THE EFFECT OF RESPONSE STRATEGIES OF INTEREST RATE CAPPING ON THE FINANCIAL PERFORMANCE OF COMMERCIAL BANKS IN KENYA

BY:

EMMA CHEPNGENO

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DECLARATION

I declare that this research project is my original work and has not been presented to any university for examination.

Signed ……………… ……………………………….. Date…………….………………

Emma Chepngeno **D61/81936/2015**

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

Signed …………………………………………………... Date…………..…………………

Mr. Abdullatif Essajee

Lecturer, Department of Finance and Accounting

School of Business,

University of Nairobi.

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DEDICATION

I dedicate this research project to Almighty God and to my loving family. A special feeling of gratitude to my mother and to my husband, Nicholas Kirui, for their constant encouragement.

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LIST OF ACRONYMS AND ABBREVIATIONS

ATM	-	Automated Teller Machine
CBK	-	Central Bank of Kenya
CBR	**-**	Central bank rate
CRM	-	Customer Relationship Management
HRM	-	Human Resource Management
KNBs	-	Kenya National Bureau of Statistics
M&A	-	Mergers and Acquisitions
ROA	-	Return on Asset

ABSTRACT

The Kenyan banking industry has for a long time recorded impressive performance due to high interest rate spread. However, due to interest rate capping, banks' pre-tax profitability declined to Ksh 69.1 billion in the six months period June to December, 2016. Capping of interest rates in Kenya has thus taken a toll on the financial institutions forcing them to re-align their operations to the changing economic environment through formulation of appropriate response strategies. The study sought to determine the effect of response strategies to interest rate capping on the financial performance of commercial banks in Kenya. The study adopted a descriptive survey in accomplishing the objectives of the study. The target population was all the commercial banks that have been in operation for the whole year of 2017 while respondents for the commercial banks comprised of staff at top management level in the 43 commercial banks in Kenya. The study used both primary data and secondary data. The primary data was gathered through structured questionnaires which were self-administered while secondary data was on the financial performance which were obtained from the published annual reports and company sources as well as CBK's banking supervision reports for years 2013 to 2018. Data was analyzed through descriptive statistics such as: measure of relative frequencies, means and standard deviation. The data was then presented using graphs and tables. The study found out that though the commercial banks have formulated and implemented various response strategies, these strategies impacted differently on the financial performance of the commercial banks. Majority of the respondents (57%) perceived that the response strategies of interest capping implemented had a large extent of effect on financial performance of the commercial banks. All the response strategies investigated were found to have a positive effect on the commercial banks' financial performance. The regression analysis further obtained a coefficient of determination R square of 0.591indicated that 59.1% of changes in the performance are explained by the studied factors. The event analysis further affirmed that financial performance of the commercial banks prior to introduction of response strategies to interest rate capping was significantly different with the financial performance of commercial banks after introduction of response strategies to interest rate capping. The study concludes that the current financial performance of the commercial banks is largely accounted for by the response strategies implemented. The study also makes the conclusion that through effective response strategies the commercial banks are shielded from adverse negative effects caused by the introduced interest rate capping in Kenya. The study recommends that all the commercial banks in Kenya to establish appropriate response strategies so as to curb the introduced interest rate regulation. The study also recommends that the commercial banks to come up with innovation products and services so as to reduce the dependence towards interest rate incomes. It is further recommended that the Government of Kenya and CBK to revise the set policies on interest rate capping to ensure that neither the banks nor the customers are negatively affected.

CHAPTER ONE: INTRODUCTION

1.1 Background of the Study

The banking sector is one of the sectors of the economy affected greatly by change. When business environment change, then businesses have to respond appropriately (Thompson, 2007). Changes should trigger strategic responses from businesses by them acting more proactively or by adapting to the changing environment. The Banking (Amendment) Act which came into effect in August, 2016 requires banks to set their minimum interest rate granted on all deposits that are in interest earning accounts to at least seventy percent of the base rate in Kenya and as for credit facilities at no more than four per cent plus the base rate set in Kenya.

Capping of interest rates in was majorly due to public outcry that the banking institutions were making super-normal profits from the borrowers. Interest rates have an effect on the cost of capital and a change in it affects the debt-equity choice of a firms. Interest rates is one among other factors that affect a bank's financial performance and therefore it is important for banks to develop response strategies so as to survive in the market (Hualan, 1992). The capping of interest rates in Kenya has taken a toll on the financial institutions and hence forcing them to develop strategies to help them align their operations to the changed environment (Cytonn, 2017).

The strategic responses adopted by commercial banks to interest capping have an effect on their financial performance as explained by various theories: Systems theory, Vrooms expectancy theory and Optimal Capital Structure theory. Commercial banks in Kenya have developed strategies in response to interest rate capping which include: laying off staff to cut on their costs, mergers and acquisitions, rigid credit standards where banks are lending to safer borrowers that include governments or large corporations instead of small and risker borrowers, and increased adoption of technology as they push their customers to online and mobile banking (Central Bank of Kenya, 2016a).

1.1.1 Response Strategies to Interest Capping

Crowley et al. in 2007 defined interest rate to be the money paid by the borrower for use of the money received from a lending institution/lender or interest paid on borrowed assets (Crowley, 2007). Interest rate capping is one among other financial controls that governments use for economic and political related reasons. The rationale for interest rate capping is to enhance accessibility of financial markets and hence impacting positively on the growth, productivity, and poverty eradication (Bekaert, 2001). Governments use interest rate cap to achieve different objectives which include supporting a certain sector of the economy experiencing market failure arising from information asymmetries in the market and due to inability to differentiate between safe and risky clients, provision of loans for short durations of time to a strategic sector of the economy, offering support to an industry no longer sustainable by itself or to protect consumers against exploitation (Miller, 2013).

Strategic response is defined as a set of actions and decisions for the formalization and implementation of plans with the aim of achieving the organizational objectives (Pearce, 2010). The changing environment alters the way firms' conduct their businesses, such adaptations are being referred to as strategic responses. Strategic responses by organizations affect their long term direction and are aimed at achieving a competitive advantage over other organizations. Effective strategic responses require continuous scanning of both the external and internal environment so as to keep abreast of the changing variables (Pearce, 2010).

The intense competition existing between financial institutions presents a huge challenge to the profit margins of these institutions. The implications of each specific response will be dependent on the social, environmental, and economic context. Capping of interest rates in

Kenya has taken a toll on the financial institutions forcing them to re-align their operations to the changing economic environment. Commercial banks in Kenya have responded in varied ways including: retrenchment strategies, technology innovation, tight credit policies and/or, mergers and acquisitions. For banks in Kenya to succeed, they must aim to increase their competitive fronts towards optimal performance (Okari, 2016).

The effect of different response strategies to interest rates capping may be measured in a number of ways. Cost of labor, which is the mean of all labor expenses incurred in the period under analysis, would serve as a measure of the impact of retrenchment strategy. Findings on a study of the effects of scaling down on the operations and changes in profit margins of Transnational bank showed that the bank's profitability improved due to a layoff of 100 staff resulting to an annual payroll cost saving of 36 million shillings (Koech, 2006).

Net interest margin will be used as a measure of the effects of tight credit policy on the interest received. In a study of the empirical analysis of interest rate spread in Kenya it was found that interest spread differences were due to efforts by banks to maintain competitive profit margins. It was also found that banks whose credit risk was on the rise as the proportion of non-performing responded by increasing the lending rate risk premium (Ngugi, 2001).Operational efficiency serves as a measure of the effect of technology innovation. Jattani in his study that examined the relationship between technology adoption and operational efficiency of commercial banks in Kenya established a positive relationship between the study variables: ATM cards, credit and debit cards, mobile banking, internet bankingand operational efficiency (Jattani, 2009).

1.1.2 Financial Performance

Financial performance according to business dictionary refers to measuring the results of a firm's operations in monetary terms and policies which in turn reflects on the organizations' return on equity (ROE), ROA and value added. Stoner (2003) as cited in a study in 2013 by Turyahebwa defined financial performance as the ability of a firm to react to environmental threats and opportunities by operating efficiently and profitably (Turyahebwa, 2013).

Quadan(2004) argued that the analysis of financial performance can be used as a measure of an organization's health over a given period of time both in the short and long term. There exist different ways of measuring financial performance. Analysis of firms' financial performance involves evaluating the relationship among the different elements of financial statements being the income statement, statement of financial position and cash flow statementwith an aim of obtaining an understanding of the firms' performance, position and liquidity (Quadan, 2004).

Financial ratios such as profitability ratios, coverage ratios, efficiency/asset utilization ratios, leverage ratios and deposit mobilization ratio are used to measure organizations' financial performance (Bekan, 2011). The level of profits is commonly used as a measure of banks' financial performance (Ceylan, 2008). In this study, banks' financial performance was measured through return on asset ratio.

1.1.3 Response Strategies and Financial Performance

In response to capping of interest rates, commercial banks have developed several strategies to enable them survive in the market. Retrenchment strategies are mostly adopted by organizations to help in dealing with economic crisis and especially in the short-term period so as to cut on their operating costs and hence improve on their financial performance. Cost reduction often begins with information technology which by taking advantage of the new technologies, organizations are better positioned to offer their services efficiently. Banks continue to advance in various ways with an effort of remaining competitive and profitable. Implementation of tight credit policies have an impact on lending as lenders scale back loan disbursements to risker borrowers. The reduced lending has an effect on interest rates earning hence affecting banks profitability (Sianida, 2017).

Khan in 2011 found that acquisitions and mergers impacted positively on the operational performance of the acquiring banks in India and that the shareholders' value increased (Khan, 2011). Mergers and Acquisitions is used as a strategy for improving organizations competitiveness and acquiring competitive advantage over other firms in the market as a result of increased market share, reduced business risk due to a broader portfolio, new markets and low economies of scale (Saboo, 2009). According to Pazarkis at al., (2006) they found economic benefit of mergers and acquisitions to be changes resulting from increased value that otherwise would not have been made in the absence of a change in control (Pazarskis, 2006).

1.1.4 Commercial Banks in Kenya

During the fiscal year ended December 31, 2017, the Kenyan banking industry had 43 banking institutions with one being a mortgage finance company and 42 being commercial banks, it also consisted of 9 representative offices of foreign banks, 3 credit reference bureaus, 13 micro finance, 8 non-operating bank holding companies, 19 Money Remittance Providers (MRPs), 73 foreign exchange (forex) bureaus and central bank being the regulating authority (Central Bank of Kenya, 2017).

Commercial banks in Kenya make profits by lending the money held in deposit accounts to businesses at a high interest rate (Central Bank of Kenya, 2016b). Kenya's banking sector in the financial year ending June 2013 to December 2016 recorded an upward trend with profitability, assets, deposits, loans and advances all growing by more than 30%. This however dropped in the year ended 2017 with pre-tax profits declining by 9.6 percent to KSh 133 billion from KSh 147 billion as reported in the year ended 2016 (Central Bank of Kenya, 2017). The reduction was attributable to reduction in income of KSh 15.7 billion in comparison to KSh1.8billion decline in expenses. The reduction in income was a result of 11.23 percent decline in interest income on advances.

However, an analysis of the first half of the year 2018 showed a positive growth with profit before tax increasing from Ksh.37.70 billion recorded in the quarter ended March 2018 to Ksh.38.48 billion in the quarter ended June 2018. The aggregate balance sheet increased by 5.43 percent from Ksh.4.05 trillion in December 2017 to Ksh.4.27 trillion in June 2018. This increase was attributed to increased placements and investment in government securities during the period.Gross loans increased by 1.63 percent from Ksh.2,452.67 billion in December 2018 to Ksh.2,492.69 billion in June 2018. The increase in gross loans was mainly due to an increased demand for loans in the Trade, Personal/ Household, Manufacturing, Financial Services, Real Estate, Tourism and Agriculture sector. Total deposits increased by 8.14 percent from Ksh.2.95 trillion in December 2018 to Ksh.3.19 trillion in June 2018. This was attributed to an increase in foreign currency deposits (Central Bank of Kenya, 2018).

1.2 Research Problem

The Kenyan banking industry has for a long time recorded impressive performance due to high interest rate spread. However, due to interest rate capping, banks' pretax profitability declined to Ksh 69.1 billion in the six months period June to December, 2016 (Central Bank of Kenya, 2016c). Organizations have to continuously review and redesign their strategies in order to survive and remain competitive in the changing environment. Failure by organizations to adapt may lead to strategic problems. Commercial banks operating in Kenya have to keep up with the changes of the turbulent competitive environment which includes reduced interest rates caps. The competition in this sector means that banks have to be proactive with various strategic initiatives aimed at differentiating a firm from its competitor. These strategies have to be sustainable into the future (Mohamed, 2012).

There are various studies on the response strategies by commercial banks in Kenya. For instance, Thuranira who examined strategies by commercial banks in Kenya in response to the change in economic environment identified retrenchment strategy, investment strategy and ambidextrous strategy as among the strategies that had been adopted in response to the changing environment. He concluded that organizations are more likely to succeed if they combined downsizing and cost efficiency strategies with strategies of positioning for future and innovation (Thuranira, 2012).

Mwangi in 2009 examined the measures put in place by Chase Bank Kenya Limited in response to the changing banking environment. The study found that Chase Bank Kenya Limited chose to adopt the proactive posture so as to sustain their performance by focusing on the local markets and by processing new products to reduce reliance on financial income and foreign exchange gains (Mwangi, 2009). Njihia in 2009 investigated the measures put in place by Kenya Commercial Bank Limited in response to changes in the Kenyan banking industry and their effect on the bank's profitability (Njihia, 2009). It was found that the competitive forces in the banking industry had been countered by strategic responses by Kenya Commercial Bank Limited. The bank had responded to the competitive forces through restructuring, information technology, product innovation and wide range of product, customer care and branch expansion, and aggressive sales and marketing.

The above empirical studies have focused on the strategic responses by commercial banks to changing economic environment and no study has focused on the effect of response strategies undertaken by commercial banks to interest rate caps and on their financial performance hence the knowledge gap that study aimed to fill. The study addressed the research question;

what is the effect of response strategies by commercial banks in Kenya to interest rate capping and on their financial performance?

1.3 Objective of the Study

To determine the effect of response strategies to interest rate capping on the financial performance of commercial banks in Kenya.

1.4 Value of the Study

This study will help to provide a foundation for management of various banks to relate response strategies with the performance outcomes, or provide an explanation as to why some banks response strategies to interest rate caps are more successful than others. It will also add to the general understanding of the changes in the Kenya's banking environment and banks adaptation to interest rate capping. The study will aid policy makers in ensuring that they plan and predict the possible impact of financial policies with an intention of ensuring banks strive to meet their objectives while ensuring that customers are not exploited.

Other organizations will benefit from this study as this will help them evaluate their current strategies and plan for the future as there is need to draw on studies of adaptation to the changing environment. The study will also provide a foundation for further academic research focusing specifically on response adaptation under interest rate capping, and a basis to elaborate the external condition of interest rate capping that make particular response strategies possible, or impossible.

CHAPTER TWO: LITERATURE REVIEW

2.1 Introduction

This chapter presents a review of the literature relating to the effect of response strategies to capping of interest rate on the financial performance of commercial banks in Kenya. The literature discussed provides an overview of the theoretical rationale of the research problem being studied and other researches that have been done and how the results of the studies relate to the problem at hand. Finally, it seeks to identify the research gap emanating from the literature discussed.

2.2 Theoretical Review

Theoretical review assists in appreciating how various response strategies to capping of interest rate impact the performance of commercial banks. This study was guided by three main theories which included: the Systems theory,Vroom's expectancy theory and Theory of Optimal Capital Structure.

2.2.1 Systems Theory

Systems theory is a modelling devise that allows an interdisciplinary study of systems with an aim of establishing principles that can be applicable to all types of systems (Bertalanffy, 1962). According to the systems theory, a change in one part of a system leads to an effect on the other parts of a system hence affecting the whole system. Kuhn in his study onthe Logic of Social Systems said that knowing one part of a system aids in knowing something about other parts of the system. Systems are of two types: controlled and uncontrolled. In controlled systems, changes are effected in response to information detected.

The important components in Kuhn's theory include: detector which communicates the information, the selector in which the rules of the system being used defines it and lastly the effector which enables transactions between the systems (Kuhn, 1974).According To Systems Theory, transaction and communication are the only interactions between systems. The theory is relevant to the study as all organizations interact with the environment as they are open systems. The study used the system theory to determine the effect of increased adoption of technology as a response strategy to capping of interest rate on the financial performance of commercial banks.

2.2.2 Vroom's Expectancy Theory

Victor Vroom in 1964 developed the concept of expectancy theory where he assumed that an individual behavior results from a conscious choice between many alternatives but with the aim of minimizing pain and maximizing pleasure. Motivation results from the anticipated value of an action. Therefore the Vrooms model is developed around the concepts of force, value and expectancy. The three variables interact to create a motivational force which will make an employee to work so as to avoid pain (Vroom, 1964).

Expectancy refers to the probability that a particular action will result in the required outcome. Vroom in his study tackles three beliefs and which he brings out with clarity and applicability. The beliefs deal with the expectation of employees if they make an effort to improve performance. The first belief is comprised of the relationship between performance and effort; the employee's belief about the probability that his/her effort will lead to an expected performance. The second belief is comprised of the relationship between performance and outcomes; the belief that employees performance will lead to outcome and lastly the third belief which is comprised of the relationship between satisfaction and outcome. This study used the Vroom's expectancy theory to find out the effect of retrenchment as a response strategy to capping of interest rate on the financial performance of commercial banks.

2.2.3 Theory of Optimal Capital Structure

The optimal capital structure of a firm is the best debt to equity ratio that will maximize its value. Debt financing offers the lowest capital since it is tax deductible. It, however, increases a firm's risk as the debt level rises. Bankruptcy arises from the inability of a firm to meet the agreed fixed obligations of their creditors which Warner in 1977 and Weiss in 1990 gave evidence on bankruptcy costs and its significance to a business (Warner, 1977; Weiss, 1990). This theory explains the effect of acquisitions and mergers on the firm's performance. An adjustment towards a set capital structure improves on the acquirers' post-merger performance.

Most empirical studies and the optimal capital structure theory have supported the positive relationship between firms' performance and adjustment towards target leverage ratio. Adjustment in absolute leverage ratio has however not been clear on its effect on the firm's performance. An increase on the firms leverage ratio implies an increase in debt capacity of the acquirer hence more leverage benefits and an improvement on the firm as a whole. Conversely, a reduction in leverage ratio increases a firm's financial flexibility and ensures future investment hence contributing to performance after the merger.

This theory offers a rationale why firms engage in risk management strategies to avoid being put under receivership due their inability to pay their customers claims. This theory was selected to explain the effect of mergers and acquisitions among banks in Kenya as a response strategy to interest rate capping on their financial performance.

2.3 Determinants of Financial performance of Commercial Banks

Financial performance of commercial banks is affected by numerous factors but as for this study it is specific on the effect of response strategies to interest rate capping on the financial performance. The response strategies include retrenchment strategies, technology innovation, tight credit policies, and mergers and acquisitions. Organizations retrench their employees with an objective of improving financial performance by reducing on costs. Although retrenchment by organizations has become a managerial strategy, their effectiveness on how it will improve on organizational efficiency is yet to be clear. There are divided theories on retrenchment and inconsistent research findings (Krasz, 2004).

Technology in the workplace has continued to improve efficiency and quality of processes and products. Improvements in technology have led to new banking products, service by fewer employees hence cutting down on the costs and improving profitability. The relevance of Information Technology (IT) to the performance of commercial banks is that it is believed to impact positively by reducing on the customers waiting time, convenient services, improved operational efficiency by cutting down on costs and hence improving banks profitability.

Mergers and acquisition help firms to reduce or eliminate functions or facilities that are overlapping. Functions such as human resource, research and development, marketing can be consolidated hence reducing the operational costs and improving profitability. Banks can expand its markets both externally or internally and in a case where a bank cannot expand internally due to physical and managerial constraints then it can expand externally either through merger or acquisitions.. Mergers and acquisitions may help to increase the pace at which a company is growing but in an inexpensive and consistent manner

Commercial banks credit policy affects their financial performance. Having an optimal credit policy reduces costs to a reasonable minimum level that create value for the firm and hence resulting to increased profitability (Shin, 1998). An efficient credit management system is crucial since over-investment in debtors results in a bank being unable to meet its obligations due to inadequate cash flows, whereas under-investment in accounts receivables may result to low revenues for the bank. Other factors that theoretically affect the financial performance of commercial banks are discussed as below

2.3.1 Capital Adequacy

Capital adequacy is defined by Kosmidou as the ability of equity to sufficiently absorb any shocks that may be experienced by the bank (Kosmidou, 2008). Regulators pay close attention to banks' capital requirement and always want to set a high threshold so as to minimize on the number of bank failures. Bankers, on the other hand, argue that setting high capital requirements is expensive and also it limits on banks competitiveness (Gavila, 2009).

Beckmann (2007) argued that having a high capital requirement results into low profits due to the likelihood of banks ignoring potentially risky investments (Beckmann, 2007). However, Gavila et al, argued otherwise that even though capital may seem to be expensive due to low expected return it reduces bankruptcy costs should the bank undergo financial distress. Also, he argued that it lowers the demand for external borrowing and particularly in the developing economies where accessing external sources of funds is difficult (Gavila, 2009).

2.3.2 Operational Efficiency

Management of expenses is important to every organization as it affects their profitability. Sufian and Chong in 2008,found poor expenses management to be the leading contributor towards poor profitability (Sufian, 2008). Operational efficiency ratio is mostly used to determine the managerial efficiency of banks. Beck and Fuchs in 2004 found overheads to be one of the most important factors that contributed to high interest rate spread in banks (Beck, 2004).

The relationship between expenses and profits may seem to be direct implying that low expenses results to high profits. This may not always be the case as expenses may be related to the volume of banking activities; low expenses may be due to low volume of transactions and hence low revenues. However in uncompetitive markets where banks enjoy market power, a positive correlation exists between overheads and banks profitability as costs are passed on to customers.

2.3.3 Liquidity

Liquidity management is another important determinant of financial performance. Liquidity in the banking sector goes beyond one individual bank. This is because a shortfall in one bank can have widespread repercussions (Central Bank of Kenya, 2009). Kamau showed that when financial institutions hold high level of liquidity they lose on opportunities of having investments that could lead to high returns (Kamau, 2009). This trade-off can be shown by observing the move from short term securities to long term securities. This leads to the dilemma of profitability and liquidity as a high liquidity ratio are features of a less risky and less profitable bank (Hempel, 1994).

2.4 Empirical Review

2.4.1Global Studies

Ajayi and Obisesan in 2016 carried out a study on the effects of mergers and acquisition on the performance of banks in Nigeria. The study set out to evaluate the effects of mergers and acquisitions on the performance of five selected banks in Nigeria. The data used for analysis were secondary data covering the period between 2001 and 2014. The secondary data were obtained from the bank's annual statement of account and reports, the study employed Ordinary Least Square for data analysis. The study found that merger and acquisition had no significant effect on the performance of selected banks' in Nigeria (Ajayi, 2016). From the review of the study, it did not include liquidity position as one of the variables which has an effect on financial costs reduction or growth hence affecting banks financial performance.

WasimHamed in 2013 conducted an empirical investigation on the effect of downsizing on the financial performance of Pakistan banks that downsized in the ten year period being 2003 to 2013. The study analysed secondary data of the banks that were involved in downsizing before downsizing and after downsizing. The study found that there were significant differences in the loan per employee and deposit per employee for the period after and before downsizing. It was found that there was insignificant difference in following four ratios; loans to assets and non-performing loans/loan, return on equity and return on assets respectively. It was thus concluded that there was no significant change in the performance of banks that had undertaken downsizing before or after downsizing (WasimHamed, 2013). The study however did not analyze the impact of service delivery by banks' employees after retrenchment on its financial performance.

Malhotra et al. (2009) researched on the impact of internet banking on the banks profit margins and risk in India. The objective of the study was to determine the impact of internet banking on the banks' risk and financial performance. A survey was of 85 scheduled bank's websites was conducted and for the period ending June 2007. Research findings indicated that more than half of commercial banks in India were offering transactional internet banking services. It also found that on average, the internet banking departments were profitable, better managed, efficient and had ah higher asset quality. However, the study found that profitability of smaller banks which had adopted internet banking was impacted negatively through adoption of internet banking. (Malhotra, 2009). The study did not however include other variables of innovation such as mobile banking and point of saleterminals so as act as control variables since they have an impact on banks financial performance and so as to make the study more comprehensive.

Misker studied the impact of credit risk on financial performance of Ethiopian banks. The researchers examined the impact of credit risk management on profitability of banks in Ethiopia, determine bank macro-economic factors, specific and industry factors that had an impact of banks financial performance. The study was done on eight banks which had been existing in the industry for eleven years. The study used secondary data on which correlation and multiple regression analysis were done with random effect model and E-View software used to regress the data (Misker, 2005).

The study found an inverse relationship between bank's financial performance and credit risk and also with capital adequacy. Loan to deposit ratio was found to have a positive relationship with the bank size. It was also found that banks specific factors like bank size had a significant effect on the profitability, while other external factors like industry specific and macroeconomic factors had no major impact on the profitability of the Ethiopian banks. A conclusion was reached that profitability of Ethiopian banking sector was greatly affected by the managerial decision than the external factors. The study however focused on credit risk as the major determinant of financial performance and not considering other risks such as liquidity risk, operational risk and market risk which are close to credit risk in the banking industry and have an effect on the financial performance.

Diaz in 2004 established the performance after the acquisition of a non-bank financial entity and from acquisition of another bank in the European Union. The study sample was composed of 1,629 banks, where in the period 1993-2000 a total of 181 acquisitions had been noted. They established that in bank mergers, the acquirer achieved efficiency gain. They study found evidence on the effect of takeover on the acquirer in a case when the acquiring firm is non-bank firms. Their results revealed that there is a possibility of European banks profitability to increase if the acquired firms are financial entities. Acquisition of other banks were found to have an impact on the acquirers return on assets (ROA) as were shown by the increase in long-term profitability (Diaz, 2004). From the study findings it is noted that the improved profitability reported from acquisition of financial entity experienced a lag of two years.

2.4.2 Local Studies

Thuranira in 2011 carried out a study on the response strategies adopted by commercial banks in Kenya to changes in the economic environment. The study sought to identify which response strategies commercial banks had adopted due to changes in the economic landscape. The study used a cross sectional descriptive survey, which included all commercial banks in Kenya as at December 2011. Primary data was then obtained through a questionnaire and administered to managers involved or responsible for developing strategy. Existing bank publications and annual reports were used as a source of secondary data. The study used descriptive statistics to analyze the quantitative and data collected using open ended questions were analyzed using qualitative data analysis method of data analysis. Study findings showed that commercial banks in Kenya had been able to respond to the environmental changes through; investment, retrenchment strategies, innovation, expansion into new markets and ambidextrous strategies. (Thuranira, 2012). The study however did little analysis on why banks choose a given strategy and whether there were any constraining or enabling conditions to a given strategy.

Mwangi in 2009 researched on the strategic responses by Chase Bank Kenya limited to environmental changes in the banking sector. The case study first sought to establish how Chase Bank Kenya Limited had responded to environmental changes and to changes in the industry forces.The study was carried out through a case study method to help the researcher achieve the study objective.The respondents of the study research were senior management staff of Chase Bank Kenya Limited, Chief Executive Officer, six divisional heads and eight branch managers. Content analysis was used since date collected was qualitative. The study identified various factors that had affected the bank which Mwangi classified as facilitators and challenges. The facilitators identified were a young and youthful culture, strong customer relations, branch network and foreign exchange pricing that is competitive. It was concluded that Chase Bank Kenya Limited had accomplished managing environmental challenges as a result of having an open-minded attitude of the management and therefore developing strategic responses to the changes. (Mwangi, 2009). The study focused on only one bank yet there are many players in the banking industry hence the findings cannot applicable to all other banks in Kenya. Also, due to high competition in the banking industry it is likely that the bank did not fully disclose all their strategic responses.

Njihia in 2009 studied the strategic responses of Kenya Commercial Bank Limited (KCB) to the changes in the Kenyan banking sector. The study objective was to identify the response strategies of KCB to the changes in the Kenyan banking sector as well as determine the effectiveness of these strategies. The research was carried out through a case study design. In order to meet its objective, the pertinent primary and secondary data was collected which was then analyzed qualitatively. Data was collected from top management of the bank at the headquarters. The people interviewed were the heads of the following departments: personal banking, micro finance, SME, corporate banking, human resource, Islamic banking and retail banking (Njihia, 2009).

The study established that the competitive forces in the banking industry had been countered by responses strategies developed by Kenya Commercial Bank Limited. According to research findings, Kenya Commercial Bank Limited had responded to the competitive forces through restructuring, information technology, product innovation and wide range of product, customer care and branch expansion, and aggressive sales and marketing. The study adopted a case study design hence its findings cannot be used to give a general view of the strategic responses being adopted by commercial banks due to the competitive forces in the banking industry.

Harrison (2016) researched on the strategic responses to environmental changes facing Faulu bank in Kenya. The aim of the study was to establish the environmental challenges facing the bank and identify the strategies which the bank had adopted to cope with the challenges. Case study research design was adopted to allow the researcher explore and have acomprehensive investigation into the unit of analysis concerning the study variable.Data was collected through interview guide. Data was analyzed using content analysis which gives a qualitative description of the objects making up study and is also systematic. The study concluded that the main responses strategies 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. These strategic responses were meant to enable Faulu bank to counter environment environmental challenges and to remain competitive in the market place (Kamwere, 2016). The study presents a need to extend population since the findings were unique to Faulu bank only and cannot be adopted by all micro finance institutions.

Muchangi in 2014 conducted a study to determine the effect of strategic responses of banks' treasury departments on the profitability of the bank, a case of Bank of Africa (Muchangi, 2014). The study used a descriptive survey design. Primary data was collected using a questionnaire and quantitative methods of data analysis such as the inferential and descriptive statistics were used. Study findings showed that every new employee needed to receive induction training and employees were satisfied with the compensation package offered in the bank and the reward motivation granted by the bank. Findings also indicated that majority of the respondents were in agreement with the statements that CRM strategy enabled banks to analyze the customer profiles and prospects. In addition, the bank had invested heavily in an ATM network and internet banking. It was concluded that the management information systems were sufficiently flexible to support banks growth and that core banks management information system was compatible with other systems. The study however concentrated on Bank of Africa only hence limiting the applicability of the study findings.

2.5. Conceptual Framework

The conceptual framework for the study is shown by Figure 2.1.

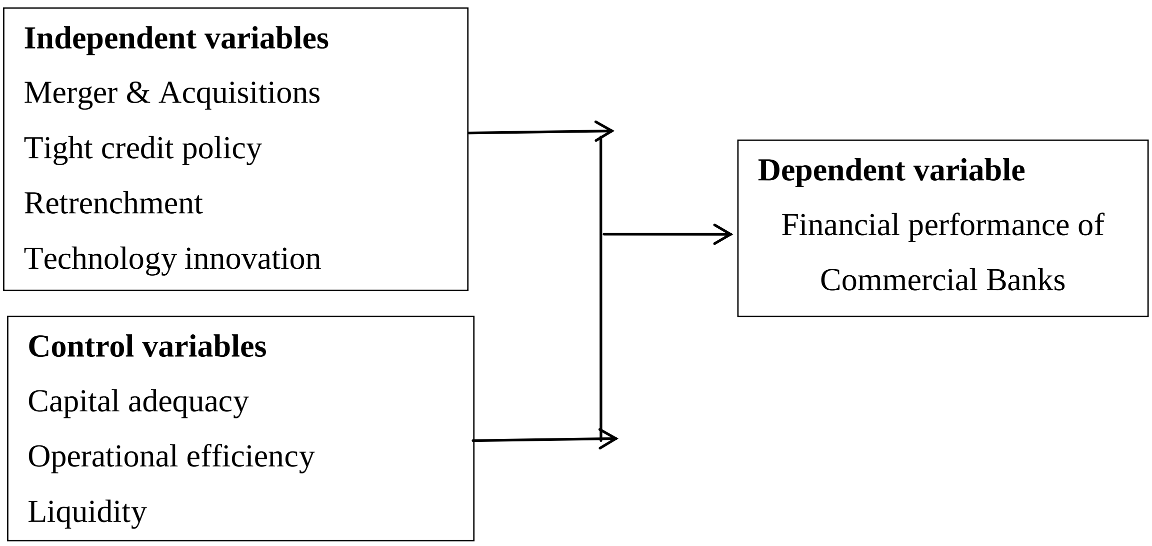

Figure 2. 1 Conceptual Framework

Source: Researcher, (2018)

2.6 Summary of Literature Review

Several studies have been done covering the various strategies which commercial banks have undertaken in response to the changes in the economic environment and their effect on their financial performance. Mixed results have been produced in some studies. For example some studies concluded that mergers have no positive impact on the institution's financial performance while others found a positive relationship between merger and the entities financial performance of the institutions that merged. The mixed findings could be attributed to the fact that companies and countries vary in many ways. Capping of interest rates is new to Kenya and hence is difficult to make conclusions based on the existing literature. Hence, there is a need for studies to be done on the various responses strategies which commercial banks in Kenya have undertaken in this period of interest rate capping and hence establish the effect on their financial performance.

CHAPTER THREE: RESEARCH METHODOLOGY

3.1 Introduction

This chapter covers techniques and procedures that wereused in selection, processing and analyzing the data obtained about the research topic.

3.2 Research Design

Research design refers to arrangement of conditions for the purpose of collection aimed at combining relevance with the research (Kombo, 2006). The study adopted a descriptive survey. According to Creswell, (2008), descriptive research design facilitates the collection about the actual phenomenon and where possible enables valid conclusions to be made pertaining to the study. The research design also enables adequate description of the variables of the study while minimizing any interferences by the researcher and was thus to be the most appropriate for the study.

3.3 Population

A study population is a large group of element or people with a minimum of one common characteristic (Kombo, 2006). The target population was all the commercial banks that have been in operation for the whole year of 2017 while respondents for the commercial banks comprised of staff at top management level in the 43 commercial banks in Kenya (Central Bank of Kenya, 2017) Appendix 1. The study adopted a census approach since the population size was small.

3.4 Data Collection

This study usedboth primary data and secondary data.The primary data was gathered through structured questionnaires which were self-administered. The preference of questionnaires was due to them being economical and able to collect a wide range of data within the shortest time possible.The questionnaire was structured to comprise of sections; each section addressing the study's specific objectives.The questionnaires were administered individually to each respondent.Secondary data on the other handwason the financial performance which were obtained from the published annual reports and company sources as well as CBK's banking supervision reports for years 2013 to 2018. The data was collected using secondary data collection sheets.

3.5 Validity and Reliability

The data was tested for both validity and reliability for meaningful and consistency of results. Mugenda and Mugenda indicated that the usual procedure for measuring content validity is to use a particular field professional or expert (Mugenda, 2003). The experts help with wording and sequencing problems as well as help in exploring ways of improving quality of the study. In this study, the researcher sought the advice and opinions of the lecturers in the department of accounting and Finance and especially that of the supervisor and moderator to ensure necessary revision and hence enhancing viability.

Reliability of the tools used for data collection is the consistency of the measurements acquired by the data collection tools. It is commonly assessed through the use of test retest reliability method (Mugenda, 2003). The questionnaire was piloted by administration to five managers not included in the study sample of 43 managers. This intended to help in correcting any ambiguity in the questionnaires and help in collection of relevant information that assisted in answering research questions. Reliability in this study was measured by correlating the scores of each questionnaire of each variable.

3.6 Data Analysis

Data collected was assessed to check for completeness and coherency. The data was coded and exported into the statistical package for social sciences (SPSS 21) for analysis. Data wasanalyzed through descriptive statistics such as: measure of relative frequencies, frequency distribution tables, means and standard deviation. Quantitative data was presented using graphs and tables. Correlational analysis was also done to demonstrate the strength of relationship between the dependent and independent variables. Also, statistical regression was done to determine the effect of response strategies to capping of interest rate on the performance of commercial banks. Event analysis was alsoconducted to establish whether the commercial banks performance measures were statistically different from those before the introduction of responses to interest rate regulation.

A linear regression model was adopted where performance of commercial banks was treated as the dependent variable and response strategies as the independent variables. The model shall also incorporate control variables affecting bank's financial performance and which included; Capital adequacy obtained by computing the capital adequacy ratio being the ratio of bank' core capital to its risk weighted assets expressed as a percentage, operational efficiency determined by the ratio of bank's operating expenses to operating income and finally liquidity referring to the ability or ease in which company's assets can quickly be converted into cash and measured by computing the liquidity ratio.

The relationship equation is represented in the linear equation as below:

Y (Commercial banks' financial performance) = $\alpha + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4 + \beta_5 X_5 + \beta_6 X_6 + \beta_7 X_7 + \varepsilon$

Where:

Y_i= Dependent Variable (Commercial Bank's Financial Performance measured using Likert scale)

α = Constant Term

$ß_1$…………$ß_7$= Coefficient of the independent variable

X_1= Merger and acquisition

X_2=Retrenchment

X_3=Technology innovation

X_4= Tight credit standards

X_5=Capital Adequacy

X_6= Operational Efficiency

X_7=Liquidity

ε = error term

CHAPTER FOUR: RESEARCH FINDINGS AND DISCUSSION

4.1 Introduction

This chapter presents the findings of the study on the effect of response strategies to interest rate capping on the financial performance of commercial banks in Kenya. It also covers the interpretations made and discussion regarding these findings. The data was collected using both primary and secondary means through the use of questionnaires and data collection sheets. The secondary data was collected for a five year period of 2013 to 2018. Analysis and interpretation of the collected data was done using inferential and descriptive statistics and presented in tables and figures.

4.2 Reliability Test

Reliability of the data collection instruments was undertaken using Cronbach's Alpha where values higher than 0.7 were considered to be reliable. Table 4.1 shows the findings obtained.

Table 4. 1 Reliability Test

Variable	Cronbach's Alpha	No of Items
Merger and acquisition	0.992	6
Retrenchment	0.798	6
Technology innovation	0.821	4
Tight credit standards	0.728	8
Control Variables	0.684	6

The findings indicated that Merger and Acquisition had a Cronbach Alpha of 0.992,Retrenchment Strategies 0.798, Technology Innovation 0.821, Tight Credit

Standards0.728 and ControlVariables0.684. This implies that all the variables had Cronbach Alpha values greater than 0,7 an indication that the data collection instruments were reliable.

4.3 Demographic Characteristics

The demographic characteristics investigated included respondents' position in the banks, years worked in the banking industry, ownership type of the banks and the market share of the banks.

4.3.1Ownership Type of Banks

The study sought to determine the ownership type of the banks based on their origin and liability status. The findings are presented in Table 4.2.

Table 4. 2Ownership Type of Banks

Ownership Type	**Frequency**	**Percentage**
Local Private Commercial Bank	16	46%
Local Public Commercial Bank	9	26%
Foreign Commercial Banks	10	29%
Total	**35**	**100%**

The findings in Table 4.2 indicate that 46% of the banks were local private commercial banks, 29% were foreign commercial banks and the remaining 26% werelocalpublic commercial banks. This implies that majority of the commercial banks (72%) were locally owned with most of them being private. However, the responses obtained were from all banks of different ownership types hence no biasness.

4.3.2 Bank Market Share

The study sought to establish the market size of the commercial banks. The findings obtained are as shown by Figure 4.1.

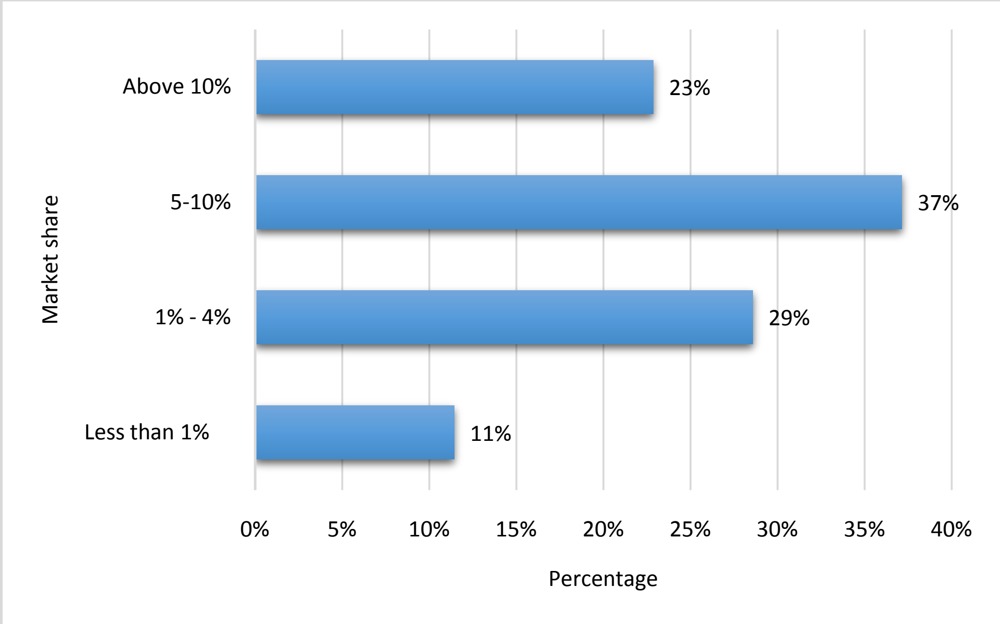

Figure 4. 1 Bank Market Share

As shown by figure 4.1, the banks had varying market share sizes with 37% having a market share of 5-10%, 29% a market share of 1-4%, 23% a market share of above 10% and 11% a market share of less than 1%. This implies that majority of the commercial banks (60%) had a considerable market share of above 5%. According to CBK, (2017) the major banks controlling over 50% of the market share include Equity Bank, Cooperative Bank, KCB, Diamond Trust Bank, CBA, Barclays and Standard Chartered Bank.

4.4 Descriptive Analysis of Study Variables

The study independent variables were the response strategies by the banks to interest rate capping in Kenya while the dependent variable was the financial performance of the banks. The variables were measured by different components of the variables and quantified using a five point Likert scaleas well as open ended questions.

4.4.1 Response Strategies to Interest Capping

The study sought to determine the effects brought about by introduction of interest capping in the banking industry in Kenya. All the respondents unanimously agreed that the business environment had changed significantly as a result of introduction of interest rate capping. This was indicated to have both direct and indirect effects on how the commercial banks conducted their operations in profit maximization. Despite the respondents agreeing that interest capping played a huge role in achievement of consumer protection from exorbitant interest rates, it necessitated the commercial banks to formulate appropriate response strategies so as to remain profitable. The study thus further aimed at establishing this exactresponse strategies that the commercial banks in Kenya had adopted in response to interest rate capping. To achieve this a Likert Scale of 1 to 5 was used in rating the responses by the respondents. Table 4.3 represents the results obtained.

Table 4. 3 Banks Response Strategies to Interest Rate Capping in Kenya

Banks Response Strategies to Interest Rate Capping in Kenya	**Strongly Disagree**	**Disagree**	**Neutral**	**Agree**	**Strongly Agree**	**Mean**	**Std Dev**
Retrenchment of staff has reduced payroll costs hence improve banks financial position	6%	9%	60%	11%	14%	3.20	0.6971
Technology Innovation in banks is on the rise due to need to improve on efficiency hence lowering banks operating expenses	6%	0%	14%	29%	51%	4.20	1.0697
Banks have implemented tight credit standards to reduce on the risk of loan loss and which has resulted to improved interest income	3%	3%	14%	46%	34%	4.06	0.8914
Banks financial performance have improved due to closure of some of its branches as they encourage their customer to use mobile and online platforms	14%	17%	26%	34%	9%	3.06	0.4817
Banks income have increased due to other bank charges that have been introduced since the law on interest rate capping came in effect	34%	14%	34%	6%	11%	2.46	0.3273
Merger and acquisition is impacting positively on Banks financial performance	11%	11%	17%	31%	29%	3.54	0.6001

As shown by Table 4.3, majority of the respondents (51%) strongly agreed that technology innovation in banks is on the rise due to the need to improve on efficiency hence lowering banks operating expenses. Majority of the respondents (80%) agreed having a mean of 4.06 and standard deviation of 0.8914 that banks have implemented tight credit standards to reduce their risk of loan loss which has resulted to improved interest income, 60% of the respondents agreed that merger and acquisition is impacting positively on banks' financial performance, 60%of the respondents were however neutral on retrenchment of staff having reduced payroll costs hence improved banks' financial position. The respondents were also neutral on banks financial performance having improved due to closure of some of its branches as they encourage their customer to use mobile and online platforms. However, the respondents disagreed on banks income have increased due to other bank charges that have been introduced since the law on interest rate capping came in effect. This shows that though the commercial banks have formulated and implemented various response strategies, these strategies impacted differently on the financial performance of the commercial banks.

4.4.2 Financial Performance of Commercial Banks

The study sought to determine the effect of the response strategies oninterest rate capping on various measures of financial performance of the commercial banks. To achieve this a Likert Scale of 1 to 5 was used in rating the responses by the respondents. Table 4.4 represents the results obtained.

Table 4. 4Financial Performance of Commercial Banks

Financial Performance Measure	Very Small Extent	Small Extent	Moderate Extent	Large Extent	Very Large Extent	Mean	Std Dev
Return on capital employed	11%	11%	14%	49%	14%	3.43	0.7387
Return on Investment	11%	11%	17%	54%	6%	3.31	0.8558
Operating profit margin	0%	3%	14%	31%	51%	4.31	1.0790
Return on Assets	6%	9%	11%	34%	40%	3.94	0.8547
Mean Score						**3.75**	**0.8821**

As shown by Table 4.4 above, on effect of response strategies oninterest rate capping on operating profit margin, majority of the respondents (82%) indicated an above average extent of influence having a mean of 4.31 and standard deviation of 1.0790. On effect on Return on Assets, majority of the respondents (77%) also indicated an above average extent of influence having a mean of 3.94 and standard deviation of 0.8547. On effect on Return on Investment, majority of the respondents (54%) stated a large extent with a mean of 3.31 and standard deviation of 0.8547. While on the effect on Return on Capital Employed, majority of the respondents (63%) indicated an above average extent of influence having a mean of 3.43 and standard deviation of 0.7387. On average, theeffect of the response strategies of interest rate capping on various measures of financial performance of the commercial banks had a mean of 3.75 and standard deviation of 0.8821. This implies that the response strategies adopted had a large extent of influence (mean>3.5) on how the commercial banks performed.

4.4.3 Effect of Response Strategies of Interest Capping on Financial Performance

This section aimed at establishing the perceived extent of the effect of response strategies of interest capping on financial performance of the commercial banks in Kenya. As shown by Table 4.5, 31% of the respondents indicated a large extent of influence, 26% a very large extent of influence, 20% a moderate extent, 14% a very small extent while the remaining 9% a small extent of influence on the financial performance. This means that majority of the respondents (57%) perceived that the response strategies of interest capping implemented had a large extent of effect on financial performance of the commercial banks.

Table 4. 5Effect of Response Strategies of Interest Capping on Financial Performance

Extent of Influence	Frequency	Percentage
Very Large Extent	9	26%
Large Extent	11	31%
Moderate	7	20%
Small Extent	3	9%
Very Small Extent	5	14%
Total	**35**	**100%**

4.5 Diagnostic Tests

4.5.1 Multicollinearity

Multicollinearity tests was conducted on the regression model so that incorrect conclusions about the relationship between dependent variable and predictor variables be avoided. Variance Inflation Factor (VIF) and tolerance degree were used to indicate presence of multicollinearity test. The findings obtained are presented by Table 4.6.

Table 4. 6Test for Multicollinearity

	Tolerance	VIF
Merger and acquisition	0.235	1.989
Retrenchment	0.123	3.224
Technology innovation	0.140	2.377
Tight credit standards	0.223	1.580
Control Variables	0.344	4.343

Source: Research Data, 2018

As shown,merger and acquisitionhad a tolerance value of 0.235and a VIF value of 1.989, retrenchment had a tolerance value of0.123and a VIF value of 3.224, technology innovation had a tolerance value of0.140and a VIF value of 2.377, tight credit standardshada tolerance value of 0.223and a VIF value of 1.580 and control variableshad a tolerance value of 0.344and a VIF value of 4.343. This shows that all the research variables had tolerance of greater than 0 and VIF less than 10 and thus implying there was no multicollinearity problem.

4.5.2 Normality Test

Normality test was undertaken to ensure that the study variables are normally distributed. The normality test results as presented by Table 4.7 show that for all the variables, skewness and kurtosis statistics were within +/-2 and hence the data was normality distributed. Therefore an implication that the normality assumption of regression analysis was in place.

Table 4. 7Normality Test

	Skewness	**Kurtosis**
Merger and acquisition	-0.254	-1.626
Retrenchment	0.815	-1.447
Technology innovation	1.884	-1.268
Tight credit standards	-1.323	1.195
Control Variables	-1.53	1.658
Financial Performance	1.224	0.655

4.6 Correlation Analysis

Correlation analysis was used to find the relationship between variablesunder study. In this study, Karl Pearson’s coefficient of correlation was employed in establishing the relationship that existed. The results of the correlation analysis are presented by Table 4.8.

Table 4. 8Correlation Analysis

		ROA	Merger and Acquisition	Retrenchment	Technology Innovation	Tight Credit Standards	Control Variables
Merger and Acquisition	Pearson Correlation	.560**	1				
	Sig. (2-tailed)	0	0.001				
Retrenchment	Pearson Correlation	.201	-0.454	1			
	Sig. (2-tailed)	0.114	0	0			
Technology Innovation	Pearson Correlation	.107	0.156	.635**	1		
	Sig. (2-tailed)	0.145	0.323	0	0.016		
Tight Credit Standards	Pearson Correlation	.711**	0.3588	0.2817	0.1177	1	
	Sig. (2-tailed)	0	0	0	0	0	
Control Variables		.173**	0.095	0.093	0.028	0.005	1
	Sig. (2-tailed)	0	0	0	0	0	0
N		215	215	215	215	215	215

As presented by table 4.8,Merger and acquisition had a Pearson Correlation of 0.560 and p-value of 0, Retrenchment had a Pearson Correlation of 0.201 and p-value of 0.114, Technology innovation had a Pearson Correlation of 0.107 and p-value of 0.145, Tight credit standardshad a Pearson Correlation of 0.711 and p-value of 0 andControl Variables namelyCapital Adequacy, Operational Efficiency, Liquidityhad a Pearson Correlation of 0.173 and p-value of 0. This implies that all the variables have a positive effect on the commercial banks' financial performance.Therefore, an increase in these variables will result in increased commercial banks' financial performance. All the variables except Retrenchmentand Technology innovation were significant at the 5%confidence level due to their p-values being less than 0.05. This concurs with Misker's (2005) findings who studied the impact of credit risk on financial performance of Ethiopian banks. However, Ajayi, (2016) from study on the effects of mergers and acquisition on the performance of banks in

Nigeria found out that merger and acquisition had no significant effect on the performance of selected banks' in Nigeria. While Wasim (2013) concluded that there was no significant change in the performance of banks that had undertaken downsizing before or after downsizing of the employees.Manyo et al (2016) further revealed that foreign exchange income has a negative and insignificant effect on the profitability of Nigerian banks for the period.

4.7Regression Analysis

The study sought to determine the relationship that exists betweenresponse strategies to interest rate capping and the financial performance of commercial banks in Kenya. To achieve this, regression analysis was undertaken where the independent variables were; Merger and acquisition, Retrenchment, Technology innovation, tight credit standards, Capital Adequacy, Operational Efficiencyand Liquidityfocus strategyand the dependent variable was financial performance of the commercial banks.Table 4.9 shows the regression analysis model summary.

Table 4. 9 Model Summary

R	R Square	Adjusted R Square	Std. Error of the Estimate
.620a	0.591	0.552	0.1112

a. Predictors: (Constant), Merger and acquisition, Retrenchment , Technology innovation Tight credit standards, Capital Adequacy, Operational Efficiency, Liquidity

As shown by Table 4.9,the coefficient of determination R square is 0.591 which implies that 59.1% of changes in the performance are explained by the studied factors. This means that only 40.9% of the changes in the performance of the commercial banksare accounted by factors not included in the model. Analysis of Variance was conducted to check on the significance of the Model as per Table 4.10.

Table 4. 10 ANOVA

	Sum of Squares	Df	Mean Square	F	Sig.
Regression	18.597	3	6.199	36.411	.000a
Residual	25.296	211	0.235		
Total	43.893	214			

a. Predictors: (Constant) Merger and acquisition, Retrenchment , Technology innovation, Tight credit standards, Capital Adequacy, Operational Efficiency, Liquidity

b. Dependent Variable: Financial Performance

According to Table 4.10, the significance of the model is 0.000 less than both 0.01 and 0.05. This thus shows that the model was highly significant at 95% and 99% confidence levels in explaininginfluence of response strategies to interest rate capping and the financial performance of commercial banks. The model coefficients obtained by the study are shown in Table 4.11.

Table 4. 11 Model Coefficients

	Unstandardized Coefficients		Standardized Coefficients		
	B	Std. Error	Beta	T	Sig.
(Constant)	0.224	0.347		0.646	0.00
Merger and acquisition	0.291	0.11	0.385	2.645	0.408
Retrenchment	0.287	0.12	0.374	2.392	0.122
Technology innovation	0.464	0.105	0.511	4.419	0
Tight credit standards	0.169	0.114	0.174	1.482	0.059
Capital Adequacy	0.266	0.121	0.293	2.198	0.018
Operational Efficiency	0.434	0.109	0.477	3.976	0
Liquidity	-0.098	0.096	0.11	-1.018	0.312

a. Dependent Variable: Financial Performance

The results in Table 4.11 indicate that Merger and acquisitionhad a model coefficient of 0.291, Retrenchment had a model coefficient of0.287, Technology innovationhad a model coefficient of 0.464, Tight credit standardshad a model coefficient of 0.169, Capital Adequacyhad a model coefficient of0.266, Operational Efficiencyhad a model coefficient of 0.434 while Liquidity had a model coefficient of-0.098.This implies that all the variables except Liquidity have a positive and significant influence on the performance of commercial banks. Hence, unit increase in these strategies will result in unit increase in the organization performance of the mobile service providers.

4.8Event Analysis

Event analysis was used to establish whether response strategies to interest rate capping had significant effect on financial performance of commercial banks in Kenya. Financial performance, in 2015 was compared to those prevailing in 2017; one year after and before introduction of interest rate regulation. The event year, 2016 was excluded in event analysisas it was used as the study year in determining the effects of interest regulations. The findings are presented in Table 4.12.

Table 4. 12Event Analysis

		Sum of Squares	Df	Mean Square	F	Sig.
ROA	Between Groups	0	1	0	0.452	0.004
	Within Groups	0.023	18	0		
	Total	0.023	19			
ROE	Between Groups	0.02	1	0.002	0.344	0.006
	Within Groups	0.201	18	0.015		
	Total	0.221	19			

The findings indicated that financial performance as measured by Return on Assets (ROA) had a p-value of 0.004 and Return on Equity had p-value of 0.006. This meant that financial performance of the commercial banks prior to introduction of response strategies to interest rate capping was significantly different with the financial performance of commercial banks after introduction ofresponse strategies to interest rate capping. Financial performance was therefore different after introduction of the response strategies. This compares with Thuranira (2012) who examined strategies by commercial banks in Kenya in response to the change in economic environment identified retrenchment strategy, investment strategy and ambidextrous strategy as among the strategies that had been adopted in response to the changing environment. Kibobo (2017) who also studied interest rates control and performance of commercial banks in Kenya, taking a case study of Equity Bank established that interest control measures such as placement of interest caps was not an efficient method in the long term and recommends the formulation of better policies. However, Matundura (2018) investigated the effects of capping interest rate on returns of KCB and indicated that interest rate capping was negatively and not statistically related to the bank's profits at 5% level of significance.

4.9Discussion of Research Findings

The study sought to determine the effects brought about by introduction of interest capping in the banking industry in Kenya. All the respondents unanimously agreed that the business environment had changed significantly as a result of introduction of interest rate capping. Despite the respondents agreeing that the interest capping played a huge role in achievement of consumer protection from exorbitant interest rates, they are of opinion that it necessitated the commercial banks to formulate appropriate response strategies so as to remain profitable. However, the study found out that though the commercial banks have formulated and implemented various response strategies, these strategies impacted differently on the financial performance of the commercial banks.

The study also sought to determine the effect of the response strategies of interest rate capping on various measures of financial performance of the commercial banks.On average, the effect of the response strategies of interest rate capping on financial performance of the commercial banks was found to have a mean of a of 3.75 and standard deviation of 0.8821. This implies that the response strategies adopted had to a large extent influenced (mean>3.5) how the commercial banks performed. Majority of the respondents (57%) further perceived that the response strategies of interest capping implemented had to a large extent affectedfinancial performance of the commercial banks.

This was supported by the correlation analysis whereby all the variables have a positive effect on the commercial banks' financial performance. Specifically, merger and acquisition had a Pearson correlation of 0.560 and p-value of 0, retrenchment had a Pearson correlation of 0.201 and p-value of 0.114, technology innovation had a Pearson correlation of 0.107 and p-value of 0.145, tight credit standards had a Pearson correlation of 0.711 and p-value of 0 and the control variables namely capital adequacy, operational efficiency, liquidity had a Pearson correlation of 0.173 and p-value of 0. This implies that all the variables have a positive effect on the commercial banks' financial performance. Therefore, an increase in these variables will result in increased commercial banks' financial performance.

The study also aimed at determining the relationship that exists between response strategies to interest rate capping and the financial performance of commercial banks in Kenya. To achieve this, regression analysis was undertaken whereby coefficient of determination R square obtained was 0.591 which indicated that 59.1% of changes in the performance are explained by the studied factors. This further implies that only 40.9% of the changes in the performance of the commercial banks are accounted by factors not included in the model. The model was significant as the p-value of 0.000 was less than both 0.01 and 0.05. The event analysis further affirmed that financial performance of the commercial banks prior to introduction of response strategies to interest rate capping was significantly different with the financial performance of commercial banks after introduction of response strategies to interest rate capping.

Theoretically, the strategic responses adopted by commercial banks to interest capping are supported to have an effect on their financial performance as explained by various theories: Systems theory, Vrooms expectancy theory and Optimal Capital Structure theory.

Contingency theory further postulates response strategies act as an operational procedure which aims to restore the normal operations or system during uncertain situations thereby minimizing losses (Hisnson& Kowalski, 2008). According to these theories, efficient response strategies are theorized to translate to improve financial performance in the commercial banks.

Emprically, this also coincides with the studies conducted by Jattani, (2009) who in his study that examined the relationship between technology adoption and operational efficiency of commercial banks in Kenya and established that a positive relationship between the study variables existed. Njihia (2009) investigated the measures put in place by Kenya Commercial Bank Limited in response to changes in the Kenyan banking industry and found that these strategies had a significant effect on financial performance. In a similar way, Harrison (2016) researched on the strategic responses to environmental changes facing FauluBank Limtedin Kenya and established that the strategic responses were meant to enable Faulu Bank Limited to counter environmental challenges and to remain competitive in the market place.

On the contrary, Muchangi (2014) conducted a study to determine the effect of strategic responses of banks' treasury departments on the profitability of the bank, a case of Bank of Africa and found a positive but insignificant relationship. Whereas Mwangi (2009) on a study on the strategic responses by Chase Bank Kenya Limited to environmental changes in the banking sector found that though Chase Bank Kenya Limited had accomplished managing environmental challenges, the effect of these strategies on financial performance was not fully established. Farah, (2014) on the other hand conducted a study on oil marketing companies established that there exists no significant relationship between response strategies adopted by the commercial banks and the financial performance.

CHAPTER FIVE: SUMMARY, CONCLUSION AND RECOMMENDATIONS

5.1 Introduction

This chapter presents a summary of findings, conclusions drawn from the study findings on the effect of response strategies to interest rate capping on the financial performance of commercial banks in Kenya. The chapter also contains the recommendations drawn from the findings and covers suggestions for further study.

5.2 Summary of Findings

The study sought to determine the effect of response strategies to interest rate capping on the financial performance of commercial banks in Kenya. The target population was all the commercial banks that have been in operation for the whole year of 2017. Both primary data and secondary data were employed in the study. The primary data was gathered through structured questionnaires which were self-administered while secondary data was on the financial performance which were obtained from the published annual reports and company sources as well as CBK's banking supervision reports for years 2013 to 2018. Data was analyzed through descriptive statistics such as: measure of relative frequencies, means and standard deviation. The data was then presented using graphs and tables. A summary of the findings of the study is presented below;

The study found out that on average, the effect of the response strategies oninterest rate capping on various measures of financial performance of the commercial banks had mean of a of 3.75 and standard deviation of 0.8821. This implies that the response strategies adopted by the commercial banks had a large extent of influence (mean>3.5) on how the commercial banks performed. Majority of the respondents (57%) further perceived that the response strategies oninterest capping implemented to a large extent had effect on fnancial performance of the commercial banks. This was supported by the correlation analysis whereby all the variables have a positive effect on the commercial banks' financial performance showing that an increase in these variables will result in increased commercial banks' financial performance.

The study also aimed at determining the relationship that exists between response strategies on interest rate capping and the financial performance of commercial banks in Kenya. To achieve this, regression analysis was undertaken whereby coefficient of determination R square obtained indicated that 59.1% of changes in the performance are explained by the studied factors. This further implies that only 40.9% of the changes in the performance of the commercial banks are accounted by factors not included in the model. The model was significant as the p-value of 0.000 was less than both 0.01 and 0.05. The event analysis further affirmed that financial performance of the commercial banks prior to introduction of response strategies to interest rate capping was significantly different with the financial performance of commercial banks after introduction of response strategies to interest rate capping. This implies that the response strategies contributed significantly on how the commercial banks performed.

5.3 Conclusions

The study found that there wereresponse strategies adopted by the commercial banks that to a large extent influenced the commercial banks' performance. The study concludes that the current financial performance of the commercial banks is largely accounted for by the response strategies implemented. Differences in the financial performances of the commercial banks are thus concluded to be as a result of varying effectiveness of these response strategies put in place. The study also established that all the response strategies to interest capping had a positive effect on the commercial banks' financial performance. The study therefore concludes that increase in the number of response strategies implemented will result in significant improvement on how the commercial banks performed.

The study further found out that the response strategies to interest rates capping had a statistically positive significant relationship on financial performance. The study thus concludes that the formulation and implementation of appropriate response strategies by the commercial banks is essential for mitigating the uncertainties brought about by interest rates capping. The study also makes the conclusion that through effective response strategies the commercial banks are shielded from adverse negative effects caused by the introduced interest rate capping in Kenya.

5.4 Recommendations of the Study

5.4.1 Managerial Recommendations

The study found out that response strategies to interest rate capping have a positive and significant relationship on how commercial banks perform. The study recommends that all commercial banks in Kenya establish appropriate response strategies so as to curb the adverse effect of introduced interest rate regulation. This will ensure that the commercial banks continue to perform as expected while being minimally interfered by this newly imposed regulations. The study also recommends that the commercial banks should first have a clear understanding on the motive and capability prior to adopting any particular response strategy. This will be essential in establishing the basis to which they will provide security against the interest capping risks.

The study also recommends that the commercial banks to come up with innovation products and services so as to reduce the dependence towards interest rate incomes. This is essential in ensuring that they are shielded against the negative impact of the interest rate capping as well as assuring of continued profitability regardless of the regulations. It is also recommended that the banks should also exploit additional ways of improving the efficiency of operations so as to improve their financial performance and protect the shareholders capital regardless of the presence of interest capping.

5.4.2 Policy Recommendation

It is recommended that the government and other regulatory bodiesmainly the CBK to conduct an evaluation on the efficiency and benefits of interest rate capping. This will enable the determination of whether the interest rate capping have achieved the intended outcomes as regards to the performance of the banks as well as customer protection. It is also recommended that the Government of Kenya and CBK to revise the set policies on interest rate capping to ensure that neither the banks nor the customers are negatively affected. The study also recommends that CBK as a regulator to be sensitive to the operating environment and hence practice flexibility in setting the interest regulations so as to attract investments and support the performance of the banking industry. CBK is also recommended to promote a favourable operating environment in which the commercial banks operate through advising the government on passing appropriate legislations.

5.5 Limitations of the Study

The studywas limited by the research design employed whereby it only focused to the commercial banks in Kenya. This is despite there being other financial and non-financial institutions which are also affected by the introduction of interest rate capping by the CBK. The findings thus obtained may not be an actual representation of the exact phenomenon in these other institutions due to the differences in organizational and financial structures in the firms. The study was also limited to only a small sample population whereby only the top managerial respondents were selected to patriatein the study without the consideration of other employees of lower cadres who may have different opinions pertaining to the study topic.

The study was also limited to four response strategies on interest rate capping which includedmerger and acquisition, retrenchment,technology innovation and tight credit standardswhich is not an exhaustive list of the available response strategies implemented by commercial banks. The study was further based on a five year study period from the year 2013 to 2018 (both years inclusive). This duration is relative short and therefore the study was not able to capture all periods of various economic significances such as booms and recessions which tend to influence the macroeconomic environment and financial performance of the banks.Despite this, the researcher ensured comprehensive data collection which was valid and accurate so as to enable generalization of the findings.

5.6 Suggestions for Further Research

The study thus suggests further studies be conducted focusing on other organizations in other sectors affected by interest capping to enable comparison to be made. The study also focused only onfour response strategies on interest rate capping including merger and acquisition, retrenchment, technology innovation and tight credit standardsaffecting the performance of the banks. It is therefore suggested that further studies be undertaken on other response strategies adopted by the commercial banks not investigated by the study. This will enable comprehensive determination of the relationship that exists. Further studies on the effect of the interest ratecapping on the general economy can be done to establish whether there could be any noted effect in theeconomy such growth in the uptake of loans. Also, further studies to be conducted at a different time frame to establish whether the same phenomenon will be prevailing or changed.

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APPENDICES

Appendix I: List of Commercial Banks at 31st December 2017

No.	Bank Name	Bank Size
1	KCB Bank Kenya Ltd	Large
2	Standard Chartered Bank (K) Ltd	Large
3	Equity Bank Kenya Ltd	Large
4	Barclays Bank of Kenya Ltd	Large
5	Co – operative Bank of Kenya Ltd	Large
6	Commercial Bank of Africa Ltd	Large
7	Diamond Trust Bank (K) Ltd	Medium
8	NIC Bank PLC	Medium
9	Stanbic Bank Kenya Ltd	Medium
10	I & M Bank Ltd	Medium
11	National Bank of Kenya Ltd	Medium
12	Chase Bank Ltd**	Medium
13	Citibank N.A. Kenya	Medium
14	Bank of Baroda Ltd	Medium
15	Family Bank Ltd	Medium
16	Bank of Africa Kenya Ltd	Medium
17	Prime Bank Ltd	Medium
18	Ecobank Kenya Ltd	Medium
19	HFC Ltd	Medium
20	Imperial Bank Ltd**	Medium
21	Bank of India	Medium
22	Gulf African Bank Ltd	Small
23	African Banking Corporation Ltd	Small
24	Guaranty Trust Bank (Kenya) Ltd	Small
25	Mayfair Bank Ltd	Small
26	Sidian Bank Ltd	Small
27	Victoria Commercial Bank Ltd	Small
28	SBM Bank (Kenya) Ltd	Small
29	Jamii Bora Bank Ltd	Small

30	Development Bank of Kenya Ltd	Small
31	Spire Bank Ltd	Small
32	DIB Bank Kenya Ltd	Small
33	Guardian Bank Ltd	Small
34	First Community Bank	Small
35	Consolidated Bank of Kenya Ltd	Small
36	Transnational Bank Ltd	Small
37	Paramount Bank Ltd	Small
38	Habib Bank A.G. Zurich	Small
39	M-oriental Commercial Bank Ltd	Small
40	Middle East Bank (K) Ltd	Small
41	Credit Bank Ltd	Small
42	Charterhouse Bank Ltd*	Small
43	UBA Kenya Bank Ltd	Small

N/B

*Banks under statutory management

**Banks in receivership

Source: Banks Published Financial Statements (December 2017)

Appendix II: Questionnaire

This questionnaire is to collect information regarding the effect of response strategies of interest rate capping on the financial performance of commercial banks. Please assist to complete each section of the questionnaire as guided and kindly Tick (√) whereappropriate.Thank you for accepting to participate in this academic study.

SECTION A: DEMOGRAPHIC INFORMATION

1. Kindly indicate your position in the bank……………………….....................................
2. How many years have you worked in the banking industry?

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

SECTION B: INFORMATION ON COMMERCIAL BANKS

3. Kindly indicate the name of your bank... (Optional)
4. Indicate the type of ownership of yourbank.

    Local Public Commercial Bank [ ]
    Local Private Commercial Bank []
    Foreign Commercial Banks []

5. What is the market share of your bank

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

SECTION C: STRATEGIC RESPONSES TO INTEREST RATE CAPPING AND FINANCIAL PERFORMANCE OF COMMERCIAL BANKS IN KENYA

6a) Has the bank's business environment changed as a result of interest rate capping?

Yes [ ] No []

b). If yes, how has it changed?

....

....

....

7 In your opinion, has interest rates capping achieved consumer protection from exorbitant interest rates as intended?

....
....
....
....

8. How is your bank responding to interest rate capping in order to survive and remain competitive in the market?

……………………………………………………………………………………………
……………………………………………………………………………………………
……………………………………………………………………………………………
………..

9. In a scale of 1 to 5, please rate below response strategies where 1 is strongly disagree, 2 is disagree, 3 is Neutral, 4 is agree and 5 is strongly agree

Banks response Strategies to interest rate capping in Kenya and their effect on financial performance	**1**	**2**	**3**	**4**	**5**
Retrenchment of staff has reduced payroll costs hence improve banks financial position					
Technology Innovation in banks is on the rise due to need to improve on efficiency hence lowering banks operating expenses					
Banks have implemented tight credit standards to reduce on the risk of loan loss and which has resulted to improved interest income					
Banks financial performance have improved due to closure of some of its branches as they encourage their customer to use mobile and online platforms					
Banks income have increased due to other bank charges that have been introduced since the law on					

interest rate capping came in effect					
Merger and acquisition is impacting positively on Banks financial performance					

10. Which other response strategies has your bank put in place in responding to the newly introduced interest rate caps?

....
....
....

11. How effective has the strategies employed so far by your bank in response to interest rate capping?
....
....
....

12. How has interest rate capping affected the financial performance of your company

....
....
....

SECTION D: PERFORMANCE OF LISTED COMMERCIAL BANKS

13. Please rate the extent to which response strategies on interest rate capping affected the following aspects of your bank using a scale of 1 to 5 where 1 is very small extent, 2 is small extent, 3 is moderate extent, 4 is large extent and 5 is to a very large extent.

Statement	1	2	3	4	5
Return on capital employed					
Return on Assets					
Return on Investment					

Statement	1	2	3	4	5
Operating profit margin					

14. Are there any other ways in which the response strategies on interest capping affect the financial performance of the commercial banks?

…………………………………………………………………………………………………

…………………………………………………………………………………………………

………………………………………………………………………………………….

15. How would you rate the overall extent of influence of the response strategies of interest capping on the financial performance of the commercial banks?

Very Large ( )

Large ( )

Moderate ( )

Small ( )

Very Small ( )

16. In your own opinion what is the general influence of response strategies of interest capping on the financial performance?

…………………………………………………………………………………………………

…………………………………………………………………………………………………

THANK YOU FOR YOUR PARTICIPATION