ABSTRACT

Microfinance institutions have played a pivotal role in deepening financial markets and enhancing access to financial services and products by majority of Kenyans. The key driver of any deposit taking institution is its deposits and loan book and therefore lending interest rates become of utmost importance in determining the income of the institution, hence its financial performance. This study aimed to determine the effects of lending rates on deposit taking microfinance institutions, given the tough conditions imposed by the regulator, Central Bank of Kenya (CBK) and dynamic banking industry in Kenya. The target population was 9 deposit taking microfinance institutions in Kenya. Data was collected from Central Bank’s Supervision Reports and the Kenya Bureau of Statistics and analysed using SPSS (Statistical Package for Social Sciences). Regression analysis was used to analyse the data and find out whether there exists a relationship between lending interest rates and financial performance of deposit taking microfinance institutions in Kenya. The study found that there is a negative and statistically significant relationship between financial performance of deposit taking microfinance institutions (DTMs) and lending interest rates. The study also found that operating efficiency is a significant factor influencing the financial performance of DTMs. High lending interest rates were found to discourage borrowing therefore adversely affecting performance due to loan delinquency. The study recommends that DTMs should ensure that interest rates charged are not prohibitive and that CBK should effect adequate regulation and control of DTMs in order to ensure that they charge the lending interest rates recommended. DTMs should also diversify their sources of income in order to minimize risk associated with interest income.