EFFECT OF INTEREST CAPS LIFT ON FINANCIAL PERFORMANCE OF COMMERCIAL LISTED BANKS IN KENYA

Stephena Basweti Bogecho.
Jomo Kenyatta University of Agriculture and Technology, Kenya.
Dr Julius Miroga.
Jomo Kenyatta University of Agriculture and Technology, Kenya.

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ABSTRACT

An interest rate cap lift is all about changing or getting rid of a government set limit on the interest rates that banks can charge their customers. In Kenya, these caps were first put in place back in 2016 with the Banking (Amendment) Act, which kept lending rates at 4% above the Central Bank of Kenya (CBK) rate to help make borrowing more affordable. The recent removal of interest rate caps in Kenya has thrown a few curveballs for both commercial banks and borrowers. One of the biggest headaches is the sharp increase in lending rates, which shot up past 13.8% in 2023. This spike has made it difficult for businesses and individuals to afford credit. High-risk borrowers are feeling the pinch the most, as banks are now more inclined to lend to low risk clients, risk-based pricing. The rising cost of borrowing has led to an uptick in non-performing loans (NPLs), with some borrowers struggling to keep up with repayments amid financial pressures. Higher lending rates are driving up the cost of living and squeezing consumer spending, ultimately decline financial performance. These challenges really underscore commercial banks. The general objective of this study were to empirically analyze the effect of interest rate caps lift on financial performance of listed banks in Kenya. The specific objectives included: to determine the effect of lending rate margins on financial performance of financial institutions in Kenya, to assess the effect of risk based pricing on financial performance of financial institutions in Kenya. Financial Liberalization Theory, Signaling Theory and Asymmetric Information Theory were used.The researcher used a descriptive research design to explore how lifting interest rate caps affects the financial performance of banks listed. This study took place at the Nairobi Securities Exchange (NSE. According to the most recent data, there are 10 commercial banks that are listed on the Nairobi Securities Exchange (NSE), out of a total of 38 licensed commercial banks operating in Kenya. The study used a purposive sampling technique to focus on the 10 listed commercial banks in Kenya. The stud gathered secondary data from various sources, including the financial statements of 9 listed banks, their annual reports, publications from the Central Bank of Kenya, and market analysis reports. Pilot study was done at Diamond trust bank using financial reports from 2014 to 2023. The study had 45 unit of observations derived from 9 listed banks and 5 years period of the data collection. Descriptive and inferential statistics was used and the results were presented by tables. The study concluded that the removal of interest rate caps had a profound and positive impact on the financial performance of listed commercial banks in Kenya, primarily through the enhancement of lending rate margins. Banks appear to have leveraged the deregulated lending environment to increase their net interest income, which significantly contributed to improved financial outcomes. However, the findings also highlight that lending rate strategies and credit segmentation efforts had a notable impact on bank performance. This could point to inefficiencies or underdeveloped frameworks in the implementation of these strategies, indicatings that banks may still be operating with conventional pricing and lending models that do not fully exploit risk-based assessments or segmented credit products. It is recommended that regulatory

authorities, particularly the Central Bank of Kenya, intensify oversight of lending practices to ensure that banks do not exploit higher interest margins at the expense of consumer welfare. Future research should consider longitudinal studies that examine the effects of interest cap removal across different economic cycles and regulatory changes. It is also recommended to revisit and refine the measurement of lending rate margin to improve its alignment with the scale's reliability.

INTRODUCTION

The removal of interest rate caps has had varied impacts on the financial performance of institutions across different firms and individuals. These effects are influenced by factors such as the structure of the financial sector, regulatory environment, and prevailing economic conditions (Pillay & Govender 2020). The decision to lift interest rate caps has produced a mixed bag of results for financial institutions around the globe. Various elements, including the makeup of the financial sector, the regulatory landscape, and the current economic climate, play a significant role in shaping these outcomes (Harb et al., 2023).

In some countries, removing these caps has opened the door to greater credit availability and has boosted the financial health of banks. In Japan, when they got rid of interest rate ceilings, it allowed banks to set loan prices based on risk. This shift led to a smarter distribution of credit and better profits for those institutions. That said, it's crucial to have strong regulatory measures in place to guard against predatory lending practices (Musoke & Tumwine, 2022)
In African countries, the effects of lifting interest rate caps have been mixed. The effect of lifting interest rate caps on how financial institutions perform can differ significantly depending on the global and regional context. Although getting rid of these caps might boost credit availability and enhance bank profitability, it's essential to have robust regulatory frameworks in place. This helps ensure responsible lending practices and keeps financial stability intact. The introduction of interest rate controls in 2016 aimed to reduce borrowing costs and increase access to credit. However, studies found that these controls led to a significant decline in credit to micro, small, and medium enterprises, a contraction of loan books in smaller banks, and reduced financial intermediation. The caps also diminished the effectiveness of monetary policy signaling. Consequently, the removal of these caps was associated with a reversal of these adverse effects, leading to improved credit access and financial performance of banks. In Uganda, discussions around interest rate caps highlighted potential risks. Evidence from other countries indicated that such caps could lead to reduced credit growth, exclusion of high-risk borrowers from formal financial systems, and a contraction in the supply of credit. In Nicaragua, annual credit growth dropped from 30% to just 2% after the introduction of interest rate ceilings in 2001. These suggest that lifting interest rate caps, when accompanied by

appropriate regulatory measures, can enhance credit availability and financial sector stability (Otieno, 2022).

Interest rate regulation plays a vital role in how governments manage access to credit, ensure financial stability, and foster economic growth (Amoaning, & Ahiakpor, 2022). In Ghana, the financial performance of banks has been shaped by various monetary policy adjustments and economic conditions (Antwi-Asare, T. O., & Addison, 2025). While there has been no recent lifting of interest rate caps, significant financial developments have impacted the banking sector. The implementation of the Domestic Debt Exchange Programme (DDEP) in 2022 led to substantial losses, with the industry reporting before-tax losses of GHS 8.0 billion compared to a profit of GHS 7.4 billion in 2021. However, the sector showed signs of recovery in early 2023, with a 47.0% increase in profit-before-tax (Citi Newsroom, 2023). Additionally, the Bank of Ghana's decision to lower the key interest rate from 29% to 27% in September 2024 aimed to stimulate economic activity and support banking sector recovery as inflation declined (Nairametrics, 2024). Although interest rate caps have not been a recent policy concern, these monetary and fiscal policy measures have significantly influenced credit availability, profitability, and financial stability in Ghana's banking sector.

In Kenya, interest rate caps were rolled out in September 2016 through the Banking (Amendment) Act. This legislation established a maximum lending rate of no more than 4% above the Central Bank Rate (CBR) and set a minimum deposit rate at 70% of the CBR. The main goals of this policy were to make credit more affordable, shield consumers from exorbitant interest rates, and encourage financial inclusion. However, it also led to some unexpected challenges for the financial sector, especially affecting the performance of commercial banks and other financial institutions. Interest rates and their fluctuations are key indicators when it comes to understanding how financial liberalization affects economic growth. According to economic theory, the base rate typically set by central banks—acts as a standard for determining lending rates across the economy. In Kenya, this standard is known as the Central Bank Rate (CBR), which is set by the Central Bank of Kenya (CBK).

The interest rate landscape plays a crucial role in shaping investment performance and returns. Decisions made by the CBK regarding monetary policy, especially changes to the CBR, have a significant effect on different sectors of the economy. For example, in December 2024, the CBK lowered its benchmark lending rate by 75 basis points to 11.25% in an effort to boost economic growth while keeping inflation in check. This was the third consecutive rate cut, showcasing the CBK's dedication to creating a favorable environment for investment and economic development.

These pointers show that the importance of interest rate on economic growth cant be overemphasized and hence the study (Lee, A., (2019). With nominal interest ranging between 20-30%, the private sector is unable to borrow to finance long term investment. In addition the 11-18% point spread between the lending and the deposit rate is much higher than 5 point common in other developing countries (Economic report on Africa, 2020). Following interest rate liberalization, interest rates have fluctuated to respond to changes in demand and supply

of loanable funds in the financial market. Rapid liberalization in the country whose enterprises and financial institution lack experienced management could prove counterproductive and result in unsound financial sector (Mbua, S., 2017).

Therefore the effect of interest rate on economic growth cannot be overemphasized liberalization. All the sectors of the Kenyan economy recorded impressive growths in the third quarter of 2021 with high growths being witnessed in Hotels and Restaurants, Construction, Electricity and Water, Manufacturing, Financial Intermediation and Agriculture. Brock, P., & Rojas. (2000) indicates on provisional results for the first nine months from the Kenya National Bureau of Statistics estimates the economy to have grown by 6.9 per cent in 2020 compared to a growth of 5.8 per cent over the same period in 2018, agriculture sector growth is estimated to have grown by 7.7 per cent in the three quarters (nine months) of 2020 compared to a growth of 4.7 per cent in 2018 over the same period.

Historically, lending rates in Kenya have seen quite a bit of ups and downs, especially when the Central Bank Rate (CBR) changes. As of November 2023, the average lending rate at commercial banks climbed to 13.8%, up from 12.4% back in August 2022. This increase is largely due to the Central Bank of Kenya's (CBK) decision to tighten monetary policies to tackle inflation and stabilize exchange rates. These actions highlight just how important the CBK is in managing credit access and influencing the broader economy.

The trend on the lift of interest rate caps in Kenya has sparked significant debate regarding its impact on the financial performance of listed banks. The Kenyan government introduced interest rate caps to regulate the cost of credit, aiming to make loans more affordable and accessible. However, this policy led to unintended consequences, including reduced credit availability to (SMEs) and a decline in banks' profitability due to compressed interest margins. Recognizing these challenges, the caps were lifted in 2019, prompting the need to assess the subsequent effects on the financial performance of banks. Potential investors therefore need to save or accumulate money balances to enable them undertake the lumpy investment. The incentive to do this comes from relatively low opportunity cost of accumulating money balances and the prerequisite for achieving success is fiscal discipline because government deficits are financed by inflationary tax that may increase opportunity cost of holding money balances.

Lending margins, defined as the difference between interest income earned on loans and the interest paid on deposits, play a critical role in determining the financial performance of banks. Higher lending margins contribute to increased profitability, enabling banks to expand credit access and sustain operations. However, excessively high margins may discourage borrowing, leading to reduced loan uptake and potential credit contraction. In Kenya, the removal of interest rate caps in 2019 allowed banks to price loans based on risk, leading to wider lending margins and improved net interest income (CBK, 2023). Despite this, rising non-performing loans (NPLs), particularly in the SME sector, have partially offset these gains, with Kenya's NPL ratio reaching 15.5% by early 2024 (CBK, 2024). Studies have shown that lending margins are influenced by factors such as central bank monetary policies, inflation rates, and

overall economic stability (Nyaboga & Mwangi, 2023). Consequently, maintaining optimal lending margins is essential for balancing profitability, financial inclusion, and economic growth.

Risk-based pricing is a strategy where financial institutions determine interest rates based on how creditworthy a borrower is, and it has had a major impact on the financial performance of banks in Kenya. After the interest rate caps were lifted in 2019, banks started using this approach to evaluate borrowers on an individual basis, which has led to better efficiency in credit allocation. Research shows that risk-based pricing has boosted net interest margins (NIMs) and overall profitability, allowing banks to charge higher rates to riskier borrowers while providing lower rates to those with solid credit histories (CBK, 2023). However, this method has also led to increased lending costs for small and medium-sized enterprises (SMEs) and individuals who have limited credit histories, which could hinder financial inclusion (Mutinda & Kamau, 2023). Moreover, while risk-based pricing enables banks to manage credit risk more effectively, the rise in non-performing loans (NPLs) is still a pressing issue, with Kenya's NPL ratio hitting 15.5% in early 2024 (CBK, 2024). In summary, risk-based pricing has improved financial performance by aligning interest rates with the risk levels of borrowers, but it also poses challenges for access to affordable credit.

Credit segments such as corporate, SME, retail, and mortgage lending are loan portfolio significantly influences its financial performance. In Tanzania, effective credit risk management practices, including robust credit approval processes, have been shown to enhance banks' capital adequacy, asset quality, and liquidity (Temba et al., 2024). Conversely, inadequate credit monitoring can adversely affect earnings and asset quality. Similarly, in Kenya, studies have demonstrated that high levels of non-performing loans, often associated with certain credit segments like SMEs, negatively impact banks' profitability (Imbuye & Miroga, 2023). Therefore, a balanced and well-managed credit portfolio is crucial for optimizing financial outcomes and maintaining institutional stability. The removal of interest rate caps in 2019 was expected to improve banks' financial performance by allowing them to price loans based on risk.

Even though Kenya has lifted interest rate caps, banks are still struggling with poor financial performance for a variety of reasons. The rise in non-performing loans (NPLs) has been significant, jumping from 12.5% in 2020 to 15.5% in early 2024, which has really hurt profitability as more borrowers are unable to repay their loans (CBK, 2024). On top of that, the high cost of borrowing, influenced by risk-based pricing, has led to a drop in credit demand, especially among small and medium-sized enterprises (SMEs) and individuals, which in turn limits the interest income banks can earn (Mutinda & Kamau, 2023).

Economic instability, with inflation averaging 7.8% in 2023 and a weakening Kenyan Shilling, has put even more pressure on banks by raising operational costs and the costs associated with servicing foreign debt (KNBS, 2023). Additionally, heavy government borrowing has pushed private sector lending to the sidelines, as banks are more inclined to invest in treasury bills and bonds, which offer lower risk and better returns (CBK, 2023). Regulatory costs, strict

compliance requirements, and lackluster performance in key sectors have also played a role in the declining financial health of banks, underscoring the urgent need for better credit risk management and policy changes to stabilize the banking sector (Nyaboga & Mwangi, 2023). Financial institutions in Kenya is a financial sector with a vibrant mix of financial markets that deliver crucial financial services. This includes everything from commercial banks to microfinance banks, SACCOs, insurance companies, and innovative fintech firms. Leading the pack are commercial banks like Equity Bank, KCB, and Co-operative Bank, which provide essential services such as deposits, loans, and money transfers. On the other hand, microfinance banks like Faulu Microfinance and KWFT focus on supporting small businesses and individuals who might struggle to secure loans from traditional banks.

Savings and Credit Cooperative Societies (SACCOs), such as Mwalimu SACCO and Kenya Police SACCO, offer their members both savings and loan options. Meanwhile, insurance companies like Britam, CIC Insurance, and Jubilee Insurance are vital in helping people manage financial risks through various coverage options, including life, health, and property insurance.

Development Finance Institutions (DFIs), like the Kenya Development Corporation (KDC), play a key role by providing long-term financing for infrastructure projects and business growth. Additionally, investment and asset management firms such as Genghis Capital and Standard Investment Bank help individuals and businesses manage their wealth and investment strategies. The emergence of fintech and digital lending platforms, including M-Pesa, Tala, and Branch, has significantly boosted financial inclusion by making mobile banking and digital loans more accessible. Together, these financial institutions are instrumental in driving Kenya's economic growth by improving access to credit, encouraging investment, and ensuring financial stability.

Financial performance is the financial health of commercial banks in Kenya closely tied to interest rate caps, which have had a big impact on lending practices, profitability, and risk management. When the Banking (Amendment) Act introduced interest rate caps in 2016, it set a limit on lending rates at 4% above the Central Bank Rate (CBR). This move restricted banks from pricing loans according to the associated risks. The intention was to make credit more affordable, but it ended up causing a drop in private sector lending as banks shifted their focus to lower risk borrowers. Consequently, commercial banks saw a decrease in interest income, which hit their profitability hard, especially for smaller banks that didn't have diverse revenue streams. After the rate cap was lifted in 2019, banks switched to risk-based pricing models, resulting in higher lending rates over 13.8% in 2023. While this change boosted banks' net interest margins and overall profitability, it also made borrowing more expensive, which in turn limited access to credit for individuals. Moreover, the increase in lending rates led to a rise in non-performing loans, with some borrowers finding it tough to keep up with repayments. The removal of interest rate caps has improved bank profitability, it has also raised serious concerns about financial inclusion and access to credit in Kenya's economy (Korir 2019).

Statement of the problem

The financial performance of Kenyan banks from 2020 to 2025 has been significantly influenced by fluctuating interest rates and broader economic challenges. In November 2023, commercial banks' average lending rates increased to 13.8%, up from 12.4% in August 2022. This rise was attributed to the Central Bank of Kenya's (CBK) tightening of monetary policy to combat inflation and manage exchange rate risks. Higher interest rates have led to increased borrowing costs, resulting in reduced loan uptake and a rise in non-performing loans (NPLs). By February 2024, the ratio of gross NPLs to gross loans had climbed to 15.5%, up from 14.8% in December 2023, with significant defaults observed in sectors such as real estate, trade, and personal lending hence decline in financial performance.

Recent studies have explored the implications of these regulatory changes. Ngaruiya, Mathuva, and Obi (2025) conducted an event study analyzing the market reaction to the introduction and repeal of interest rate caps in Kenya. Their findings indicate that the announcement of interest rate controls resulted in negative and statistically significant cumulative abnormal returns for banks' stocks. However, the long-term impact on market valuations was found to be insignificant beyond the event period. Despite these insights, gaps remain in the literature regarding the comprehensive impact of lifting interest rate caps on the financial performance of listed banks in Kenya. Additionally, there is a need for empirical research that examines the long-term effects on key financial performance indicators such as return on assets (ROA), return on equity (ROE), and net interest margins (NIM). The study will address these gaps to provide a more nuanced understanding of the effect of interest rate cap policies and inform more about financial decisions in Kenya's banking sector Sarfo-Kantanka et al. (2022) investigated the effect of interest rate changes on the profitability of Ghana Bank PLC. Their findings indicate significant relationships between changes in interest rates and profitability metrics, such as Return on Assets (ROA) and Return on Equity (ROE). The study concluded that fluctuations in interest rates notably influence the bank's financial performance, hence gap to address.

Objectives of the study

The general objective of this study were to empirically analyze the effect of interest rate caps lift on financial performance of listed commercial banks in Kenya.

The specific objectives included:

i. To determine the effect of lending margins on financial performance listed commercial banks in Kenya.
ii. To assess the effect of risk based pricing on financial performance of listed commercial banks in Kenya..

Research hypotheses

This research guided by the following research hypotheses:

$H0_1$: Lending rate margins has no statistically significant effect on financial performance of listed commercial banks in Kenya

$H0_2$: Risk based pricing has no statistically significant effect on financial performance of listed commercial banks in Kenya

Justification of the study

This study aims to dive into the financial performance of listed banks in Kenya after the interest rate caps were lifted. It takes a close look at important factors like lending margins, risk-based pricing, and credit segmentation to see how they affect profitability, access to credit, and the overall stability of the banking sector. The research will focus on the time following the removal of these caps in 2019 to 2024, comparing data from before and after to identify trends and financial outcomes to. This study is important because it helps us understand how banks have changed their lending strategies in light of the new regulations and whether these changes have improved their financial performance. With non-performing loans climbing to 15.5% in early 2024 (CBK, 2024) and worries about credit affordability for SMEs and individuals, this research will offer valuable insights into how effective risk-based pricing has been and what it means for financial inclusion. Furthermore, by looking at credit segmentation, the study will shed light on which types of borrowers have been most impacted by the removal of the interest rate caps. The results will be beneficial for policymakers, financial regulators, banking institutions, and investors as they work to shape future monetary and credit policies aimed at boosting the efficiency and stability of the banking sector.

The research will form a resource base for future researchers who can develop their research on this basis.

Scope of the study

This study focused on the impact of the lifting of interest rate caps on the financial performance of listed banks in Kenya. It specifically examines how lending margins, risk-based pricing, and credit segmentation influence profitability, credit accessibility, and overall financial stability. The study covered the period from 2019 to 2024, when interest rate caps were removed, to the most recent financial data may not be available in 2025. The research was limited to commercial banks listed on the Nairobi Securities Exchange (NSE) to ensure a standardized assessment of financial performance metrics such as net interest margins, return on assets (ROA), and non-performing loans (NPLs).

The study utilized both primary and secondary data, including financial statements, Central Bank of Kenya (CBK) reports, and empirical studies on banking performance. The geographical scope is restricted to Kenya, but relevant global and regional trends would be considered for comparative analysis. The findings would provide valuable ways to policymakers, financial institutions, and investors in assessing the effectiveness of interest rate liberalization in enhancing banking sector growth and stability.

LITERATURE REVIEW

Financial Liberalization Theory

The Financial Liberalization Theory, introduced by McKinnon and Shaw back in 1973, suggests that lifting restrictions on interest rates can boost the efficiency of financial markets and make credit more accessible. When banks are free to set loan prices according to market dynamics, it not only enhances their profitability but also broadens access to credit. This aligns perfectly with the study's goal of examining the effects of removing interest rate caps. On the other hand, we have the CAMEL Model, which was created by bank regulators like the Basel

Committee in 1999. This model evaluates financial performance through five areas: capital adequacy, asset quality, management efficiency, earnings, and liquidity. It's particularly useful for understanding how liberalizing interest rates impacts the financial stability and profitability of banks (Sah, G. K., & Pokharel, 2023).

Signaling Theory

The Signaling Theory, first introduced by Spence in 1973, sheds light on how publicly listed banks use their financial performance metrics to communicate their stability and growth potential to investors. When banks show improved profitability following the liberalization of interest rates, it can boost investor confidence, which in turn can have a positive effect on their stock performance. On the other hand supported by the Interest Rate Spread Theory, put forth by Ho and Saunders in 1981, focuses on how banks determine their lending margins based on the level of risk and the competitive landscape in the market (Denje 2021).
With the removal of interest rate caps, banks can adjust these lending margins to better reflect market risks. While this adjustment might enhance their financial performance, it could also have implications for the affordability of credit.

Empirical Reviews

Lending rate margins

Lending margins is the difference between the interest rates financial institutions charge borrowers and the rates they pay to depositors are critical determinants of banks' profitability. In Kenya, a study by Dondi and colleagues (2023) looked into how lending interest rates marging affect the financial performance of commercial banks between 2015 and 2022. They used a moderated multiple regression approach, analyzing data from 27 banks that offer mortgages. The findings revealed that higher lending rates had a significant negative impact on financial performance, indicating that elevated rates might discourage borrowing, which in turn could lead to lower income and profitability for the banks.

Okech (2013) investigated the relationship between lending interest rates and the financial performance of Kenyan commercial banks. The study, encompassing all 43 commercial banks operating as of December 2012, revealed a weak but positive correlation between lending rates and financial performance, with lending rates explaining 14.3% of the variance in financial performance. This indicates that while lending rates contribute to profitability, other factors also play significant roles. Globally, the relationship between lending margins and financial performance has been extensively studied. For instance, a study by Demirgüç-Kunt and Huizinga (1999) examined banks across 80 countries and found that higher net interest margins were associated with lower bank profitability, suggesting that excessive margins might indicate inefficiencies or higher risk premiums that adversely affect performance.

Regionally, in sub-Saharan Africa, a study by Flamini, McDonald, and Schumacher (2009) analyzed the determinants of bank profitability in 41 countries. The research indicated that higher lending margins contributed positively to bank profitability, reflecting the compensation

for higher operational costs and risk premiums prevalent in the region's banking sector. In Nigeria, Olarewaju and Folarin (2020) investigated the effect of interest rate spread on the profitability of deposit money banks. Their findings demonstrated a positive relationship, indicating that wider spreads, resulting from higher lending margins, enhanced bank profitability by increasing the income generated from lending activities.
a study by Maredza and Ikhide (2013) explored the impact of bank concentration and lending margins on financial stability and performance. The results suggested that while higher lending margins improved profitability, they also raised concerns about financial stability, as they could lead to increased risk-taking behaviors among banks

Another Kenyan study by Gitari and Musau (2023) investigated the influence of liquidity management policies on the financial performance of commercial banks. They found that effective liquidity management, encompassing cash and credit management policies, positively impacted banks' return on equity (ROE). While not directly focused on lending margins, their research underscores the importance of prudent financial policies in enhancing bank profitability.

Olarewaju and Folarin (2020) examined the effect of interest rate spread on the profitability of deposit money banks. Their findings demonstrated a positive relationship, indicating that wider spreads, resulting from higher lending margins, enhanced bank profitability by increasing income from lending activities.

Ngaruiya, Obi, and Mathuva (2025) examined the effects of interest rate regulation on bank lending behavior. Their study revealed that interest rate caps led banks to shift their lending focus towards government securities, reducing credit availability to the private sector and interbank markets. This reallocation potentially affects the financial performance of banks by altering their income streams.

Kosgei, Alala, and Maingi (2024) investigated the effect of lending innovation on the financial performance of listed commercial banks in Kenya. While their study established a significant positive relationship between lending innovation and financial performance, it did not specifically isolate the impact of lending margins. This leaves a gap in understanding how traditional lending margins, independent of innovation, affect financial performance

Dondi, Mule, and Ombok (2023) analyzed the effect of lending interest rates on the financial performance of Kenyan commercial banks from 2015 to 2022. Their findings indicated a statistically significant negative relationship between lending rates and financial performance. However, the study did not differentiate between various components of lending margins, such as the cost of funds and risk premiums, which could provide a more nuanced understanding of the factors influencing financial performance. the World Bank's 2024 report highlighted Kenya's economic challenges, including high debt servicing costs and rising non-performing loans. While these factors are linked to the broader economic environment affecting financial institutions, the report does not specifically address how lending margins contribute to or are

affected by these challenges, indicating a gap in the literature regarding the direct impact of lending margins on financial performance in the current economic context.
Critique is that Dondi et al. (2023) analyzed lending rates using statistical models, Kosgei et al. (2024) focused on lending innovations without isolating lending margins, limiting the applicability of their findings. dditionally, the reviewed studies do not sufficiently account for financial performance trends post-interest rate caps lift. Many studies primarily focus on data from 2019 or earlier, yet economic shocks such as rising inflation and post-pandemic recovery in 2023 and 2024 have significantly influenced bank profitability. The World Bank (2024) report highlights Kenya's economic challenges, yet it does not explicitly link lending margins to financial performance, leaving a significant research gap. Furthermore, the literature review does not comprehensively examine external macroeconomic factors such as inflation, exchange rate fluctuations, and global economic trends. Given Kenya's integration into global financial markets, external shocks can significantly impact lending margins, and their exclusion limits the depth of analysis.

The review does not adequately address the policy implications of the findings. While it presents the impact of lending margins on financial performance, it does not offer a detailed discussion on how financial institutions and regulators can optimize lending margins while ensuring financial stability. A stronger emphasis on policy recommendations would make the findings more actionable. In conclusion, while the literature review provides a solid foundation, addressing these gaps through recent data analysis, broader macroeconomic perspectives, stronger theoretical linkages, and regional comparisons would significantly enhance its comprehensiveness and relevance.

Alexandro (2021) points out that high interest rates can lead to financial instability, raising doubts about how well markets can allocate credit and making a case for government intervention. In a similar vein, Fredrick (2016) discusses how a strong preference for liquidity can crowd out the private sector, stifling economic growth, while also noting that high interest rates can help keep inflation in check. Gibson and Kaufman (2016) take a closer look at how money supply and income affect interest rates, but they find only limited evidence that managing debt has a significant impact on those rates. A notable gap in these studies is that they don't explore how removing interest rate caps has affected financial performance, especially in Kenya after the caps were lifted. None of the research specifically looks at how the shift from controlled to market-driven interest rates has impacted bank profitability, lending practices, or overall financial stability in Kenya. To fill this gap, we need more recent empirical analysis, particularly focusing on data from 2020 onward to truly understand the effects of interest rate liberalization on the financial sector.

Giovanni (2016), argues that small economies are affected by conditions in large countries that is, high large country's interest rate have the concretionary effect on the annual real GDP Growth in the domestic economy. But this effect is cantered in countries with fixed exchange Rates. The effects on interest rate in small countries are through direct monetary policy Channel and the general capital market or trade effect. A demand shock leads to short term Rise in the real interest rate.

Korir (2016), noted that high interest rate on lending by the financial institutions in the Country have made the accessibility almost impossible to the poor and effectively negates on Poverty alleviation. Korir (2016), contend that for the first time borrowers can confidently Face their bankers and negotiate interest rates on their loans based on the new CBK rate. McKinnon (1973) and Shaw (1973), content that financial repression through a controlled Interest rate regime has adverse effects on economic growth and development. The standard Recommendation is that positive real interest rates must be established on deposits and loans by eliminating interest rates and credit ceilings, stopping selective credit allocation and lowering the reserve requirements. McKinnon (1973), argue in favour of financial deepening And high interest rates as they spur economic growth and development.

Tehran (2017), contend that an efficient financial system is critical not only for the domestic Capital mobilization but also a vehicle for gaining competitive advantage in the global Market. Financial reforms emphasize the abolition of interest rate and credit ceilings and the Promotion of competitive environment with reduced government control and ownership.

Although achieving competitiveness does not imply the nonexistence of an interest rate Spread, it has been noted the size of the spread is much higher in a non-competitive market. This also calls for strengthening of the regulatory and the legal framework to enhance the Stability of the market. Bank interest rate spread could be interpreted as an indicator of the Efficiency of the financial system. A well-developed efficient banking system is prerequisite for saving and the investment decisions vital for rapid economic growth.

Montel (2017), recommended financial liberalization as it's expected to generate positive Gains to economic growth and development. Financial liberalization leads to positive real Interest rate as the nominal interest rate increase from the government set low levels. Real Deposit rates were found to have a positive impact on the savings, which in turn affects the Level of investment positively. The financial system also gains efficiency in the Intermediation process such that the interest spread between the lending and the deposit rate Narrows.

Modigliani and Cohn (2017), interpret the negative relationship between changes in interest and stock returns to a misunderstanding of the relationship between interest rates and Fundamentals: A reduction in interest rate reduces the cost of borrowing and thus serves as an incentive for expansions. This will have a positive effect on future expected Returns for the firm. Secondly a substantial amount of stocks are purchased with borrowed Money hence an increase in interest rate would make transaction more costly. Mega et al (2022), and Mach aria (2017), urge from a convectional economic theory, that High interest rates have two separate effects on private savings that work in opposite Directions. First they have a positive effect on savings as people tend to save more and secondly reduce current consumption. Ross (2014), argue that a cross — economic growth Regressions indicate that financial restraints with perhaps the exceptions of control on capital Flows may hamper financial sector development while, Shaw (1973), further argues that financial repression has led to large differentials between deposits and lending interest rates.

Risk based pricing

Recent studies have delved into how risk-based pricing affects the financial performance of banks. Mwangi, Ong'era, and Matanda (2022) carried out a descriptive analysis using secondary data from 12 publicly listed commercial banks, looking at the years from 2015 to 2020. They utilized STATA software for their statistical analysis and discovered that credit risk positively impacted financial performance, whereas market risk and operational risk had negative effects. However, the research didn't specifically focus on risk-based pricing, which leaves us with some unanswered questions about how personalized pricing strategies might affect profitability.

Mwalolo (2024) conducted an explanatory research design to examine secondary data from five investment firms listed on the Nairobi Securities Exchange. Through multiple regression analysis and various diagnostic tests, the study found that managing interest rate risk, exchange rate risk, and inflation rate risk had a significant impact on financial performance, with firm size playing a moderating role in these relationships. However, the study didn't explore the specific ways that risk-based pricing directly affects financial outcomes. While these findings underscore the importance of financial risk management, they also highlight a notable gap in understanding how risk-based pricing, when considered on its own, influences the financial performance of banks in Kenya. Future research should aim to quantify how personalized pricing models, tailored to borrowers' risk profiles, can provide deeper insights into their effects on bank profitability and stability.

Lelgo and Obwogi (2018) took a closer look at how financial risk impacts the performance of microfinance institutions in Kenya. While their research shed light on important financial risk factors, there are a few areas where their approach could be improved. For one, they used a descriptive research design, which is great for spotting trends but doesn't really show how risk-based pricing directly affects financial performance. It would be beneficial for future studies to use experimental or longitudinal designs to see how risk-based pricing changes over time. On a conceptual level, their study looked at financial risk in general but didn't specifically focus on risk-based pricing as a separate factor influencing financial performance. A more detailed framework that clearly connects risk-based pricing to profitability would offer deeper insights. Additionally, in terms of data analysis, they relied on descriptive statistics and regression analysis, missing out on more advanced econometric models like structural equation modeling (SEM) or panel data techniques, which could lead to stronger conclusions about the effects of risk-based pricing on financial institutions. By addressing these gaps, we could gain a better understanding of how risk-based pricing affects financial performance and develop more targeted policy recommendations.

A study by Tamakloe and colleagues (2023) took a closer look at seven commercial banks through a panel regression analysis, using secondary data pulled from their annual financial statements. They discovered that operational risk played a major role in shaping bank performance, explaining a whopping 99.24% of the variability. On the other side, other risks, such as credit and liquidity, didn't have quite the same impact. Interestingly, the research didn't

dive into risk-based pricing strategies, which leaves to the wondering how tailored pricing models that consider borrower risk profiles might influence financial results.

Researchers Müller, Andersen, and Juelsrud (2024) exmiend how competition affects the way banks set their prices for corporate loans based on risk. By examining supervisory data from 2012 to 2018, they discovered that when competition heats up, banks become less responsive to their own internal risk evaluations, which results in lower risk-adjusted returns. This study highlights the strategic changes banks implement in their loan pricing when faced with competitive pressures, although it stops short of connecting these changes to broader financial performance indicators.

Hunjra et al. (2022) explored on who credit, liquidity, and operational risks influence the financial performance of 76 commercial banks in Pakistan, India, Bangladesh, and Sri Lanka over the period from 2009 to 2018. Using the generalized method of moments (GMM) for their analysis, they discovered that credit risk evaluated through the Z-score and the ratio of non-performing loans had a significant impact on how well the banks performed. They also found that liquidity risk, measured by current and loan-to-deposit ratios, played a crucial role. While this study offered some valuable insights into managing risks, it didn't specifically delve into strategies for risk-based pricing.

Conceptual framework

The conceptual framework shows how different factors like lending margins, risk-based and pricing affect banks' financial performance, including metrics like ROA, and ROE.

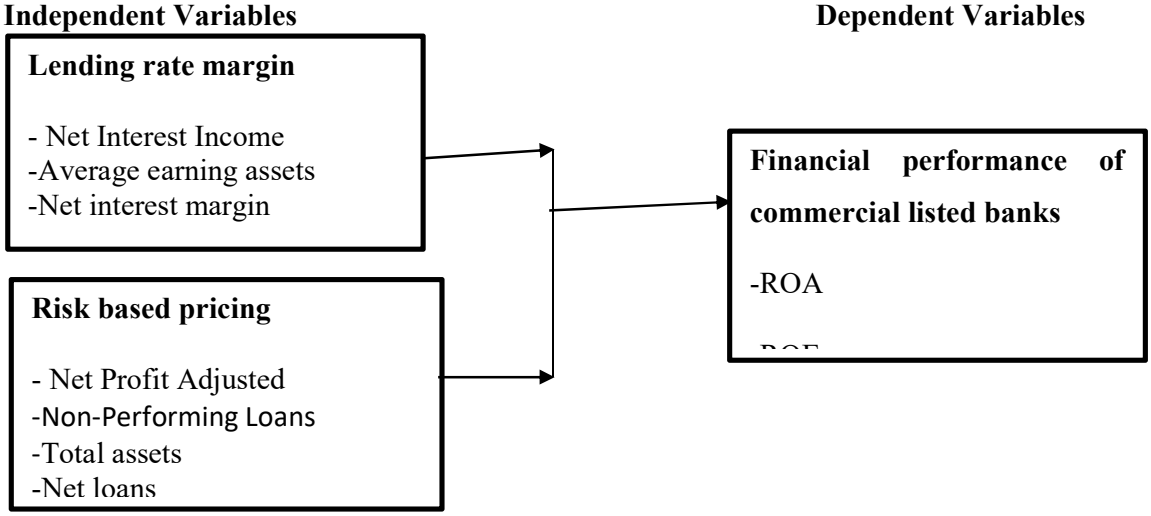

Figure 2.1 conceptual framework

Lending rate margin is gauged by what's known as the Net Interest Margin (NIM). When these lending margins are on the higher side, it usually points to better profitability, thanks to the gap between the income generated from interest and the expenses tied to interest.

Risk-based pricing is evaluated using the Risk-Adjusted Return on Assets (RAROA) or the Non-Performing Loan (NPL) Ratio. When banks have a high NPL ratio, it can be tough for them to stay profitable, which often points to flaws in their risk-based pricing strategies.
Bank's financial performance was shown by the metrics like Return on Assets (ROA) and Return on Equity (ROE). These figures give a clear picture of how profitable the bank is and how well it's doing at generating returns for its shareholders.

RESEARCH METHODOLOGY

Research Design

Research design is all about the game plan for conducting a study. It lays out a clear and logical framework to tackle research questions by gathering, interpreting, and analyzing data (Kothari, 2014). In this study, the researcher is going to use a descriptive research design to explore how lifting interest rate caps affects the financial performance of banks, and the economy as a whole. By taking a descriptive approach, she can thoroughly investigate trends, relationships, and patterns in the financial sector, which provided a valuable understandings into the impacts of interest rate cap lift.

Target Population

This study was done at the Nairobi Securities Exchange (NSE), concentrating specifically on the listed commercial banks. The NSE stands out as one of the leading capital markets in Kenya, offering a space for banks and various investment firms to gather capital and trade securities. The study has chosen listed commercial banks as our focus because they are directly influenced by changes in interest rate policies and they provide the publicly accessible financial data that needed for analysis.

According to the most recent data, there are 10 commercial banks that are listed on the Nairobi Securities Exchange (NSE), out of a total of 38 licensed commercial banks operating in Kenya. The banks that are listed include ABSA Bank Kenya Plc, Stanbic Holdings Ltd., I&M Holdings Plc, Diamond Trust Bank Kenya Ltd., HF Group Plc, KCB Group Plc, NCBA Group Plc, Standard Chartered Bank Kenya Ltd., Equity Group Holdings Plc, and The Co-operative Bank of Kenya Ltd (Cytonn, 2024). These banks play a crucial role in Kenya’s economy and are significantly affected by shifts in interest rate policies. Since the listed banks provide financial statements that are accessible to the public, they serve as a dependable source of secondary data for examining how changes in interest rate caps influence financial performance. By concentrating on these banks, the study guarantees a thorough overview of the banking sector, enabling a more data-driven analysis of lending margins, risk-based pricing, and credit segments in the era following the interest cap.

Sampling techniques and sample size

Maranga (2025) describes sampling as a method for choosing a specific number of subjects from a larger population to accurately reflect the whole group. In this research, the study will use a purposive sampling technique to focus on the 10 listed commercial banks in Kenya. This approach is ideal because it guarantees that the researcher only include banks that have been

directly affected by the lifting of the interest rate cap and that have publicly accessible financial data for the analysis.

To determine the sample size, the study wil look at the total number of listed commercial banks on the Nairobi Securities Exchange (NSE). According to the latest figures, there are 10 banks listed, and the researcher plan to include all of them in the study to ensure it cover everything thoroughly. If needed, then might also consider a stratified sampling method to group banks by asset size, market share, or profitability, which would help make the findings even more representative.

Table 3.1 Sample size of Listed of listed commercial banks

	Bank	Number of banks
1	ABSA Bank Kenya Plc	1
2	Stanbic Holdings Ltd	1
3	I&M Holdings Plc	1
4	Diamond Trust Bank Kenya Ltd	1
5	HF Group Plc	1
6	KCB Group Plc	1
7	NCBA Group Plc	1
8	Standard Chartered Bank Kenya Ltd	1
9	Equity Group Holdings Plc	1
10	The Co-operative Bank of Kenya Ltd	1

Data Collection instruments

The study gathered secondary data from various sources, including the financial statements of listed banks, their annual reports, publications from the Central Bank of Kenya, and market analysis reports. The study focused on the indicators Return on Assets (ROA), Return on Equity (ROE) to spot trends before and after the interest rate caps were lifted from 2019 to 2024. By using secondary data can take a well-rounded look at the wider economic effects of deregulating interest rates.

RESULTS AND DISCUSIONS

Introduction

The study extracted secondary data from published financial statements of 9 listed commercial banks covering 5 years from 2019 to 2024. Diamond trust bank was used in testing pilot analysis using descriptive statistics so excluded in the final study. The researcher utilized the bank's annual reports, audited financial statements, publications from the Central Bank of Kenya (CBK), reports from the Kenya Bankers Association (KBA), and disclosures from the Nairobi Securities Exchange (NSE). Secondary data was used by the research to ensure consistency, accuracy, and completeness over the ten-year span.

Each independent variable assessed using specific indicators and units of measures of the amount is in millions. Measured the lending margin through the net interest margin (NIM), which shows the difference between the interest earned on loans and the interest paid on deposits in relation to earning assets. Risk-based pricing was inferred from trends in interest

rate cap ratio was determined, which indicates how the bank adjusted its pricing based on the risk profiles of borrowers. The credit segment was evaluated using the loan-to-deposit ratio, reflecting the bank's lending aggressiveness and its dependence on customer deposits to fund loans.

The study assessed financial performance through ROA and ROE. ROA was calculated by dividing net income by total assets, indicated how effectively the bank utilized its assets to generate profit. Meanwhile, ROE was determined by dividing net income by shareholder equity, indicating the returns generated on shareholders' investments. The analysis of the collected data unveiled dynamic interactions between the independent variables and the bank's financial performance.

Data screening

Data screening is an essential first step in the data analysis journey, designed to ensure that the data to work with is high-quality, complete, and appropriate for statistical analysis. In this study, carried out data screening to pinpoint and tackle issues like missing values, outliers, and inconsistencies that could skew the relationships between independent variables lending rate margin, risk-based pricing, and credit segments and the dependent variable, financial performance, which measured using indicators like ROA and ROE.

Descriptive statistics

Descriptive statistics help summarize and describe the basic features of the financial information, offering a simple overview of the sample and the measures used in the study. In this objective, the statistics cover net interest income, average earning assets and net interest margin indicators of lending rate margnis after the interest rate cap was lifted.

Lending rate margin

Table 4.1 presents descriptive statistics for the variables used to assess the lending rate margin of commercial listed banks in Kenya following the removal of interest rate caps. Specifically, it summarizes the net interest income, average earning assets, and net interest margin for a sample of 45 observations.

Table 4.1 Lending rate margins

	N	Minimum	Maximum	Mean	Std. Deviation
Net Interest Income	45	8.00	18.00	13.9667	3.02001
Average earning assets	45	6.40	9.40	7.7711	1.16663
Net interest margin	45	3.35	18.04	7.0458	4.31186
Valid N (listwise)	45				

The net interest income, which reflects the difference between interest earned and interest paid, ranges from Ksh 8.00 million to Ksh 18.00 million, with a mean of Ksh 13.97 million and a standard deviation of 3.02. This suggests a moderate spread in interest-related earnings across the sampled banks, indicating relatively consistent performance in interest income generation. The average earning assets, which are the assets that generate interest revenue, fall between Ksh 6.40 million and Ksh 9.40 msillion, with a mean of Ksh 7.77 million and a low standard

deviation of 1.17. This indicates that most banks had comparable levels of income-generating assets during the period under review. However, the net interest margin, calculated as the ratio of net interest income to average earning assets, exhibits a wider range from 3.35% to 18.04% with a mean of 7.05% and a relatively high standard deviation of 4.31. This wide variation suggests significant differences in how effectively banks converted their earning assets into interest income after the interest cap was lifted. Some banks achieved high margins, possibly due to better risk pricing and credit assessment practices, while others may have struggled to adjust. Overall, the statistics highlight the uneven impact of the interest cap removal on the financial performance of banks, pointing to institutional differences in adaptability and lending strategy execution.

These findings are consistent with recent studies on the effects of interest cap deregulation. For instance, Dondi, Kiptoo, and Wanjiru (2023) established that lending interest rates had a significant and adverse impact on the financial performance of commercial banks in Kenya, emphasizing the need for strategic adjustments to lending practices. Similarly, Mokua (2023) reported that the removal of interest rate caps led to increased variation in banks' financial outcomes, highlighting institutional differences in risk management and lending capacity. These studies reinforce the current findings, suggesting that the impact of the interest cap lift was not uniform across the sector but instead depended heavily on individual bank strategies and operational efficiencies.

Risk based pricing

Table 4.2 presents descriptive statistics relating to risk-based pricing, which is a strategic approach where loan interest rates are set based on the borrower's credit risk profile. The analysis includes net profit adjusted for risk, non-performing loan (NPL) ratio, total assets, and net loans for 45 observations.

Table 4.2 Risk based pricing

	N	Minimum	Maximum	Mean	Std. Deviation
Net Profit Adjusted for Risk	45	5.40	65.00	38.1311	18.23635
Non performing loan(NPL Ratio)	45	9.00	68.00	33.4338	16.26237
Total assets	45	12.00	35.30	18.1667	6.57622
Net loans	45	15.30	38.13	26.5247	8.37343
Valid N (listwise)	45				

The net profit adjusted for risk ranges from Ksh 5.40 million to Ksh 65.00 million, with a mean of Ksh 38.13 million and a standard deviation of 18.24. This wide spread suggests significant variation in how banks manage profitability while accounting for credit risk. The NPL ratio, ranging from 9% to 68% and averaging 33.43% (SD = 16.26), indicates a concerningly high and diverse level of loan defaults across institutions. Total assets range from Ksh 12.00 million to Ksh 35.30 billion, with a mean of Ksh 18.17 million, while net loans range from Ksh 15.30 million to Ksh 38.13 million, averaging Ksh 26.52 million. Both asset and loan figures show moderate dispersion, pointing to differences in bank size and lending capacity

These findings highlight the critical importance of risk-based pricing in the post-cap environment. The variability in NPL ratios underscores the need for banks to properly assess borrower risk and price loans accordingly to protect profitability. Recent research supports this interpretation. Gitonga and Karanja (2023) observed that banks which adopted risk-based pricing mechanisms were better able to maintain profitability and minimize default rates after the removal of the interest cap. Similarly, Omondi (2023) emphasized that banks with robust risk assessment frameworks were more likely to experience sustainable growth, as they priced loans in line with borrower risk and market dynamics. The observed disparities in net profit and loan performance in this study reflect the uneven adoption of such practices across Kenya's banking sector. Therefore, risk-based pricing remains a crucial strategy for managing risk and improving financial performance in a deregulated interest rate environment.

Inferential statistics

Correlation analysis

Table 4.5 presents the results of a Pearson correlation analysis, aimed at examining the strength and direction of relationships among the key variables: lending rate margin, risk based pricing, credit segments, and financial performance of listed commercial banks in Kenya after the lifting of the interest rate cap.

Table 4.5 Correlations

		Lending rate margin	Risk based pricing	Credit segments	Financial performance
Lending rate margin	Pearson Correlation	1	.862**	.642**	.998**
	Sig. (2-tailed)		.000	.000	.000
	N	45	45	45	45
Risk based pricing	Pearson Correlation	.862**	1	.381**	.864**
	Sig. (2-tailed)	.000		.010	.000
	N	45	45	45	45
Credit segments	Pearson Correlation	.642**	.381**	1	.634**
	Sig. (2-tailed)	.000	.010		.000
	N	45	45	45	45
Financial performance	Pearson Correlation	.998**	.864**	.634**	1
	Sig. (2-tailed)	.000	.000	.000	
	N	45	45	45	45

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

All correlations are significant at the 0.01 level (2-tailed), indicating statistically strong associations between the variables.

The correlation between lending rate margin and financial performance is extremely high ($r=.998$, $p<.001$), suggesting a nearly perfect positive relationship. This implies that an increase in lending rate margins is almost directly associated with an increase in financial performance, reinforcing the argument that the removal of the cap enabled banks to price loans more profitably. Similarly, risk based pricing also shows a strong positive correlation with financial

performance high (r=.864, p<.001), indicating that banks that effectively assess borrower risk tend to report better financial outcomes. These findings are supported by Gitonga and Karanja (2023), who noted that lending flexibility post-cap allowed banks to align loan pricing with risk levels, thus enhancing returns

The correlation between credit segments and financial performance is moderately strong (high (r=.634, p<.001) suggesting that diversification across different borrower types or industries also contributes positively to profitability. Meanwhile, lending rate margin is also strongly correlated with risk based pricing high (r=.862, p<.001) and credit segments high (r=.642, p<.001) showing that these financal components tend to move together; banks that implement better pricing also tend to diversify their credit portfolios.
These results align with Njoroge and Koskei (2023) who found that a combination of flexible pricing, risk sensitivity, and targeted lending to well-defined credit segments formed a triad of effective post-cap banking strategies in Kenya. The significant positive correlations across all variables reflect the interdependence of internal financial strategies and their collective impact on bank performance.

Simple Regression

Lending rate margin

The model summary for the simple regression analysis, where lending rate margin is the only predictor of financial performance, shows a very strong model fit.

Table 4.10 Lending rate margin Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.998[a]	.996	.996	.49707

a. Predictors: (Constant), Lending Rate Margin

The R value os 0.998, indicating an almost perfect positive linear relationship between lending rate margin and financial performance.This suggests that lending rate margin alone explains nearly all of the variation in the financial performance of the banks.

The R square 0.998 means that 99.8% of the variance in financial performance can be explained by the lending rate margin, highlighting the dominance of this variable in predicting financial outcomes. The adjusted R square of 0.996 confirms that this high explanatory power remains robust after adjusting for the single predictor variable. The standard error of the estimate is indicating that the prediction errors are small and the model is highly accurate in estimating the financial performance of commercial banks based on lending rate margins. The simple regression model demonstrates an excellent fit, with lending rate margin accounting for almost all of the variation in financial performance.

The ANOVA table for the simple regression model, where lending rate margin is the sole predictor of financial performance, shows that the regression model is statistically significant.

Table 4.11 ANOVA

Model		Sum of Squares	Df	Mean Square	F	Sig.
1	Regression	2901.911	1	2901.911	11744.809	.000[b]
	Residual	10.624	43	.247		
	Total	2912.536	44			

a. Dependent Variable: Financial performance

b. Predictors: (Constant), Lending Rate Margin

The sum of squares of regression is 2901.911, indicating that the model explains a substantial portion of the variation in financial performance. The Mean square for regression 2901.911, derived from dividing the regression sum of squares by its degrees of freedom. The sum of squares for residual is 10.624 which represents the unexplained variation in financial performance, with the corresponding mean square for residuals value .247.

The f-statistics is 11744.809 which is more than 1, indicating that the model explains significantly more variation in financial performance than it leaves unexplained. The significance value of 0.000 ($p < 0.05$) indicates that the regression model is highly significant, meaning that lending rate margin is a meaningful predictor of financial performance. This result confirms the model's validity and supports the strong relationship between lending rate margin and financial performance in the context of commercial banks.

The coeficients table provides information on the relationship between lending rate margin and financial performance as shown table 4.12.

Table 4.12 Coefficients

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	.105	.127		.828	.412
	Lending Rate Margin	.997	.009	.998	108.373	.000

a. Dependent Variable: Financial performance

The unstandardized coeficients for lending rate is 0.997, implied that for each one-unit increase in lending rate margin, variation is expected to increase by 0.997 units, holding all other variables constant.

The standardized coeficients (Beta) for lending rate margin is .998 indicating a very strong positive relationship between lending rate margin and financial performance. Since the Beta value is close to 1, it suggests that lending rate margin has an extremely strong influence on the dependent variable, financial performance, compared to other potential predictors in a multiple regression.

The t-value for lending rate margin is 108.373, which is highly significant. The associated p-value is 0.000, which is much smaller than the significance threshold of 0.05. This indicates that lending rate margin is a highly statistically significant predictor of financia performance and its effect is not due to random chance. The constant (intercept has a value of 0.105, but it

is not statistically significant, as indicated by the p-value 0.412, which is greater than 0.05. This suggests that the intercept does not significantly contribute to the model and does not meaningfully affect the prediction of financial performance.

Regression model equation would be

$Y = \beta_0 + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \varepsilon$……..

Becomes $Y = .105 + .997 X_1$

Risk based pricing

The model summary for the simple regression analysis, where risk based pricing is the only predictor of financial performance, shows a strong but slightly lower model fit as compared with lending rate.

Table 4.13 Risk based pricing Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.864[a]	.747	.741	4.13933

a. Predictors: (Constant), Risk Based Pricing

The R value os 0.864, indicating a strong positive linear relationship between risk based pricing and financial performance.This suggests that risk based pricing alone explains nearly all of the variation in the financial performance of the banks.

The R square 0.747 means that 74.7% of the variance in financial performance can be explained by the risk based pricing. sThe adjusted R square of 0.741 confirms that this high explanatory power remains robust after adjusting for the single predictor variable.

The simple regression model demonstrates an excellent fit, with lending rate margin accounting for almost all of the variation in financial performance. This is a substantial amount of variance, but it also indicates that other factors not included in the model contribute to the remaining 25.3% of the variability in financial performance. This is very close to the R Square, which indicates that the model remains a good fit even after adjusting for the number of predictors.

The ANOVA table for the simple regression model, where risk based pricing is the sole predictor of financial performance, shows that the regression model is statistically significant.

Table 4.14 ANOVA

Model		Sum of Squares	Df	Mean Square	F	Sig.
1	Regression	2175.771	1	2175.771	126.985	.000[b]
	Residual	736.764	43	17.134		
	Total	2912.536	44			

a. Dependent Variable: Financial performance

b. Predictors: (Constant), RISK BASED PRICING

The sum of squares of regression is 2175.771, indicating the variation in financial performance. The Mean square for regression 2175.771, derived from dividing the regression sum of squares by its degrees of freedom. The sum of squares for residual (the unexplained variation) is

736.764 which represents the unexplained variation in financial performance, with the corresponding mean square for residuals value 17.134. This reflects the variation in financial performance that is not accounted for by the model.

The f-statistics is 126.985 which is more than 1, indicating that the model explains significantly more variation in financial performance than it leaves unexplained. The significance value of 0.000 ($p < 0.05$) indicates that the regression model is highly significant, meaning that risk based pricing is a meaningful predictor of financial performance. ANOVA results confirm that the risk based pricing model is statistically significant and provides a good fit, effectively explaining the variation in financial performance.

The unstandardized coeficients for risk based price is 0.966 implied that for each one-unit increase in risk based price, variation is expected to increase by 0.966 units, holding all other variables constant.

The standardized coeficients (Beta) for risk based price is .864 indicating a very strong positive relationship between risk based price and financial performance. Since the Beta value is close to 1, it suggests that risk based price has an extremely strong influence on the dependent variable, financial performance, compared to other potential predictors in a multiple regression.

Table 4.15 Coeficients

Model		Unstandardized Coefficients		Standardized Coefficients	T	Sig.
		B	Std. Error	Beta		
1	(Constant)	.973	1.104		.882	.383
	Risk Based Pricing	.966	.086	.864	11.269	.000

a. Dependent Variable: Financial performance

Regression equation would be

$Y = \beta_0 + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \varepsilon$……..

Becomes $Y = .973 + .966 X_2$……..ii

The t-value for risk based pricing is 11.269, which is highly significant. The associated p-value is 0.000, which is less than the significance threshold of 0.05. This indicates that lending rate margin is a highly statistically significant predictor of financia performance and its effect is not due to random chance. The constant (intercept has a value of 0.973, but it is not statistically significant, as indicated by the p-value 0.383, which is greater than 0.05. This suggests that the intercept risk based pricing does not significantly contribute to the model and is not statistically significant, meaningfully affect the model's predictions.

Conclusion and Recommendations

Conclusions

The results of the study indicate that the removal of interest rate caps had a profound and positive impact on the profitability of listed commercial banks in Kenya, primarily through the

enhancement of lending rate margins. Banks appear to have leveraged the deregulated lending environment to increase their net interest income, which significantly contributed to improved financial outcomes. However, the findings also highlight that lending rate strategies and credit segmentation efforts had a notable impact on bank performance. This could point to inefficiencies or underdeveloped frameworks in the implementation of these strategies, suggesting that banks may still be operating with conventional pricing and lending models that do not fully exploit risk-based assessments or segmented credit products.

Recommendations

Based on the findings, it is recommended that regulatory authorities, particularly the Central Bank of Kenya, intensify oversight of lending practices to ensure that banks do not exploit higher interest margins at the expense of consumer welfare. While increased margins have improved bank performance, unchecked lending rates may burden borrowers, particularly small and medium enterprises (SMEs). Furthermore, there is a need to encourage and support the adoption of comprehensive risk-based pricing frameworks. Although currently underutilized, such models could improve credit risk management and align loan pricing with borrower risk profiles. Policymakers can promote this by offering incentives, capacity building, or mandating risk-based pricing standards.

Additionally, banks should refine their credit segmentation strategies to better serve diverse market segments, especially those that are underserved or high-potential. The lack of significant impact from credit segmentation in this study suggests that current segmentation efforts may be ineffective or not sufficiently data-driven. Investments in data analytics and financial technologies could enhance credit targeting and boost financial inclusion.

To build on these findings, future research should consider longitudinal studies that examine the sustained effects of interest cap removal across different economic cycles and regulatory changes. In addition, a qualitative approach involving in-depth interviews with bank executives and policy makers may provide insights into why risk-based pricing and segmentation strategies remain underperforming. Future studies could also explore whether the effects of interest cap removal differ based on bank size or sectoral lending patterns. With the increasing role of digital finance and fintech innovations in Kenya, it would also be relevant to study how digital lending platforms are influencing credit allocation, pricing, and financial performance in the evolving banking sectors.

It is also recommended to revisit and refine the measurement of lending rate margin to improve its alignment with the scale's reliability. Moreover, given the presence of multicollinearity, advanced statistical techniques such as ridge regression or variance inflation factor (VIF) analysis should be considered to manage overlapping explanatory power among independent variables. Strengthening variable definitions and incorporating longitudinal data would further improve the robustness of future financial performance assessments and guide more accurate policy and managerial decisions in the banking industry.

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