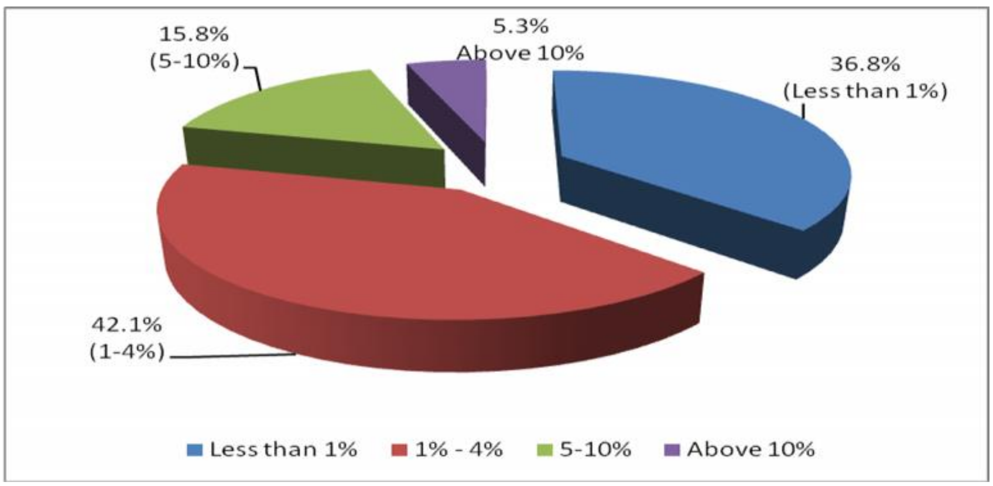


Source: Research Data (2017)

The study findings in Figure 4.1 show that 42.1% of the respondents indicated that they had worked in their respective banks for duration of 11-15 years while 34.2% they had worked for duration of 5-10 years. On the other hand, 10.5% of the respondents indicated that they had worked in their respective banks for a duration of 16-20 years and less than 5 years respectively. The findings show that majority of the respondents had worked in their respective banks for more than five years.

4.2.4 Market Share of the Banks

Figure 4.2: Market Share of the Banks



Source: Research Data (2017)

The study findings in Figure 4.2 show that 42.1% (n=16) of the banks had a market share of between 1-4% while 36.8% (n=14) had a market share of less than 1%. On the other hand, 15.8% (n=6) the banks had had a market share of 5-10% while 5.3% (n=2) had a market share of above 10%.

According to CBK report (2016), seven banks (tier one banks) out of 42 banks control 58.2% market share. These banks are KCB, Equity, Co-operative, Standard Chartered, Barclays, CBA and Diamond Trust banks.

4.2.5 Duration of Operation in Kenya

In this section, the study sought to establish the number of years the bank had been in operation in Kenya. The findings are presented in Table 4.3

Table 4.3: Duration of Operation in Kenya

No. in Years	Frequency	Percent
6-10 years	2	5.3
11-15 years	5	13.2
16-20 yrs	4	10.5
Over 20 years	27	71.1
Total	**38**	**100.0**

Source: Research Data (2017)

The study findings show that majority of the banks (71.1%) had been in operation in Kenya for more than 20 year while 10.5% had been in operation in Kenya for a duration of 16-20 years. The study findings further show that 13.2% of the banks had been in operation in Kenya for 11-15 years while 5.3% had been in existence in the Kenyan market for 6-10 years.

4.2.6 Form of Ownership of the Bank

The study sought to establish the form of ownership of the banks which took part in the study. The results are presented in Table 4.4.

Table 4.4. Form of Ownership of the Bank

Form of Ownership	Frequency	Percent
Local Public Commercial Bank	8	21.1
Local Private Commercial Bank	23	60.5
Foreign Commercial Banks	7	18.4
Total	**38**	**100.0**

Source: Research Data (2017)

The findings in Table 4.4 show that majority of the banks (60.5%) were local private commercial banks; 21.1% were local public commercial bank while 18.4% were foreign commercial banks. This shows that the study was inclusive of all banks irrespective of their form of ownership.

4.3 Interest Rate Capping

In this section, the study sought to establish the how the interest rate caps introduced in the year 2016 had affected the commercial bank's business environment, the Non-Performing Loans and whether it had helped in enhancing consumer protection from exorbitant interest rates.

4.3.1 Whether Interest Rates Capping have changed the Business Environment

The respondents were asked to indicate whether interest rates capping had changed the bank's business environment. The findings are presented in Table 4.5.

Table 4.5 Interest Rates Capping and Banks Business Environment

Responses	**Frequency**	**Percent**
Yes	38	100.0
No	-	-
Total	**38**	**100.0**

Source: Research Data (2017)

The study results in Table 4.5 show that all the respondents 100% (n=38) indicated that interest rates capping had changed the bank's business environment. The respondents explained that the interest rates capping had narrowed the pricing gap of the banks and had removed banks ability to price risk. As a result, it has bundled all risks to the bank.

4.3.2 Whether Interest Rates Capping has affected the NPLs in the Bank

The respondenbts were asked to indicate whether the interest rates capping had affected the NPLs in their bank. They revealed that with the introduction of interest rates caps, banks were finding it hard to assess potential borrower's ability to service loans leading to high NPLs. Initially, banks would caution this risk of lack of information on borrowers' credit worth by raising rates to cover for this risk. However, with the caps, they are unable to cover these risks. However, some respondents felt that the effect of interest rates caps on NPLs was not significant because they had reduced their lending to small enterprises and high-risk borrowers.

4.3.3 Interest Rates Capping and Consumer Protection

The respondents were asked whether the interest rates capping had helped achieve consumer protection from exorbitant interest rates. All the respondents reported that interest rate caps have not managed to pass the benefits of the low rates to the consumers as it was intended. Instead, the interest rate caps have starved and limited access to credit to low-income consumers, who need it most for their economic development. The respondents indicated that the cap has cut lending to risky borrowers like small enterprises, curbing economic growth.

4.3.4 Effects of Interest Rate Caps on Commercial Banks

The respondents were asked to indicate the extent to which the interest rate caps introduced in the year 2016 had affected the various aspects in the bank. A five point likert scale was used to interpret the responses whereby the scores of "Not at all" and "small extent" were represented by mean score, equivalent to likert scale (1≤small exent≥2.5). The scores of ‘moderate extent’ were equivalent to 2.6 to 3.5 on the likert scale (2.6≤ moderate extent ≥3.5) The scores of “great extent” and “very great extent” were equivalent to (3.6≤Great Extent≥5) on the likert scale. The results are presented in Table 4.6.

Table 4.6: Effects of Interest Rate Caps on Commercial Banks

Effects of Interest Rate Caps	**N**	**Mean**	**Std. Deviation**
Reduced banks profits.	38	3.05	0.613
Reduced supply of credit.	38	4.18	0.692
Increased high operational costs and risks.	38	3.82	0.766
Has increased access to finance to small enterprises and low income borrowers.	38	1.53	0.603

Source: Research Data (2017)

The study findings show that the respondents indicated that interest rate caps had reduced the supply of credit to the borrowers to a great extent (mean score = 4.18). The respondents also revealed that interest rate caps had increased the operational costs and risks to the bank to a great extent (mean score = 3.82). On the other had, the respondents reported that interest rate caps had reduced banks profits to a moderate extent (mean score =3.05). The respondents further indicated that interest rate caps had increased access to finance to small enterprises and low income borrowers to a small extent as shown by a mean score of 1.53.

The respondents further explained that interest rate caps had increased competition in the industry for the few quality customers. They have also had an impact on profits and that they have weaken bank’s balance sheets. A number of banks have showed a decline in earnings and dividends to owners of the banks. The respondents also revealed that sustained capping of commercial banks' lending rates could potentially pose a risk to financial stability. Small banks may find it difficult to survive in the market.

4.4 Strategic Responses to Interest Rate Capping

4.4.1 Strategic Responses employed by the Banks to Interest Rate Capping

In this section, the study sought to establish how the commercial banks were responding to interest rate caps, to cope with interest rate caps and to remain competitive in the market. A five point likert scale was used to interpret the responses whereby the scores of "strongly disagree" and "disagree" were represented by mean score, equivalent to 1 to 2.5 on the continuous Likert scale (1 ≤ disagree ≤ 2.5). The scores of 'neutral' were equivalent to 2.6 to 3.5 on the likert scale (2.6 ≤ neutral ≤ 3.5). The score of "agree" and "strongly agree" represented were equivalent to 3.6 to 5.0 on the likert scale which shows a strong agreement. The findings are presented in Table 4.7.

Table 4.7: Strategic Responses to Interest Rate Capping

Strategic Responses	N	Mean	Std. Deviation
Innovate and expand into new markets	38	4.21	0.741
Retrenchment of staff to cut operating costs	38	3.21	1.069
Diversifying into other products	38	3.66	0.745
Product and service innovation.	38	4.05	0.695
Closing some branches/ establishments	38	2.55	0.921
Adopting modern technology in bank operations to enhance efficiency.	38	4.50	0.507
The banks have increased supply of credit (lending) to lower-income borrowers.	38	1.79	0.777
Banks have reduced/excluded high-risk borrowers from credit/lending.	38	3.29	1.011
Reducing staff expenses and benefits (e.g. bonuses etc)	38	4.11	0.727

Source: Research Data (2017)

The study findings show that the respondents agreed that they were responding to interest rate caps by adopting modern technology in bank operations to enhance efficiency (mean score = 4.50); and by innovating and expanding into new markets (mean score = 4.21). The respondents also agreed that their institutions reduced staff expenses and benefits such as bonuses (mean score = 4.11). On the other hand, the respondents agreed their banks innovated new products and service (mean score = 4.05), as well as diversifying into other products (mean score = 3.66) in order to cope with the interest rate caps.

However, the respondents disagreed that the banks had increased supply of credit to lower-income borrowers in order to cope with the interest rate caps (mean score =1.79). The respondents neither agreed nor disagreed whether the banks had reduced or excluded high-risk borrowers from lending to them (mean score = 3.29). The respondents were also neutral when asked whether their banks were retrenching of staff to cut operating costs (mean score = 3.21); and on whether the banks were closing some branches or establishments as a strategic response to interest rate caps (mean score = 2.55).

4.4.2 Whether the Strategic Responses Were Effective

The respondents were asked to indicate whether the strategic responses employed by the banks were effective in addressing the challenges pose by the interest rate caps. Most of the respondents indicated that the strategic responses were effective to a moderate extent. Others reported that the strategies they had put in place were still under implementation and review and therefore it was not clear on whether the strategies were effective. A number of the respondents indicated that the measures that were put in place were not effective in coping with interest rate capping and that the only solution was scrap interest rate cap and let the market forces regulate the prices.

4.4.3 Suggestion on Interest Rate Caps in Commcercial Banks

The respondents were asked to give a suggestions or recommendation in regard to interest rate caps. Majority of the respondents were of the opinion that interest rate cap should be removed to allow forces of demand and supply to set prices of the interest rates charged in the market. The respondents revealed that it is essential to remove these controls, while taking steps to prevent predatory lending and increase competition and transparency of the banking sector.

4.5 Discussion

The study found out that interest rates capping had changed the bank's business environment. They had narrowed the pricing gap of the banks and had removed banks ability to price risk. They have also reduced the banks' profits, weakened their balance sheet, and affected the share earnings which pose a risk to financial stability of the banks. The study also found out that interest rates capping has not helped achieve consumer protection from exorbitant interest rates as it was intended, but instead it had starved the market of the needed credit. Interest rates capping has also locked out small business and other "high risk" borrowers from accessing credit. These finding are in agreement with those of Agolla (2016) who revealed that capping of interest rates distort the market and prevents financial institutions from offering loan products to those at the lower end of the market that have no alternative access to credit. The findings are further supported by Miller (2013) who indicated that interest rates caps have an effect on the quantity of credit available in the market which is detrimental to financial outreach and credit growth.

The study found out that commercial banks in Kenya were employing a myriad of strategies to cope with interest rate capping. It was found out that they were adopting modern technology in bank operations to enhance efficiency, innovating and expanding into new markets, diversifying into other products as well as cutting on staff expenses and benefits, and retrenching some staff to cut operating costs to a moderate extent. The above findings are in agreement with those of Gichuki (2013) who conducted a study on multinational companies and found out that they were adopting different strategies in response to changes in their operating environment which ranged from outsourcing, retrenchment, product diversification, innovation, cost leadership and enhanced marketing. The findings are also supported by Koech (2012) who examined the strategic responses adopted by the commercial banks, and the intensity of the competitive forces to the banks operation. The study found out that commercial banks responded strategically to the competitive challenging environment through cost leadership strategies, investment in technology, focus strategy and customer focus strategy, expansion into new regions and restructuring.

CHAPTER FIVE: SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

5.1. Introduction

This chapter provides a summary of findings, conclusions and recommendations of the study based on the objective of the study. It entails a synthesis of key issues of the objective of the study as deduced from the entire research.

5.2. Summary of Findings

The study found that all the managers agreed that interest rates capping had changed the bank's business environment. They revealed that interest rates capping had narrowed the pricing gap of the banks and had removed banks' ability to price risk. The study also found out that interest rates capping had not helped to achieve consumer protection from exorbitant interest rates, but instead it starved the market of the needed credit.

On the effects of interest rate caps on commercial banks, the study found out that interest rate caps had reduced the supply of credit to the borrowers to a great extent; and had also increased the operational costs and risks to the bank to a great extent. The study further found out that interest rate caps had reduced banks profits to a moderate extent. The interest rate caps were also found to limit access to finance to small enterprises and low income borrowers. Instead, the capping had increased competition in the industry for the few quality customers.

On the strategic responses employed by the bank cope with interest rate capping, the study found out that they were adopting modern technology in bank operations to enhance efficiency as well as innovating and expanding into new markets. The respondents also agreed that the banks were innovating new products and services, diversifying into other products as well as cutting on staff expenses and benefits such as bonuses. The banks were also retrenching some staff to cut operating costs to a moderate extent.

5.3 Conclusions

The study concludes that interest rates capping have an effect on the commercial banks efficiency, stability and performance as it doesn't account for several factors that might affect the banks' decision to opt for certain spreads. This includes factors such as market structure, credit risk, distribution of market power and lack of information on borrowers' credit worth (information flow/asymmetry). Interest rates capping have also locked out SMEs and other "high risk" borrowers from accessing credit as banks are competing for the few quality clients in the market.

The study concludes that interest rate caps may result in a slowdown in credit growth. This may further result in the high risk borrowers and small scale businesses (which are offering employment) being excluded from the formal financial system. Introduction of an interest cap in a fully liberalized capital market results in capital flight. Shares of the largest Kenyan Banks listed on the Nairobi Exchange plummeted by ten percent in response to the news of the introduction of the interest rate cap. This was mainly due to loss of investor confidence and capital flight.

The study concludes that commercial banks are employing various strategies to manage the interest rate caps introduced in the year 2016. These includes innovating and expanding into new markets, diversifying into other products, adopting modern technology in bank operations to enhance efficiency, and reducing staff expenses and benefits so as to cut on operation costs. Introduction of interest rate caps have weakened bank's balance sheets and posed a risk to financial efficiency and stability; and therefore banks are adopting these strategies as way to maintain their performance and competitive edge in the market.

5.4 Recommendations

The study recommends that CBK should review or remove the interest rate cap introduced in the year 2016 to allow forces of demand and supply to set prices of the interest rates charged. There are market driven prescriptions for addressing the cost of credit in order to improve access to finance other than putting caps. These include enhanced competition in the banking industry, product innovation, improved financial consumer protection framework, increased financial literacy, promotion of credit reference bureaus, enforced disclosure of interest rates and total cost of borrowing, and promoting micro-credit products.

The study further recommends that, if the law on interest rate cap is to remain, and for it to achieve its intended purpose, the government will have to cut down on its domestic borrowing. When the government sets to sell a 10 year bond at an average yield of 15 per cent which is risk free, you do not expect banks to lend to a risky business and individuals at 14.5 per cent. The point is, there is a need for a fiscal adjustment as well or else, banks will; prefer to loan to the government and shun all the other borrowers who are the drivers of the economy.

Due to the increasing competition whereby the banks are competing for few quality clients in the market to offer credit; the study recommends for realignment especially of the small banks through mergers and acquisition so that they are able to compete with their larger counterparts. Failure to do such realignment may pose challenges to the small banks in the long run which have a small market share.

5.5 Limitations of the Study

In the pursuit of conducting this study, the researcher initially experienced challenges of getting information/data from the respondents who were management staff. Accessing the management staff in the commercial banks was difficult as they were busy. It was difficult to fit in their busy schedules. However, the researcher countered this limitation by booking for appointments at the most convenient time of the respondents so as to avoid interfering with their busy schedules. The researcher also used drop and pick later method so give the respondents ample time to fill the questionnaire at their own free time.

Other than the challenge of access to the respondents, some of the respondents were also unwilling to share information for fear that the data may released to other unauthorized persons or to their competitors. However, the researcher overcame this challenge by informing the respondents on the purpose of the study and how it could benefit the institutions. The researcher also followed ethical procedures and ensured confidentiality of the data given.

5.6 Suggestion for Further Studies

This study was limited to examining the strategic responses employed by commercial banks in Kenya to cope with interest rate capping. The study did not fully and deeply investigate on the effect of interest rate capping on all commercial banks in Kenya. In this regard, the study recommends that a future study should unearth the positive and negative effects of interest rate capping on commercial banks in Kenya, for a more conclusive study. The future study should also have a wider coverage by targeting other stakeholders such as CBK as the regulator as well as borrowers who are the consumers of the banks' products.

In addition, the study was conducted one year after the enactment of the Banking (Amendment) Act, 2015 which caps banks' interest rates. One year may not be adequate for this research to give a conclusive representation on the strategies employed by commercial banks in Kenya to cope with interest rate capping. It is expected that the banks will continually adopt new strategic responses over the years. In this regard, the researcher suggests that a similar study be conducted in the future, preferably after a period of five years for comparison purposes of the results.

REFERENCES

Agolla, V. (2016). *Interest rate caps & their impact on financial inclusion in Kenya.* Available on: https://www.linkedin.com/pulse/interest-rate-caps-impact-financial-inclusion-kenya-agolla. Retrieved on July 8th 2017.

Banking (Amendment) Act, 2015.

Bastedo, M. N. (2006). *Open systems theory*. In F. English (Ed.), Encyclopedia of Educational Leadership and Administration. London: Sage Publications Inc.

Breznik, L., & Lahovnik, M. (2016) Dynamic capabilities and competitive advantage: Findings from Case Studies. *Management*, 21, 167-185.

Bryman, A. (2008). 'Of methods and methodology'. Qualitative Research in Organizations and Management. *An International Journal*, 3(2), 159-168.

Central Bank of Kenya report (2011): http://www.centralbank.go.ke

Central Bank of Kenya report (2016). http://www.centralbank.go.ke

Central Bank of Kenya Supervision Report (2015). http://www.centralbank.go.ke

Cooper, D. R., & Schindler, P. S. (2011). *Business Research Methods*. (11th ed). New York: McGraw Hill International Edition.

Cytonn Research (2016). *The Impact of Capping Interest Rates on the Kenyan Economy.* Accessed March 25th from: http://cytonn.com/download/

DiMaggio, P., & Powell, W. (1983). The iron cage revisited: institutional isomorphism and collective rationality in organizational fields. *American Sociological Review*, 48 (2), 147-160.

Duffy, F. M. (2008), '*Open system theory and system dynamics: the twin pillars of transformational change in school district'*, in Despres B (ed.) System thinkers in action, Rowman & Littlefield Education, America, pp. 1-23

Eisenhardt, K.M., & Martin, J.A. (2000). "Dynamic capabilities: what are they?" *Strategic Management Journal*, 21 (10-11), 1105-21.

Fereidouni, H.G., Masron, T.A., Nikbin, D, Amiri, R.E. (2010). Consequences of External Environment on Entrepreneurial Motivation in Iran. *Asian Academy of Management Journal.* 15(2), 175–196.

Gasparotti, C. (2009). The internal and external environment analysis of Romanian naval industry with Swot model. *Management & Marketing*, 4(3), 97-110.

Gichuki, C. K. (2013). *Strategic responses to environmental challenges adopted by multinational companies in the cosmetics industry in Kenya*. Unpublished Research Project, University of Nairobi.

Grant, R. (2002). *Contemporary Strategy Analysis*. Blackwell Publishers, United States.

Kamwere, H. G. (2016). *Strategic Responses to Environmental Challenges Facing Faulu Bank in Kenya.* Unpublished MBA Research Project, University of Nairobi.

Katz, D., & Kahn, R. (1971). '*Open system theory'*, in J.G Maurer Reading in Organisation Theory, Random House, New York, pp. 13-30

Koech, L. C. (2012). *Strategies adopted by local commercial banks in response to the competitive environment*. Unpublished Research Project, University of Nairobi.

Kombo, D. K., & Tromp, D. L. A. (2009). *Proposal and Thesis Writing: An Introduction.* Paulines Publications Africa, Don Bosco Printing Press, Nairobi Kenya.

Macharia, F.G. (2014). *Strategic responses to environmental challenges by alliance ginneries Ltd in Tanzania.* Unpublished MBA Research Project, University of Nairobi.

Maimbo, S. M., & Gallegos, C.A. (2014). *Interest Rate Caps Around the World: Still Popular, But a Blunt Instrument*. World Bank Policy Research Working Paper No. 7070.

Matabishi, M. (2015). *Strategic responses to environmental challenges by international award foundation in Keny*a. Unpublished Research Project, University of Nairobi.

Mbengue, D. M. (2013). *The Worrying Trend of Interest Rate Caps in Africa*. http://www.cgap.org/blog/worrying-trend-interest-rate-caps-africa. Retrieved July 10th 2017.

McLaughlin, H. (2012). "*The Philosophy of Social Research*." In Understanding Social Work Research (2nd edition). London: SAGE Publications Ltd.

Miller, H. (2013). *Interest rate caps and their impact on financial inclusion*. EPS-PEAKS.

Ndung'u, C. W. Machuki, V.N., & Murerwa, T. (2013). Response Strategies by Commercial Banks to Economic Changes in Kenya. *Journal of Economics and Sustainable Development, 5* (2), 137- 153.

Nitu, F. (2015). Hungarian Small and Medium Enterprises' Strategies and their Effects on the Economic Performance. *AUDŒ*, 11 (3), 81-93.

Oliver, C. (1991). Strategic Responses to Institutional Processes. *The Academy of Management Review*, 16 (1), 145-179.

Ongeri, B. (2013). "*The Role of Kenya's Listed Commercial Banks in Economic Growth - An Econometric Analysis*." University of Nairobi.

Pearce, J. A., & Robinson, R. B. (2010). *Strategic management formulation, implementation and control* (12th ed.). Boston, MA: McGraw-Hill.

Pearce, J. A., & Robinson, R. B. (2011). *Corporate Social Responsibility and Business Ethics. Strategic management: formulation, implementation, and control* (12th ed.). New York: McGraw-Hill/Irwin.

Pogutz, S., & Tyteca, D. (2010). *Business organisational response to environmental challenges: innovation*. In: Environmental Challenges of Business Management in Europe . s.l.:s.n

Ramsay, I. (2010). 'To heap distress upon distress?' comparative reflections on interest-rate ceilings. *The University of Toronto Law Journal*, 60(2), 707-730.

Rincón, V. G. (2014). Beyond the internal dynamics of organizational responses to conflicting institutional demands. *Estudios Gerenciales*, 30 (133).

Scott, R. (2005). *Institutional theory: Contributing to a theoretical research program in great minds in managemen*t. In K. Smith, & M. Hitt (Eds.), The process of theory development. London: Oxford University Press.

Scott, W. R. (2008). *Institutions and organisations: ideas and interests*. SAGE Publications, Los Angeles, CA.

Seo, M., & Creed, D. (2002). Institutional contradictions, praxis, and institutional change: A dialectical perspective. *Academy of Management Review*, 27(2), 232–247

Shehada, F. (2010). *Strategic organizational responses to environmental pressures: the case of three Palestinian non-governmental organizations* (Doctoral dissertation, Rutgers University-Graduate School-Newark).

Smith, B. (2002). Strategic responses to market changes. *International Journal of Medical Marketing*, 3(1), 80–85.

Stewart, J., & Ayres, R. (2001). “Systems theory and policy practice: an exploration”. *Policy Sciences*, 34(1), 79-88.

Teece, D.J., Pisano, G., & Shuen, A. (1997). Dynamic Capabilities and Strategic Management. *Strategic Management Journal*, 18 (7), 509-533

Thompson A. and Strickland A.J. (2003), *Strategic Management. Concepts and Cases*. Irwin: New York.

Thompson, A. A., Strickland, A. J., & Gamble, J. (2010). *Crafting and executing strategy: The quest for competitive advantage: concepts and cases*. Boston: McGraw-Hill/Irwin.

Voiculet, A., Belu, N., Parpandel, E.D., & Rizea, I.C. (2010). *The Impact of External Environment on Organizational Development Strategy*. MPRA Paper No. 26303, 1–5.

Wang, C., & Ahmed, P. (2007). “Dynamic capabilities: a review and research agenda.” *International Journal of Management Reviews*, 9(1), 31-51.

Wasike, L. N. (2015). Strategic Responses to the Business Environment and Performance of Old Mutual Kenya. Unpublished Research Project, University of Nairobi.

Williams, C. (2007). ‘Research Methods’. *Journal of Business & Economic Research*, 5 (3), 65-72.

Xinhua, (2017). *News Analysis: Kenyan banks trying hard to adapt to interest rate caps*. http://news.xinhuanet.com/english/2017-04/24/c_136232741.htm. Retrieved on July 15th 2017.

Yoon, S., & Kuchinke, K. P. (2005). "Systems theory and technology. Lenses to analyze an organization". *Performance Improvement*, 44(4), 15-20.

APPENDICES

Appendix I: Questionnaire for Managers in the Bank

Instructions: Please read the answer the questions as appropriately as possible. It is advisable that you answer or fill in each section as provided. Tick (√) where appropriate.

Section A: Demographic Information

1. Indicate your designation in your bank...

2. Please indicate how long you have worked in your current position?

Less than 1 year [ ]   1-5 years [ ]   6-10 years [ ]

Over 10 years [ ]

3. How many years have you worked in this bank?

a) Less than 5 Years [ ]   b) 5-10 Years [ ]

c) 11-15 Years [ ]   d) 16-20 Years [ ]

e) Above 20 Years [ ]

Section B: Information on Commercial Banks

4. What is the market share of your bank?

Less than 1% [ ]   1% - 4% [ ]   5-10% [ ]

Above 10% [ ]

5. How long has your bank been in existence/operational in Kenya?

5 years and below [ ]   6-10 years [ ]   11-15 years [ ]

16-20 years [ ] Over 20 years [ ]

6. Indicate the form of ownership of your bank.

Local Public Commercial Bank [ ] Local Private Commercial Bank [ ]

Foreign Commercial Banks [ ]

Section C: Interest Rate Capping

7a). Has the interest rates capping changed the bank's business environment?

Yes [ ] No [ ]

b). If yes, how has the interest rates capping changed the bank's business environment? Explain..

....

....

8. How has the interest rates capping affected the NPLs in the bank? ....

....

....

9. Do you think the interest rates capping has helped achieve consumer protection from exorbitant interest rates as intended? Explain ....

....

....

10. To what extent has the interest rate caps introduced in the year 2016 affected the following aspects in your bank? Use a scale of 1-5, where 1 Not at all, 2

is Small extent, 3 is Moderate extent, 4 is Great extent and 5 is Very great extent

Effects of Interest Rate Capping	**1**	**2**	**3**	**4**	**5**
Reduced banks profits.					
Reduced supply of credit.					
Increased high operational costs and risks.					
Has increased access to finance to small enterprises and low income borrowers.					

11. How else has interest rate caps affected your bank? ....

....

....

Section D: Strategic Responses to Interest Rate Capping

12. How is your bank responding to interest rate caps, in a bid to protect its bottom line and remain competitive in the market? Use a scale of 1 to 5 where 1 is strongly disagree, 2 is disagree, 3 is Neutral, 4 is agree and 5 is strongly agree

Statements on Strategic Responses to Interest Rate Caps	**1**	**2**	**3**	**4**	**5**
Innovate and expand into new markets					
Retrenchment of staff to cut operating costs					
Diversifying into other products					
Product and service innovation.					
Closing some branches/ establishments					
Adopting modern technology in bank operations to enhance efficiency.					

The banks have increased supply of credit (lending) to lower-income borrowers.					
Banks have reduced/excluded high-risk borrowers from credit/lending.					
Reducing staff expenses and benefits (e.g. bonuses etc)					

13. How else is your bank responding to the newly introduced interest rate caps?

....

....

....

14. Are the strategic responses employed by your bank managed to effectively address the challenges posed by the interest rate caps by the government?

....

....

....

15. What recommendations or suggestion can you give in regard to interest rate caps in commercial banks? ....

....

....

THANK YOU FOR YOUR PARTICIPATION

Appendix II: List of Commercial Banks in Kenya as at 31st December 2016

1. African Banking Corporation Limited
2. Bank of Africa Kenya Limited
3. Bank of Baroda (K) Limited
4. Bank of India
5. Barclays Bank of Kenya Limited
6. Stanbic Bank Kenya Limited
7. Charterhouse Bank Limited (Under - Statutory Management)
8. Chase Bank (K) Limited (In Receivership)
9. Citibank N.A Kenya
10. Commercial Bank of Africa Limited
11. Consolidated Bank of Kenya Limited
12. Co-operative Bank of Kenya Limited
13. Credit Bank Limited
14. Development Bank of Kenya Limited
15. Diamond Trust Bank Kenya Limited
16. Ecobank Kenya Limited
17. Spire Bank Limited (Formerly Equatorial Commercial Bank Limited)
18. Equity Bank Limited
19. Family Bank Limited
20. Fidelity Commercial Bank Limited
21. Guaranty Trust Bank (K) Ltd
22. First Community Bank Limited

23. Giro Commercial Bank Limited
24. Guardian Bank Limited
25. Gulf African Bank Limited
26. Habib Bank A.G Zurich
27. Habib Bank Limited
28. Imperial Bank Limited (In – Receivership)
29. I & M Bank Limited
30. Jamii Bora Bank Limited
31. KCB Bank Kenya Limited
32. Sidian Bank Limited (Formerly K-Rep Bank)
33. Middle East Bank (K) Limited
34. National Bank of Kenya Limited
35. NIC Bank Limited
36. M-Oriental Commercial Bank Limited
37. Paramount Bank Limited
38. Prime Bank Limited
39. Standard Chartered Bank Kenya Limited
40. Transnational Bank Limited
41. UBA Kenya Bank Limited
42. Victoria Commercial Bank Limited

Source: CBK (2016)