THE EFFECT OF THE INTEREST RATE CAPPING ON THE PERFORMANCE OF FOREIGN BANKS IN KENYA

BY

DAVID NJIRU MATHENGE

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A RESEARCH PROJECT SUBMITTED IN PARTIAL FULLFILMENT OF THE REQUIREMENTS OF THE DEGREE OF MASTER OF BUSINESS ADMINISTRATION, UNIVERSITY OF NAIROBI

OCTOBER 2018
DECLARATION

I the undersigned, declare that this project is my original work and has not been submitted to any other university or institution for academic credit.

Sign………………………….. Date…………………………

DAVID NJIRU MATHENGE

D61/5999/2017

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

Sign………………………….. Date…………………………

Dr. Cyrus Iraya

Project Supervisor
ACKNOWLEDGMENTS

I thank Almighty God for guiding me through my studies. I also greatly appreciate my supervisor Dr. Cyrus Iraya for the support and guidance through this research project. Finally I give special thanks to my family for their continued support and encouragement all throughout my pursuit of the Masters studies. God bless them all abundantly.
DEDICATION

I dedicate this project to God and to my loving family. My wonderful parents Micah Mahinda and Mary Kagendo. My precious siblings Joseph, Esther and Sarah. Finally to my special friends Caleb and Simon.
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<tr>
<td>APR</td>
<td>Annual Percentage Rate</td>
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<tr>
<td>CAMEL</td>
<td>Capital Adequacy, Asset Quality, Management Soundness, Earnings Capacity and Liquidity</td>
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<td>CBK</td>
<td>Central Bank of Kenya</td>
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<tr>
<td>CBR</td>
<td>Central Bank Rate</td>
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<td>MFI</td>
<td>Micro-Finance Institution</td>
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<td>NBFI</td>
<td>Non-Bank Financial Institution</td>
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<td>NPL</td>
<td>Non-Performing Loan</td>
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<td>NSE</td>
<td>Nairobi Stock Exchange</td>
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<td>SME</td>
<td>Small and Medium Enterprises</td>
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ABSTRACT

This study investigated the effect of interest rate capping on the performance of foreign banks in Kenya. A descriptive research design was adopted in this study. The study targeted all the 14 foreign banks registered and licensed under the Banking Act. Secondary data was used in this study to achieve the set objective. The secondary data was obtained from the financial statements published on official websites of the foreign banks in Kenya as from June 2015 to December 2017. Data was analyzed using descriptive statistics and pair T-test was also applied. Skewness and Kurtosis were used to test the normality of the data. The findings indicated that Capital Adequacy, Asset Quality, Management Soundness, Liquidity and Earnings Capacity for the foreign banks in Kenya had a positive change in the average means after interest rate capping enforcement. This change was found statistically significant for all variables. A statistically significant mean difference was established between average capital adequacy ratio for foreign banks in Kenya before and after interest rate capping. The enforcement of interest rate capping positively influenced the Capital Adequacy ratio to a great extent causing the mean to increase. The study also established that the mean difference between asset quality ratio for foreign banks in Kenya before and after interest rate capping was statistically significant ($t (13) = -25.50, p < 0.000$). The study further established that the mean difference between average Management Soundness ratio for foreign banks in Kenya before and after interest rate capping was statistically significant. This implies that the increase in average Management Soundness ratio for foreign banks after interest rate capping was influenced by the interest rate capping regulation. A statistical mean difference between average Earnings and Profitability ratio for foreign banks in Kenya before and after interest rate capping was statistically significant hence the finding that the average Earnings and Profitability for foreign banks after interest rate capping was influenced by interest rate capping regulation. The study recommends the banks to innovatively bring in products that yield an income to the bank as opposed to relying on the interest income alone. Relying on the interest income has seen a reduction in income received by the banks and thus lowering the return on equity. Banks should work aggressively to bring in new products that generate them non-interest income. This study recommends that the law on interest rates capping should be repealed once suitable strategies are put in place to ensure access to credit for many clients hence improving the earning capacity for foreign banks. This study also recommends that the foreign banks in Kenya and the government through the central bank of Kenya should further explore other options of lowering the interest rates other than the capping, as this will improve the affordability and access to credit for most of the population, and this may spur economic growth and push up the profitability of banks in the country. Further research is recommended on other areas affecting the performance of foreign banks in Kenya as compared to interest rate capping. It will ensure that the study assesses the most important factors in the performance of banks.
CHAPTER ONE: INTRODUCTION

1.1 Background of the Study

Interest rate capping is introduction of interest rate ceilings to check financial institutions that are charging clients exorbitant interest rates to their clients to generate extraordinary surplus profits. This market failure situation requires some government intervention to protect vulnerable clients from these predatory lending practices. Normally the financial markets was segmented so that all the financial institutions find a niche to serve while taking advantage of the asymmetry in information. The financial institutions imposes a maximum price (maximum interest) on loans to mitigate against the problem of moral hazards posed by the willing borrowers with unidentifiable creditworthiness (Miller, 2013). Banks then have limited options in their business operations and incurred more expenses by being forced to either to increase their lending to bad customers leading to more NPLs. The will also have to invest more in systems that can help them identify and reach out to good customers. These increased overheads will reduce the chances of a bank maintaining its profitability levels.

Scholars have advanced some theories explaining the rationale and consequences of such controls. Firstly, the Agency theory as explained by Friedman (2007) describes the relationship between the management of the organization and the shareholders. He explained that the responsibility of the corporate executive, as an employee of the business owners, is to conduct business to make as much returns as possible. Therefore, this motive may lead to the exploitation of the borrowers and hence the government come to the rescue of the borrowers and imposed the interest rate capping regulation. Friedman
(1995) also strongly considered the Free Market theory, by arguing that investment and consumption are not affected by interest rates and thus interest rates should be determined by the demand and supply of credit of which banks are the main contributors and thus should be given the liberty to influence the interest rates. Keynes (1937) also affirmed that the rate of interest should depend on the present supply of money. This basically means that the rate of interest was dependent on the supply and demand of money. He was supported by Ohlin (1936) who argued that interest rates should be dependent on the demand and supply of credit therefore disapproving the interest rate capping regulation.

The capping of interest rates is a measure of control carried out by the government on the financial sector of a country. The Kenyan economy has long been market based allowing market forces to determine various macroeconomic variables. Interest rates are normally determined by the CBK monetary policies and these rates eventually influence both the rate of growth and size of money supply in the economy. The banking amendment Act, 2016 was a major departure from the regulatory market based pricing policy. The interest rates by commercial banks was to be capped at a maximum of 4% above Central Bank rate while customer deposits attract a minimum rate of 70% of the CBR. This can be found in the amended Banking Act (Section 33B) and in line with Central Bank of Kenya (CBK) Act (Section 36 (4)), and the CBK see the Central Bank Rate (CBR) as the base rate.
Overtime the consumer protection agencies in Kenya kept pressuring the government to review interest rates mainly because they argued that commercial banks were exploiting struggling businesses and other borrowers so as to reap huge profits. There were mixed reactions from different quotas as to the effect of the interest rate cap. Banking institutions need to find other ways of being profitable despite interest rate capping done by the government. Commercial banks can achieve this through diversifying into other income sources like non-funded income and also through cost cutting measures. They can also branch into alternative lending like lending to the government. In severe cases where it becomes unprofitable, banking institutions may withdraw from various locations like high end market segments and rural areas to enable them cover their costs.

1.1.1 Interest rate capping

Interest rate caps are the ceilings imposed on the interest rates to check or contain the rates paid by loan borrowers. The rate on the loan advanced should exceed the applicable ceiling level. These restrictions on the rate are managed by computing the interest to be paid as a variable of the ceiling level (Villegas, 1982). Maimbo (2014) defined interest rate capping as a form of government financial control which may involve the use of interest rate regulations purposely for consumer protection. Nkwoma (2014) described interest rate capping as the interest rate regulation imposed by the government as a monetary policy tool to enhance the availability of credit and improve deposits.

Interest rate caps are measures undertaken by governments for a various political and economic reasons. In some cases it may be to support a specific industry or area of the
economy. This may be due to a market failure in that industry. The capping may also be instrumental in forcing directing the market to allocate more financial resources to that sector. Such has taken place in Bangladesh to boost the agricultural sector and in Zambia where financial institutions were constrained to provide loans to credit constrained SMEs (Miller, 2013).

The interest rate capping is a government directive that was necessitated by the high interest rates that banks levied on their credit products. Banks argued that the exploitative interest rates were fair as they had factored in the cost of funds, interest paid on deposits, when computing the rates that they impose on lending out to their customers. Financial institutions also argued that they have to include is a profit margin so as to satisfy their shareholders, according to (Miller, 2013).

Different governments use different types of interest controls to limit the lending rates. Some apply the vanilla interest rate cap which is indiscriminately applied as the other regulations for licensed financial institutions while others have a more flexible approach which simply puts an upper limit on any loans from formal institutions meaning that no financial institution can issue a loan at a rate greater than the stipulated rate (Miller, 2013). Alternatively, the respective government can impose a rigid interest rate limit by discriminating between the different types of loan and setting individual caps based on the client and type of loan. The logic advanced for such a variable cap is that it can be applied on the various levels of the market and eventually minimize the consumer surplus.
1.1.2 Bank Performance

Kagecha (2014) described the performance of banks as how well the institution effectuates the management decision and policy objectives as well as how successful the institution thrives in the industry and market growth prospects and how adaptive the institution is to the dynamism of the economic environment it is operating in. Moosa and Bhatti (2010) described performance to be how good is the outlook of accounting information derived from the institution’s financial statements.

Performance of banks can be affected by both internal and external factors (Al-Tamimi, 2010) and (Aburime, 2005). These factors can further be classified into bank specific (internal) and macroeconomic variables. The internal factors include the bank characteristics that are specific to the individual institution which affect the bank’s performance such as management and board decisions. The external factors on the other hand are the factors that affect the entire industry as a whole and are beyond the control of the institution. Bonin (2005) found out foreign-owned banks to be more cost-efficient than other commercial banks. He also realized that the foreign banks provided superior service. Other parameters considered in measuring the performance of the foreign banks is their growth in bank size, credit risk and default risk.

The state of soundness of the foreign banks is critical to the economy. This can be evaluated using the CAMEL model of rating. This model was developed by federal banking supervisors in the U.S as part of the “Uniform Financial Institutions Rating System” that was aimed at providing a summary of the bank’s condition as at the time of
its examination. The key components being scrutinized included the Capital Adequacy, Asset Quality, Management Soundness, Earnings Capacity and Liquidity. Each component was scored between 1 and 5 with a final composite total of the scores being the bank’s overall condition. Many years later in 1996, the system was revised to include an additional parameter ‘S’ for measuring the sensitivity to market risk, effectively changing the ‘CAMEL’ to ‘CAMELS’ as it is practiced today (Kumar, 2012).

Other scholars have viewed performance of banks from three dimensions; variables that are induced by management decision and policy objectives (bank-specific factors), variables that capture the industry structure and market growth (industry-specific factors) and elements that reflect the economic atmosphere under which the bank operates (macroeconomic factors) according to Kagecha (2014).

The foreign banks’ performance can be measured according to Moosa and Bhatti (2010) through the organizational performance indicators that can be broadly categorised to: accounting, market, and hybrid measures. Accounting measures of organizational performance include: return on assets (ROA), return on sales (ROS), return on equity (ROE), return on investment (ROI), return on capital employed (ROCE), sales growth (SG) and Net interest Margin(NIM). All these measures can be done by using of the accounting information provided in the banks’ financial statements.

Studies have shown that in the last two decades, banks in Sub-Saharan Africa (SSA) have been more profitable as compared to the rest of the world when considering their ROA,
which averages 2 percent (Flamini, 2009). The main reason advanced for this is the riskiness in the investment and the existence of a huge gap between the supply and demand for banking services meaning there is reduced completion among banks and they can therefore charge high interest rates as much as they would want to.

1.1.3 Interest rate capping and Foreign Banks performance

Miller (2013) established that with capping of interest rates, banks have limited options to enhance their business. They may have to increase lending to risky customers and in the process increase their NPLs. Banks may also opt to invest more in intelligent systems that can help them evaluate the riskiness of their customers to identify good borrowers, which means increased overheads. Alternatively, they can also increase investment in activities to reach out to borrowers with good repayment potential, which was increase their expenses. Therefore all the options identified by Miller (2013) increase costs for the foreign banks and reduce their profitability. Therefore if the banks cannot adopt a way of absorbing the additional costs, they may be forced to ration credit.

Prior to the interest rate capping law, foreign banks had the liberty to maximize on their interest spread barring the market condition. However, after the implementation of the interest capping law this privilege has been withdrawn and their interest margin reduced significantly (Miller 2013). This has reduced their advances business by locking out of SMEs and other borrowers who are deemed to be high risk. Foreign Banks just as their local competitors are then forced to prefer lending to the government. Also the foreign banks with small operations in the country are locked out of the lucrative interbank
market and thus can only borrow funds at higher rates but only lend within the stipulated margins. This has greatly reduced their return on investments and led to the foreign banks scaling down their operations in the country through closure of some branches and reducing staff numbers. Also in some cases the capping has improved the risk performance of the advances portfolios and reduced the NPLs that adversely affect the profits.

1.1.4 Foreign Banks in Kenya

There are 14 registered foreign banks operating in Kenya. They differ in size of operations and market share. These banks are normally regulated from two jurisdictions; the Kenya Banking Act and their home country’s banking law. They offer similar products as their local competitors such as interest earning deposits, loans and advances, foreign exchange deals, fund remittances and financial advisory.

The profitability ratios in the Kenyan banking sector is relatively high in comparison to that in other African countries. Statistics show that in 2016, the return on assets (ROA) and return on equity (ROE) in Kenya stood at 3.1 percent and 24.5 percent, respectively – which is much higher compared to other countries in the region (CBK, 2018).

In a comparative study between the performance domestic banks and foreign banks, Noti (2012) noted that there was substantial differences in the risk and return characteristics of foreign and domestic banks in Kenya. In his study he confirmed that foreign banks earn superior returns when compared to domestic banks. The study also showed that foreign banks exhibit a low credit risk as compared to domestic banks. This was mainly due to
the quality credit risk management of foreign banks when compared to the domestic banks. In the study he also observed that foreign banks deploy superior management techniques.

1.2 Research Problem

After effecting the interest rate capping, Miller (2013) found out that banks became reluctant to lend to SMEs and instead opted to buy government securities which are less risky. There was a disconnect because of low expected returns from this investment contrary to expected business practice of demanding a higher return for the high level of risk. There a need to evaluate if the foreign banks embraced the conservative lending and increased the portion of their investment portfolio in government securities. This also dissect further the effects of the interest rate capping on other performance parameters beyond profitability. Furthermore, foreign banks are deemed to have superior structures in place due to the accountability reporting in more than one regulatory jurisdiction. In this view there is need to establish how the foreign banks, in spite of their superior attributes, were affected by the new regulations and the extent the new regulatory regime had on their performance.

Foreign banks operating in Kenya have long enjoyed high interest rates which were deemed to be too high as compared to other developing economies in the world. The interest rate capping law was meant to change course and provide much needed relief to struggling businesses who for years had been incurring high cost of credit. For these banks however, this created the need to change strategy and reduce overreliance on
interest rates as the primary source of income. A lot of uncertainties had engulfed the economy after the enactment of the banking amendment Act, 2016 and to date there are conflicting accounts on the real impact of the interest rate cap to banks, SME’s and the economy in general.

In a study by Khan and Sattar (2014) to evaluate the effect of changes in interest rates on the profitability of four major banks in Pakistan they found out that interest rates significantly affects bank income and therefore the profitability of the banks are heavily dependent on the interest policy set by the State Bank of Pakistan. With this view in mind there is need to establish if the same is replicated elsewhere in the world and also identify the extent of the influence that interest rates have on the performance of foreign banks operating in the sub-Saharan region.

In a recent study by Tarawneh (2017) on non-interest income and financial performance of Jordanian banks, it was concluded that the increase in banks profitability is greatly influenced by the non-interest income. This income is not depended on the lending and borrowing activities of the banks but includes charges and fees levied on the other various banking services. Therefore the wider the range of services availed the greater the portion of non-interest income generated. This study didn’t establish the significance of interest income on the overall profitability of banks which was clearly addressed in this study.
On analysing the APRs of loan terms, by Durkin and Elliehausen (2013) found substantial evidence of customer apathy. The study found out that some customers despite being aware of the APRs that is extended from the various credit products, they didn’t consider that information in making decisions on availing credit facilities. This study showed that the changes of the interest rates had little or no significant effect on some unique customers. The impact of customer apathy on the overall credit business for the banks is not assessed. This study confirms if interest rate capping was met with similar customer behaviour, if not the extent of the consequences of their reaction.

In a study of payday loans in the US, DeYoung and Phillips (2009) found that there was price competition among the payday lenders. The lending rate in the long run moved towards the statutory limit and thus gave rise to non-interest rate competition among the lenders. This led to competition in areas such as convenience and customer service. The study also revealed that the lenders practised price differentiation as a strategy to enhance their sustained profits by charging lower interest rates to first-time borrowers and higher interest rates to repeat borrowers. Also lenders with multiple locations had higher interest rates as compared to those with single stores. This study doesn’t clearly establish if the interest rate price competition was sufficient in ensuring a sustained growth in performance of the lenders. It also doesn’t examine competition among the institutions in an interest rate regulated environment. This study assessed the trend in performance of the financial institutions in an interest controlled regime.
Ngugi (2001) studied the factors that determined the interest rate spread for the banking sector in Kenya. She compared data from the pre-liberalization period and data after the effecting of the minimum and maximum ceilings on deposit and lending rates. She observed that after liberalization, contrary to the expected, the interest spread in Kenya widened due to inefficiencies and delays in adopting other indirect monetary policy tools. The study didn’t clearly establish the poor performance of the banking institutions due to the inefficiencies associated with interest controls. This study highlight some effects due to these inefficiencies.

Ng’ang’a (2017) studied the impact the interest rate capping had on the financial performance of commercial banks in Kenya. The study population was focused on the entire banking sector in Kenya comprised of 42 banks at the time. He also solely focused on the financial performance using the Return on Equity (ROE) as the measure. He arrived at the conclusion that interest rate cap negatively affected the financial performance of commercial banks. The study did not capture other performance aspects of the banks. This study consider other performance measurements such as Capital Adequacy, Asset Quality, Management Soundness, Earnings and Liquidity.

Okwany (2017) examined the effects of interest rate capping on the operating performance of commercial banks in Kenya by limiting the scope of the study to KCB Bank Kenya Limited. In this study he focused on the impact of the interest rate capping on credit performance, profitability and NPLs. Results from the study indicated that interest rate capping reduced credit uptake, reduced profitability and increased NPLs. The
study was limited to one bank which could be undergoing a unique experience. This study was based on a number of banks and thus the findings can be generalized to the industry.

Scholars have undertaken various studies on the relationship between the interest rates and banks’ performance and came up with diverse views and conclusions. These various studies have also used different parameters and methodologies to examine performance and thus arriving at different results and conclusions. To coalesce all this views, this study was on a fact finding mission and evaluated the effect of interest rate capping on performance of foreign banks in Kenya.

1.3 Research objective
To examine the effect of interest rate capping on the performance of foreign banks in Kenya.

1.4 Value of the study
The findings of this study is helpful to the management and staff of foreign banks as it enable them to identify the effects of the interest rate capping on crucial components of performance and then craft suitable strategies to alleviate the adverse effects and to enhance their sustainable competitiveness.
Potential foreign investors also benefit from this study as they use the information to evaluate the viability of an investment in the sector given the prevailing regulatory framework.

The study also provide much needed findings that prove to be useful to the Central Bank of Kenya and the Government before putting into place similar policies in the future by considering the various challenges emerging from the controls and considering suitable alternatives.

The study also is of great benefit to the existing knowledge in the area and also act as a source of reference for further research in the areas of knowledge associated with interest rate capping.
CHAPTER TWO: LITERATURE REVIEW.

2.1 Introduction

In this chapter analyzed specific areas covered including the theoretical underpinning of the study, other determinants of bank performance, and related empirical reviews both locally and globally, the conceptual framework and a summary of the literature review.

2.2 Theoretical Review

The theoretical review highlights the various theories and concepts put forward by scholars in an attempt to expand knowledge on a particular research study.

2.2.1 Agency Theory

This theory was first proposed by Ross (1973) where he defined the agency relationship as one between two parties whereby one party acts on behalf of the other party. The theory explains the relationship between the management of the organization and the shareholders. Friedman (2007) described the responsibility of the corporate executive, as an employee of the business owners, to conduct business to make as much returns as possible while complying with the society’s basic rules. Therefore, the management of the banking institutions are tasked with maximizing the shareholders wealth and thus strive to push for the highest rates of interest on their credit facilities. This led to the exploitation of the borrowers and forced the government to impose the interest rate capping regulation.
The theory is based on the assumption that firms are mainly concerned with maximizing the wealth of their owners or shareholders (Blair, 1995). Based on the assumption of the selfishness of the human nature resulting in a difference between the interests of managers and the interests of the owner. The owner is motivated to prosper himself with increasing profitability, while the manager is motivated to maximize the fulfillment of personal economic goals, among others, in terms of acquiring the investment and loan. In all these scenarios, the customer is vulnerable and needs to be protected from exploitation.

Other scholars argued that despite the proposition of the theory suggesting that the purpose of a business is to create as much value as possible for stakeholders this cannot succeed and is not sustainable over time, without the executives considering the interests of customers, suppliers, employees, communities and shareholders and then aligning all of them in the same direction. It starts from the premise that organizations serve a broader social purpose than just maximizing the wealth of shareholders. The theory claims that the welfare of various stakeholders, both individuals and groups, is affected by the organization’s activities as it strives to achieve its objectives. The role of the stakeholders is key to the organization’s success but yet still these stakeholders have legal and moral rights (Ulrich, 2008). When stakeholders are pleased with what they get from the organization, they keep coming back. Therefore, the organization’s management have to seriously take into consideration the needs of the stakeholders in decision making and carry out the business bearing responsibility of the stakeholders (Manville & Ober, 2003).
Banks should thus consider all stakeholders in the pricing of their products to ensure sustainable competitiveness in the long run.

2.2.2 Free Market Theory

Smith (1776) was the first to originate this theory by explaining that there was an invisible hand called the market force that helps the demand and supply of goods in a free market to attain equilibrium. In this theory, scholars argue that interest rates do not affect investment and consumption and therefore interest rates should be solely determined by the demand and supply of credit of which banks are the main contributors. Friedman (1995) in his study noted that even if lower rates are achieved, this would not be sufficient but contrary to the intended purpose they lead to a contraction in investments. Instead he proposed increase in government spending to boost the level of aggregate demand.

Another proponent of the theory, Marglin (1991), argued that if the aggregate demand is high enough in the economy then the levels of capital utilization was sufficient to meet the needs of the workers and the owners of the businesses. This view emphasizes the need to allow the forces of demand and supply in the economy to determine the levels of investments rather than imposing government controls such as interest rate capping.

According to Frenkel (2010) introduction of a leverage ratio as regulation is retrogressive to the banking industry. This strongly advocated for the banks should be given the liberty to set their rates competitively as this improves the economic stability.
2.2.3 Liquidity Preference Theory

This theory has a strong inter-linkage with interest rates as first fronted by Keynes (1937) who proposed that the rate of interest should depend on the present supply of money. This basically means that the rate of interest was dependent on the supply and demand of money. This theory was supported by other scholars who focused on the supply of credit rather than the supply of money. According to Ohlin (1936), interest rates should be dependent on the demand and supply of credit. Both Ohlin and Keynes are not in favour of interest rate capping regulation.

Ohlin (1936) argued that since interest rates are the price of credit, then they should be determined by the supply and demand of credit. He emphasized the fact that since the banking system is the provider or supplier of credit, then is should be the one to influence the level of the interest rates. This is contrary to the interest rate capping that reduces the influence that banks have on the levels of the interest rates.

According to Keynes (1937), investors also hold some cash balances so as to assure themselves that they make key investments in future when a good opportunity emerges. This mean that the banks reduced deposits that they can keep as loanable funds and consequently reduce their income from advances.

2.3 Determinants of Bank Performance of Foreign Banks

Interest rates have a significant role in influencing the performance of foreign banks. This is because they affect the net interest margin of the banking business. There are, however,
several other factors that crucially contribute to the performance of these banks including; Ownership structure, Costs of operations, Capital adequacy, Asset quality, Management. Earnings and Profitability. Liquidity, Sensitivity to market risk and Inflation rates.

2.3.1 Ownership Structure

This aspect is both firm specific and industry specific. Podder (2012) argued that the performance of bank can be influenced by the ownership structure. In his study he observed that this relationship between ownership and performance was mainly due to the superior performance of private owned banks as compared to the government owned banks. This superior performance was mainly linked to the efficiency in running the private owned banks as compared to the government owned banks that are rife with operational inefficiencies. He further argued that private owned banks are very keen on maximizing profits unlike the government owned banks. He however recommended further studies in the area to ascertain the strength of the relationship.

2.3.2 Cost of operations

The cost of operations negatively affects the performance of the banks. It is normally computed as a percentage of the profit. Rasiah (2010) showed the negative relationship between financial performance of banks and the expenses. This basically means that the bank is incurring a lot to provide its services. These high cost reduced the profit margins of the institution.
For banks to compete effectively and maintain high profitability, they should come up with strategies to efficiently manage their operating costs. Athanasoglou et al. (2008) in his study noted that firms which are more efficient minimize their operations costs and attain higher profit margins.

2.3.3 Capital adequacy

This is measures how well the financial institution can cope with shocks to their balance sheets. The main risks considered include credit risk, foreign exchange risk and interest rate risks. In the computation of this ratio, the institutions assets are assigned weights according to their respective risks.

Goddard et al. (2004) in their study found a positive relationship between the capital/asset ratio of a bank and its earnings. This is an indicator of how solid the bank is and this sound capital base boosts the confidence of depositors. This ratio indicates the level of protection for depositors and is often an indicator of the stability and efficiency of financial systems in many countries all over the world.

2.3.4 Asset quality

This involves evaluating the strength of the financial institution in the event of loss of value in assets. This is because as the assets lose value, the losses are eventually written off against capital exposing the earning capacity of the organization. The assets evaluated for this aspect include; non-performing advances, provisions, recoveries and distribution of these assets.
Chan et al. (1986) determines the soundness of financial institutions in case of a loss in the value of its assets. A good measure of this aspect is the ratio of NPLs to total loans. The higher the ratio, the poorer the institution is in credit decision making.

2.3.5 Management

This aspect mainly evaluates compliance with the set rules, ability to plan and adopt to changes in the environment, technical competence, leadership and administration ability. Sound management is a key factor in the financial institutions’ performance (West, 1985). However the quality of management determined as per the individual institutions, and is not easily aggregated across the sector. But key ratios such as total advance to total deposit, business per employee and profit per employee helps in evaluating the quality of the management of the specific banking institution.

2.3.6 Earnings and profitability

This is a key contributor to the capital base of the firm. It is mainly used to improve present and future operations of the institutions. This aspect is best measured by the Return on Assets (ROA) ratio computed by finding the net income after taxes to total asset ratio. According to Nimalathasan (2008), a bank with a strong earnings and profitability profile indicates that the institution has the ability to support operations currently and in the future. He also concluded that such an organization was in a good position to absorb losses and finance expansion. In his study he also observed that these institutions also consistently pay dividends to their shareholders and improve their capital
base. However, in some cases, extraordinary high profitability may be due to excessive risk taking.

2.3.7 Liquidity

A favourable liquidity position is when the financial institution can obtain additional funds to satisfy its needs by either getting more liabilities or through conversion of its existing assets quickly at minimal cost. This is assessed by determining how well the institution’s liabilities are covered by its assets. Basically this is to determine the solvency of the bank meaning the availability or ease of access or convertibility of cash so that it can meet the needs for cash by its customers. Therefore, a bank with high liquidity is preferable due to its ability to execute its functions and be more profitable (Athanasoglou et al. 2008).

According to Golin (2013) an institution’s liquidity is linked to its cash on hand, its short-term cash needs, available options of quick credit, ease of liquidating its assets and its reputation. This emphasizes the crucial role that liquidity plays in the establishing the sustained competitiveness of the bank and its position in the industry.

2.3.8 Inflation rates

This is a macro-economic factor that a number of scholars have identified to influence the performance of banks. They are of the view that due that the higher the inflation then the higher the interest rates. Demirgüç-Kunt et al. (1999) found a positive correlation between inflation and the interest rate margin thus higher income levels.
Swarnapali (2014) argued that the effect of inflation on the performance of the bank was realized if the inflation was anticipated. This is because the banks have sufficient time to adjust their interest rates accordingly.

High inflation rates can also affect the purchasing power of consumers in the economy. Therefore they may use most of, if not entirely, their income in consumption and thus may not have money left for savings to be deposited in banks which in turn reduces the cash reserves of banks and limits the banks’ ability to issue loans (Rasiah, 2010). This leads to reduced profitability.

2.4 Empirical Studies
Maimbo & Gallegos (2014) examined the countries that used interest rate regulations as a measure of consumer protection. They analyzed the kind of controls the governments used in those countries, the regulating bodies involved and the criteria used to develop the interest caps. The study confirmed that 76 countries use various forms of interest rate caps with varying effects. One of the effects they noted were withdrawal of some financial institutions from some specific market segments, increased additional commissions and fees. They concluded that the governments should employ other methods of lowering interest rates and improving the accessibility of credit by enhancing competition, encouraging product innovation and other micro credit products, promoting financial literacy, ensure full disclosure of interest rates and strengthen consumer protection platforms.
Naceur & Omran (2011) researched on the effect of bank regulation and concentration along with financial and institutional development on the margins and profitability of banks in some Middle East and North Africa countries. Results from the study showed that some internal aspects such as bank capitalization and credit risk had a substantial influence on the banks’ net interest margin, cost efficiency and profitability. They also found out minimal impact, with exception to inflation, of macroeconomic factors and financial development factors on the net interest margins of the studied banks. Their study also revealed that regulatory and institutional factors significantly influence performance of banks.

Kumbhakar & Sarkar (2003) sought to understand the impact deregulation had on total factor productivity growth of banks in India. In this study they employed a generalized shadow cost function method. This is where they subdivided total factor productivity into three components; technological change, a scale and a miscellaneous aspect. Data collected for analysis was from a population of both public and private banks before and after the effecting of the regulations over the period between 1985 and 1996. From the study they noted that on deregulation, private banks’ performance improved but the same wasn’t the case for public banks.

Nkwoma (2014) studied the effect of using interest rate deregulation by the Nigerian government as a monetary policy tool to enhance the availability of credit and improve deposits. This study was carried out between the period of 2002 and 2010. The models used were the Vector Error Correction Model and Vector Auto Regression. At the same
time the data was assumed to be stationary. The study results revealed that deregulation of interest rates had a positive effect on lending. However the relationship was noted only in the short run.

Ngugi (2001) sought to explain the factors determining interest rate spread of the banking sector in Kenya. In her study she further examined data from the pre-liberalization period and data after the effecting of the minimum and maximum ceilings on deposit and lending rates. The latter effectively fixed the interest rate spread. She noted that the regulatory authorities revised the interest upwards to counter the increased inflation brought about by the variations in the interest spread. It was also observed that after liberalization, contrary to the expected, the interest spread in Kenya widened due to inefficiencies and delays in adopting other indirect monetary policy tools as well as adjusting the legal framework.

Nyakio (2017) conducted a study in Kenya investigating the effects of the interest rate capping regulation on the shares of banks listed in the Nairobi Securities Exchange. The study population was the listed 11 commercial banks. The data analyzed was between the periods of 2015 and 2016. The analysis revealed a negative impact on the performance of bank shares on imposing of the interest rate capping control mainly due to investors having inhibitions about the banks future profit prospects. She concluded that indeed the government regulations do have an impact on the perception of investors on the securities trading and greatly impact the value that they assign the securities from affected industries.
Ng’ang’a (2017) studied the impact the interest rate capping had on the financial performance of commercial banks in Kenya. The study population was the 42 banks operating in Kenya. The data for analysis was gathered from the banks’ financial statements. He used the Return on Equity (ROE) to measure financial performance. He arrived at the conclusion that interest rate cap negatively affected the financial performance of commercial banks especially the Return on Equity (ROE) and recommended that banks should seek alternative innovative products to reduce reliance on interest income.

Okwany (2017) examined the effects of interest rate capping on the operating performance of commercial banks in Kenya by limiting the scope of the study to KCB Bank Kenya Limited. In this study he focused on the impact of the interest rate capping on credit performance, profitability and NPLs. The data was collected through interviews and questionnaires given to various KCB bank staff members in several branches in Nairobi. Results from the study indicated that interest rate capping reduced credit uptake, reduced profitability and increased NPLs.

In a different study, Odhiambo (2010) examined the relationship between interest rate reforms and economic growth in Tanzania. He employed a financial deepening model and also a trivariate model to assess economic growth. He found that financial inclusion in free market economy due to the liberty given to market forces to set interest rates led to good economic growth. The study however did not specifically focus on growth in the financial sector.
2.5 Conceptual Framework

Theories have been advanced describing the relationship between the interest rate capping regulation and bank performance. The conceptual framework tries to give a representation of the relationship between independent variables and the dependent variable which in our case is the performance of foreign banks. The foreign banks’ performance is measured for two years; a year before the introduction of the interest rate capping regulation and a year from the effecting of the law.

<table>
<thead>
<tr>
<th>Independent Variable</th>
<th>Dependent Variable</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Interest Rate capping</td>
<td>Bank Performance</td>
</tr>
<tr>
<td></td>
<td>• Capital Adequacy</td>
</tr>
<tr>
<td></td>
<td>• Asset Quality</td>
</tr>
<tr>
<td></td>
<td>• Management Soundness</td>
</tr>
<tr>
<td></td>
<td>• Earnings Capacity</td>
</tr>
<tr>
<td></td>
<td>• Liquidity</td>
</tr>
</tbody>
</table>

2.6 Summary of Literature Review

This chapter has reviewed the theories justifying the need to impose interest caps to contain exploitation of customers by banking institutions. On the other, interest rate capping was opposed as it failed to achieve its intended goal of improving the availability of credit to the lower segment of borrowers. On the contrary, the regulation forced the banks to limit credit and adopt contractionary strategies so as to sustain profitability.
Studies carried out in several countries including India, Nigeria and the Middle East showed how the use of interest rate capping as a monetary policy tool was not effective as it did not increase credit availability or enhance customer deposits. Instead the government should employ alternative options that encourage transparency and full disclosure of banks rates and encourages competition among the banks. The studies carried out locally focused on the effect of the regulation on all the entire industry but there is need to focus on the foreign banks operating in the country to assess if the regulation had the profound effects as it has been aggregated in the whole sector.
CHAPTER THREE: RESEARCH METHODOLOGY

3.1 Introduction
This chapter highlights the steps and procedures used to ensure implementation of the project by trying to address the research questions raised in chapter one. It covers the research design, population, the sample design, data collection and analysis.

3.2 Research Design
This defines the plan and structure that guided the execution of the study to provide answers to the research questions (Coopers & Schindler, 2008). The descriptive research design was the most suitable for this study. This design helped the study to solve the research problem of determining the impact of interest rate cap on the performance of foreign banks in Kenya. The CAMEL criteria was computed from published income statements of banks either on their respective websites, local dailies or the NSE for the listed institutions. A clear analysis of Asset Quality, Management Soundness, Earnings Capacity and Liquidity was established in the process.

3.3 Population
Cooper & Shindler (2008), identified the population as the whole component of elements of interest to be studied. According to Alex (2017), the population can be seen as combination of elements with different characteristics but have commonalities with regards to the study being conducted. The population of foreign banks in Kenya stands at 14. The population was all the 14 registered commercial Banks operating in Kenya. The data to be used was collected from various secondary sources including the Banks
financial statements, periodicals and press releases from the five quarters prior to September 2016 and the five quarters thereafter.

3.4 Data collection
The data collection technique is critical to the reliability and validity of research findings. Data on Capital Adequacy, Asset Quality, Management Soundness, Earnings Capacity and Liquidity was collected by use of secondary data which include already available financial statements published on official websites of the foreign banks. The data analysis was carried out from June 2015 to December 2017.

3.5 Diagnostic Tests
This involved testing the data for normality through use of parametric tests. This is key in drawing accurate conclusions when conducting reference intervals for variables (Ghasemi & Zahediasl 2012). This test was carried out using the software tool, Statistical Package for the Social Sciences (SPSS). The test is to ascertain that the test data’s distribution is normal.

Linearity was tested in the relationship between the independent (X) and dependent variables (Y) for linearity. Linearity is the causal relationship of two variables that is represented in a mathematical equation \( y = cx \), where "c" is a constant number. This test is necessary because the data collected is believed to portray a linear relationship. The linearity could have been established through scatterplot testing methods or F-statistic in ANOVA. The independent variables are also tested for multicollinearity. This is the
degree of relationship between the independent variables which if high can lead to error in the conclusions. This multicollinearity can be detected by using the variance inflation factor (VIF) diagnosis (Garcia et al. 2015).

3.7 Data Analysis

Data collected was quantitative and was subjected to comparative analysis. The analysis involved was interpreting the collected information with a view of answering the research questions raised. The interest rate capping was viewed as an event and thus employed the use of an events methodology in the study.

In the study’s time line, t=0 denote the date of the event; when the interest rate capping law was effected. The study then employed comparative analysis of the three quarters preceding the event date and three quarters post event.

<table>
<thead>
<tr>
<th>Pre-Capping Period</th>
<th>Post-Capping Period</th>
</tr>
</thead>
<tbody>
<tr>
<td>Jun,15 Sep,15 Dec,15 Mar,16 Jun,16 t=0</td>
<td>Dec,16 Mar,17 Jun,17 Sep,17 Dec,17</td>
</tr>
</tbody>
</table>

Data Analysis Based on the conceptual framework developed in the previous chapter, the performance of the foreign banks was conducted using a paired comparison test. This assumes a normal distribution of the data. The test was comparing two sets of measurements to determine if their population means differ.
3.7.1 Test of Significance

Statistical testing was carried out to establish the significance of both the model and individual parameters. The F-test obtained from the Analysis of Variance (ANOVA) was used to determine the significance of the model while the t-test was used to establish statistical significance of individual variables.
CHAPTER FOUR: DATA ANALYSIS, RESULTS AND DISCUSSION

4.1 Introduction
The chapter comprehensively covers the analysis and presents the findings of the study. The purpose of the study was to establish the effect of interest rate capping on the performance of foreign banks in Kenya. Secondary data was collected on Capital Adequacy, Asset Quality, Management Soundness, Earnings Capacity and Liquidity for the all the 14 registered foreign banks operating in Kenya. The loan book amount of the banks for five quarters before and after the capping was extracted from their financial statements.

4.2 Diagnostic Tests
The data collected was tested for statistical assumptions i.e. T-test assumption and statistic used. The tests performed included both test of normality and multicollinearity Test.

4.2.1 Normality Test
Skewness is a measure of the availability of symmetry in data. Data is considered to have symmetry when it has similarity on the right and the left in relation to the center point. Kurtosis measures whether the data in a study is heavy tailed or light tailed relative to normal distribution. The kurtosis levels between -2 to +2 are considered acceptable to prove the existence of normal univariate distribution while a skewness of -1.96 to +1.96 is considered within the normal distribution (Trochim & Donnelly, 2006). Table 4.1 summarizes the results.
Table 4.1 Normality

<table>
<thead>
<tr>
<th></th>
<th>Descriptive Statistics</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>N</td>
</tr>
<tr>
<td>Capital Adequacy</td>
<td>14</td>
</tr>
<tr>
<td>Asset Quality</td>
<td>14</td>
</tr>
<tr>
<td>Management Soundness</td>
<td>14</td>
</tr>
<tr>
<td>Earnings Capacity</td>
<td>14</td>
</tr>
<tr>
<td>Liquidity</td>
<td>14</td>
</tr>
<tr>
<td>Valid N (listwise)</td>
<td>14</td>
</tr>
</tbody>
</table>

Source: Author, 2018

From the analysis kurtosis fell between -0.430 and 0.978 which is within the acceptable levels. Skewness fell between -0.897 and 1.120 which is within the acceptable ranges for existence of a normal univariate distribution.

4.2.2 Multicollinearity

Multicollinearity is determined by examining the Variance Inflation Factor (VIF) and levels of tolerance. A small tolerance indicates that the linear relationship between the variables is almost perfect and should not be added to the regression analysis. A low tolerance of 0.1 should be subjected to further investigation. VIF is a measure of the impact of collinearity among the variables indicated in the regression analysis. The VIF should always be greater than 1. No formal value of VIF has been determined to establish whether multicollinearity exists. However, values greater than 10 are considered to indicate the existence of multicollinearity. Table 4.2 summarizes the findings

Table 4.2: Collinearity Statistics

<table>
<thead>
<tr>
<th>Variables</th>
<th>Tolerance</th>
<th>VIF</th>
</tr>
</thead>
<tbody>
<tr>
<td>Capital Adequacy</td>
<td>.942</td>
<td>1.475</td>
</tr>
<tr>
<td>Asset Quality</td>
<td>.787</td>
<td>1.975</td>
</tr>
<tr>
<td>Management Soundness</td>
<td>.831</td>
<td>1.577</td>
</tr>
<tr>
<td>Earnings Capacity</td>
<td>.963</td>
<td>1.703</td>
</tr>
<tr>
<td>Liquidity</td>
<td>.698</td>
<td>1.868</td>
</tr>
</tbody>
</table>
Source: Author, 2018
The model in this study had a VIF above 1 and tolerance levels above 0.1 showing that multicollinearity does not exist.

4.3 Descriptive Statistics

Descriptive analysis was carried out to establish the range, mean and standard deviation of the Capital Adequacy, Asset Quality Management Soundness Liquidity and Earnings Capacity for the foreign banks in Kenya before and after interest rate capping. Findings are summarized in the table 4.3 below.

Table 4.3: Descriptive Statistics

<table>
<thead>
<tr>
<th>Variables</th>
<th>Period</th>
<th>N</th>
<th>Maximum</th>
<th>Minimum</th>
<th>Mean</th>
<th>Std. Deviation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Capital Adequacy</td>
<td>Pre-Capping</td>
<td>14</td>
<td>.184337</td>
<td>.140481</td>
<td>.160737</td>
<td>.014081</td>
</tr>
<tr>
<td></td>
<td>Post-Capping</td>
<td>14</td>
<td>.218879</td>
<td>.164095</td>
<td>.193731</td>
<td>.016719</td>
</tr>
<tr>
<td>Asset Quality</td>
<td>Pre-Capping</td>
<td>14</td>
<td>.162664</td>
<td>.084537</td>
<td>.121059</td>
<td>.030535</td>
</tr>
<tr>
<td></td>
<td>Post-Capping</td>
<td>14</td>
<td>.185536</td>
<td>.102230</td>
<td>.149535</td>
<td>.026735</td>
</tr>
<tr>
<td>Management Soundness</td>
<td>Pre-Capping</td>
<td>14</td>
<td>.692538</td>
<td>.415476</td>
<td>.547463</td>
<td>.089556</td>
</tr>
<tr>
<td></td>
<td>Post-Capping</td>
<td>14</td>
<td>.799733</td>
<td>.535414</td>
<td>.689490</td>
<td>.094486</td>
</tr>
<tr>
<td>Liquidity</td>
<td>Pre-Capping</td>
<td>14</td>
<td>54562080</td>
<td>6603165</td>
<td>36170207.07</td>
<td>13957567.32</td>
</tr>
<tr>
<td></td>
<td>Post-Capping</td>
<td>14</td>
<td>67672805</td>
<td>16677271</td>
<td>44832987.36</td>
<td>17703994.24</td>
</tr>
<tr>
<td>Earnings Capacity</td>
<td>Pre-Capping</td>
<td>14</td>
<td>.047228</td>
<td>.020890</td>
<td>.031972</td>
<td>.007977</td>
</tr>
<tr>
<td></td>
<td>Post-Capping</td>
<td>14</td>
<td>.068640</td>
<td>.030533</td>
<td>.053141</td>
<td>.012376</td>
</tr>
</tbody>
</table>

Table 4.3 findings indicates that the average mean of capital adequacy for the period after the announcement date was .193731 while the mean for the period before the date of
effecting the interest rate capping was 0.160737. This means that the average mean of capital adequacy of banks increased after the enforcement date. Before the interest rate capping, the mean of asset quality was 0.121059 however after the enactment date of the interest rate capping the average mean increased to 149535 with a standard deviation of .026735. Similarly the average mean for Management Soundness, before and after interest rate capping enactment date increased from 0.547463 to 0.689490 with the maximum value of 0.799733. Further the liquidity for foreign banks were affected by interest rate capping, liquidity mean before date of enforcement was 36170207.07 while thereafter the it became 44832987.36 with a deviation 17703994.24. Earning capacity also indicates a positive increase after interest rate capping announcement. The mean before announcement was 0.031972 while after the announcement the mean became 0.053141. From this finding all the variables i.e Capital Adequacy, Asset Quality, Management Soundness, Liquidity and Earnings Capacity for the foreign banks in Kenya registered a positive change in the average means after interest rate capping announcement.

4.4 Inferential Statistics

SPSS software was used in this study to run the paired t-test of significance for Capital Adequacy, Asset Quality, Management Soundness Liquidity and Earnings Capacity for the foreign banks in Kenya for the period before and after the announcement date. A statistical test carried out to assess if the mean difference between two sets of data is zero is referred to as Paired t-test. When carrying out a paired sample t-test, pairs of observations are achieved by measuring each subject or entity twice. Therefore on this
section the study established whether the observed difference in descriptive statistics on the five variables was dependable one or had happened by chance. The study also used the t-test to establish whether the increase of value of the variable was a significant one across the foreign banks. The t-test for all the five variables were calculated and findings were tabulated in table 4.4 below.

**Table 4.4: Pair T-test**

<table>
<thead>
<tr>
<th>Paired Differences</th>
<th>Paired Samples Test</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Mean</td>
</tr>
<tr>
<td>--------------------</td>
<td>------</td>
</tr>
<tr>
<td>Pair 1 Pre capital – Post Capital</td>
<td>-.03299</td>
</tr>
<tr>
<td>Pair 2 Pre Asset – Post Asset</td>
<td>-.02847</td>
</tr>
<tr>
<td>Pair 3 Pre Management – Post Management</td>
<td>-.1420</td>
</tr>
<tr>
<td>Pair 4 Pre Liquidity – Post Liquidity</td>
<td>.866278</td>
</tr>
<tr>
<td>Pair 5 Pre Earnings – Post Earnings</td>
<td>-.02116</td>
</tr>
</tbody>
</table>

T-test results in Table 4.4 revealed that the mean difference between average capital adequacy ratio for foreign banks in Kenya before and after interest rate capping was statistically significant ($t (13) = -25.50, p < 0.000$). This implies that the difference in average capital adequacy ratio for foreign banks after interest rate capping increased significantly. Therefore it mean that interest rate capping had a significant effect on the
capital adequacy ratio for foreign banks in Kenya. Similarly the difference between the average asset quality ratio for foreign banks in Kenya before and after interest rate capping was found statistically significant at $t (13) = -10.32, p < 0.000$. This implies that interest rate capping had a positive influence on asset quality and therefore it contributed to the change of the means.

Further T-test results shows that the mean difference between average management Soundness ratio for foreign banks in Kenya before and after interest rate capping was statistically significant ($t (13) = -19.96, p < 0.000$). This implies that the increase in average Management ratio for foreign banks after interest rate capping was influenced by interest rate capping regulation. Therefore the interest rate capping had a significant effect on the average Management efficiency ratio for foreign banks in Kenya. Rate interest capping regulation had also significant effect on Bank liquidity for foreign banks in Kenya ($t (13) = -5.71, p < 0.000$). This means that the increase in foreign bank liquidity after the announcement date was due to interest capping regulation.

Finally a statistical mean difference between average earnings and profitability for foreign banks in Kenya before and after interest rate capping was statistically significant ($t (13) = -15.01, p < 0.000$). This implies that the increase in average earnings and profitability for foreign banks after interest rate capping was influenced by interest rate capping regulation. Therefore the interest rate capping had a significant effect on the average earnings and profitability for foreign banks in Kenya.
4.5 Discussion of the Research Findings

The t-statistic results show that the interest rate capping significantly influenced Capital Adequacy, Asset Quality, Management Soundness, Liquidity and Earnings Capacity for the foreign banks in Kenya. All the variables registered a positive change on the average means after interest rate capping announcement. Goddard et al. (2004) in their study found a positive relationship between the capital/asset ratio of a bank and its earnings. This study similarly established a statistically significant mean difference between average capital adequacy ratio for foreign banks in Kenya before and after interest rate capping. This is an indicator of how solid the foreign bank are and this sound capital base boosts the confidence of depositors. The high ratio indicates the level of protection for depositors.

The study revealed an increase in the average asset quality ratio after the announcement date of the interest rate capping regulation, this was found to be statistically significant at $t (13) = -10.32, p < 0.000$. This implies that the interest rate capping had a positive influence on asset quality and therefore it contributed to the change of the average means which in turn results to a better bank performance. This result was in line with Nzoka (2015) analysis which established that all the factors influencing asset quality to some degree statistically significantly affected financial performance.

The study used total advance to total deposit ratio to measure the sound management. According to Maimbo & Gallegos (2014) quality management improves the performance of the organization. In this study the mean difference between average management
Soundness ratio for foreign banks in Kenya before and after interest rate capping was found statistically significant. This implies that the increase in average Management ratio for foreign banks after interest rate capping was influenced by interest rate capping regulation. Therefore the interest rate capping had a significant effect on the average Management efficiency ratio for foreign banks in Kenya.

Rate interest capping regulation had also significant effect on Bank liquidity for foreign banks. Therefore the increase in foreign bank liquidity after the announcement date was due to interest capping regulation. Finally a statistical mean difference between average earnings and profitability for foreign banks in Kenya before and after interest rate capping was statistically significant. This implies that the increase in average earnings and profitability for foreign banks after interest rate capping was influenced by interest rate capping regulation. Therefore the interest rate capping had a significant effect on the average earnings and profitability for foreign banks in Kenya. This finding correlate to Athanasoglou et al. (2008) that established that there was a considerable predilection for financial institutions with high liquidity as they are deemed to be more profitable and to be in a better position in carrying out their functions.
CHAPTER FIVE: SUMMARY, CONCLUSION AND RECOMMENDATIONS

5.1 Introduction

This chapter covers a summary of key findings realized in the study, conclusions from the findings, and proposed recommendations by the researcher. The conclusions and recommendations are focused on reinforcing and addressing the main objective of the study. This chapter also presents suggested areas for future research.

5.2 Summary of Findings

This section discusses the key findings as considered by the objective of the study. This study sought to examine the effect of interest rate capping on the performance of foreign banks in Kenya. The findings indicated that capital adequacy, asset quality, management soundness, liquidity and earnings capacity for the foreign banks in Kenya registered a positive change in the average means after interest rate capping announcement. This change was found statistically significant for all variables.

A statistically significant mean difference was established between average capital adequacy ratio for foreign banks in Kenya prior to and after interest rate capping. The announcement of interest rate capping positively influenced the capital adequacy ratio in great extent causing the mean to increase. The study also established that the mean difference between asset quality ratio for foreign banks in Kenya before and after interest rate capping was statistically significant \( t (13) = -25.50, p < 0.000 \). This therefore means that interest rate capping had a positive significant effect on the capital adequacy ratio for foreign banks in Kenya.
The study further established that the mean difference between average management Soundness ratio for foreign banks in Kenya before and after interest rate capping was statistically significant. This implies that the increase in average Management ratio for foreign banks after interest rate capping was influenced by interest rate capping regulation. Therefore the interest rate capping had a significant effect on the average Management efficiency ratio for foreign banks in Kenya. Further it was revealed that rate interest capping regulation had significant effect on bank liquidity for foreign banks hence the increase in foreign bank liquidity after the announcement date was due to interest capping regulation. A statistical mean difference between average earnings and profitability for foreign banks in Kenya before and after interest rate capping was statistically significant hence the increase in average earnings and profitability for foreign banks after interest rate capping was influenced by interest rate capping regulation. Therefore the interest rate capping had a significant effect on the average earnings and profitability for foreign banks in Kenya.

5.3 Conclusion
This study has provided a comprehensive review on the effect of interest rate capping on the performance of foreign banks in Kenya. Based on the findings of this study, the study concluded that capital adequacy, asset quality, management soundness, liquidity and earnings capacity for the foreign banks in Kenya had a significant positive change in the average means after interest rate capping announcement in Kenya. A statistically significant mean difference existed between average capital adequacy ratio for foreign banks in Kenya prior to and after interest rate capping. The announcement of interest rate
capping positively influenced the capital adequacy ratio in great extent causing the mean to increase. The mean difference between asset quality ratio for foreign banks in Kenya before and after interest rate capping was statistically significant. Interest rate capping had a positive significant effect on the capital adequacy ratio for foreign banks in Kenya.

The mean difference between average management soundness ratio for foreign banks in Kenya before and after interest rate capping was statistically significant. Therefore study concluded that increase in average Management ratio for foreign banks after interest rate capping was influenced by interest rate capping regulation. Rate interest capping regulation had significant effect on bank liquidity for foreign banks hence the increase in foreign bank liquidity after the announcement date was due to interest capping regulation. A statistical mean difference between average earnings and profitability for foreign banks in Kenya before and after interest rate capping was statistically significant hence the increase in average earnings and profitability for foreign banks after interest rate capping was influenced by interest rate capping regulation.

**5.4 Recommendations**

The study recommends the banks to innovatively bring in products that yield an income to the bank as opposed to relying on the interest income alone. Relying on the interest income has seen a reduction in income received by the banks and thus lowering the return on equity. Banks should work aggressively to bring in new products that generate them non-interest income.
The study revealed that interest rate caps regulation had significant effect on banks liquidity in Kenya, therefore interest rate caps regulation does not achieve the objective of lowering interest rates in the long term. This is because it only addresses the manifestations of financial market failures rather than the root cause. In order for the government to maintain the interest rates low in the long term, there is need to encourage a greater level of financial sector reform by actively being involved in ensuring policies are in place that enhance efficiency of market information coupled with the suitable market structures.

This study recommends that the law on interest rates capping should be repealed once all the stakeholders devise and put in place strategies to ensure access to credit for many potential borrowers and in turn improving the earning capacity for foreign banks. This study also recommends that the foreign banks in Kenya and the government through the central bank of Kenya should further explore other options of lowering the interest rates, such as improving customer financial literacy, enforcing disclosure of interest rates and improving financial consumer protection frameworks. This will open up the access to credit to most of the population, and this will spur economic growth and push up the profitability of banks in the country.

This study recommends that commercial banks in Kenya should strive to contain and reduce operational expenses, embrace technology for efficiency, as this will allow for a growth in income even at lower levels of interest rates, as low rates will enable them attract more clients.
5.5 Limitations of the Study
This study focuses on foreign commercial banks. Therefore the results do apply only to foreign commercial banks and attempts to there is need to be very careful in generalizing the findings to firms beyond this scope.

Secondly, the study focused on specific determinants of performance of banks as a concept. Therefore these results should be only be interpreted in the context of the concept and as per the methodology applied in the study.

The study also strongly proposes the need for a further study to be conducted in the banking industry but covering a longer period of time in order to access the trends and establish what factors influence bank performance in the long run.

5.6 Suggestions for Further Research
Lastly, this study is country specific to Kenya. This limits the study’s application to Kenya and caution is advised in generalizing the findings to other countries. This study was focused on a foreign banks however it can be replicated to other areas of the financial sector such as the insurance and micro-finance industries. This will help to understand the effect of the interest rate capping on other areas key to the economy.

The researcher also proposes that a study needs to be undertaken to investigate the long term effects that the law is having on macroeconomic factors of inflation and exchange
rates given that interest rates is one of the instruments that can be used to regulate these factors which are critical to the well-being of the economy

Further research is recommended on other areas affecting the performance of foreign banks in Kenya beyond the interest rate capping. It will focus on other important factors that have significant influence on the performance of banks.
REFERENCES


Ng’ang’a, A. K. (2017). The impact of interest rate capping on the financial performance of commercial banks in Kenya


APPENDICES

APPENDIX 1: FOREIGN BANKS IN KENYA

1. Barclays Bank of Kenya
2. CFC Stanbic Holdings
3. Standard Chartered Kenya
4. Bank of Africa
5. Bank of Baroda
6. SBM Bank Kenya Limited
7. Bank of India
8. Habib Bank AG Zurich
9. United Bank for Africa
10. Citibank
11. Nedbank
12. M-Oriental Commercial Bank
13. Guaranty Trust Bank Kenya
14. Dubai Islamic Bank
## APPENDIX 2: RESEARCH DATA

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