

**EFFECTS OF SPREADING INTEREST RATES ON FINANCIAL  
PERFORMANCE OF COMMERCIAL BANKS IN KISII TOWN**

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## DECLARATION AND APPROVAL

### Declaration by the candidate

The content of this proposal is original, unpublished material and has not been submitted for academic credentials or any other accolades at another institution.

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### Approval by the supervisors

I hereby verify that the research presented in this thesis was conducted by the candidate under my direct guidance and oversight.

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## **DEDICATION**

This project is dedicated to my cherished parents and all my family members, whose love, guidance, and dedication have been crucial in completing this proposal.



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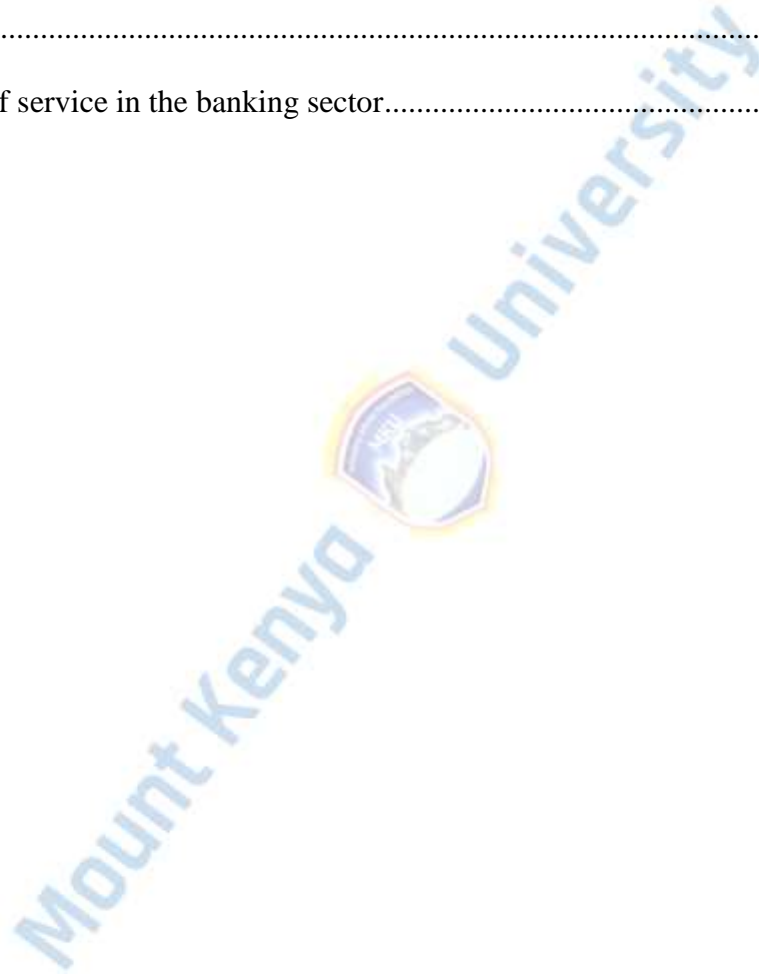


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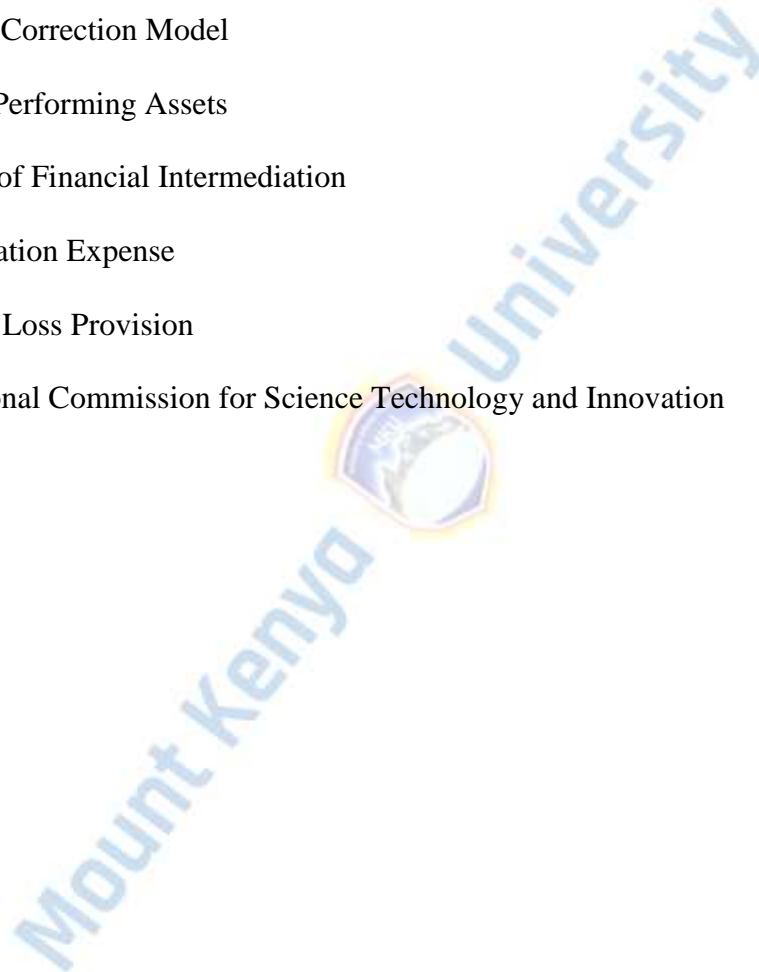
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## LIST OF ABBREVIATION

IRS	Interest Rate Spread
ROI	Return on Investment
SWOT	Strength Weakness Opportunities and Threats
SSA	Sub-Sahara Africa
ECM	Error Correction Model
NPA	Non Performing Assets
CFI	Cost of Financial Intermediation
OE	Operation Expense
LLP	Loan Loss Provision
NACOSTI	National Commission for Science Technology and Innovation



## ABSTRACT

Banks hold a central role in daily financial transactions, making it crucial for them to operate with effectiveness, efficiency, and competitiveness. One sensitive economic variable in this context is the interest rate spread, which should be harmoniously balanced to assure savers of optimal returns on their investments and to provide borrowers with reasonable lending rates. This study aimed to evaluate the influence of interest rate spreads on the financial performance of commercial banks in Kisii town. The study has multiple objectives, including assessing the impact of cash lending on the financial robustness of these institutions, investigating how loan repayment rates affect their financial health, and examining the influence of domestic savings rates on their performance. The research was grounded in the Profit Maximization and Dealership models, which offer theoretical frameworks for understanding the operational and financial dynamics at play. The methodology featured a descriptive survey research design. The target population comprised of 227 individuals employed in commercial banks in Kisii town. A census technique will be used to determine the sample size for the study. Data collection was primarily carried out through questionnaires and semi-structured interviews. To ensure the reliability and validity of the research instruments, a test-retest method was used for the former, while the latter will undergo validation through academic supervision. For data analysis, a combination of descriptive and inferential statistical tools were employed. Frequencies, percentages, and chi-square tests were utilized to interpret the collected data. Qualitative data gathered from interview schedules was subject to thematic analysis. The research findings were displayed through various graphical representations such as tables, figures, graphs, and charts. The study anticipated that its findings served as a valuable resource for commercial banks in Kisii town, aiding in the enhancement of their profitability and growth.

# CHAPTER ONE

## INTRODUCTION

### 1.0 Introduction

This chapter provides a comprehensive overview of the study, covering various elements essential for understanding the scope, aim, and significance of the research. It starts with an introduction that situates the study within a broader context before delving into the background, which lays the groundwork by presenting relevant literature, theories, and models that inform the study.

The statement of the problem then elucidates the specific issue or gap that the study aims to address, usually highlighting why existing literature or current practices are insufficient. Following this, the purpose of the study is clarified, detailing what the research intends to achieve. This often includes the main aim and any subsidiary goals that contribute to the overall objective.

Objectives of the study break down the purpose into actionable pieces, providing a roadmap for what the study seeks to accomplish in more concrete terms. These are complemented by research questions, which act as guides for the investigation, helping to focus the research process.

The significance of the study is then discussed, outlining the potential impact of the research findings on the field, industry practices, or even societal issues. This section explains why the study is worth conducting and what contributions it aims to make.

Limitations of the study acknowledge the constraints that may affect the research process or the interpretation of results, such as sample size, methodology, or available resources. Delimitations, on the other hand, refer to the boundaries set by the researcher, such as the scope, geographical area, or time frame within which the study is conducted.

Assumptions of the study are the conditions or facts that the research assumes to be true for the purpose of the study. These might include certain prerequisites that are not empirically tested

within the research but are necessary for the arguments or procedures to hold.

Finally, operational definitions of terms are provided to ensure clarity. This section elucidates the specific meaning of key terms as they are used within the context of the study, offering readers a unified understanding of the language employed throughout the research.

## **1.1 Background of the Study**

Commercial banks serve as pivotal financial intermediaries, channeling funds from sectors of economic surplus to those in deficit. Their ability to effectively execute this function has far-reaching consequences, impacting not just the institution's rates but also the economic health of a nation. According to Wainaina (2013), there's a relationship between a bank's rate and the overall economic growth and development. Interest rate spread (IRS), defined as the gap between interest rates charged to borrowers and those paid to depositors (Were & Wambua, 2014), also holds considerable significance. Unlike rates, spreads are determined by individual financial institutions (Mlachila, 2005), and they offer insights into bank efficiency and the impact of monetary policy (Were & Wambua, 2014).

Commercial banks function as essential financial intermediaries that mediate between sectors of economic surplus and deficit, a role that has a domino effect on national and global economies (Allen & Gale, 2000). The interest rate spread (IRS), defined as the difference between lending and deposit rates, serves as a microcosm of broader economic trends and policies (Bernanke & Blinder, 1992). Globally, high interest rate spreads can indicate market inefficiencies or even financial crises (Kaminsky & Reinhart, 1999).

The performance of banks is not just a national concern but has global implications, particularly in an increasingly interconnected global economy (Schoenmaker, 2013). Multinational

stakeholders rely on these indicators for global investment decisions (Eichengreen & Rose, 1998). Moreover, the macroeconomic factors affecting bank performance, such as inflation and exchange rates, are often interconnected across borders, affecting global financial stability (Obstfeld & Rogoff, 1996).

The performance of commercial banks guides stakeholders in decision-making. For instance, Chen, Roll, and Ross (1986) argue that macroeconomic factors significantly explain firm performance and returns to investors. Simon (1997) indicates that exchange rates and current accounts are key factors that negatively impact smaller economies. Deteriorating economic conditions like low GDP, inflation, and exchange rate fluctuations can result in bank failures (Herrero, 2003).

In the global context, commercial banks are often seen as a cornerstone of financial stability, and their performance has far-reaching implications. The interest rate spreads (IRS) are monitored closely by regulators, investors, and policymakers as an indicator of market health and efficiency (Schwartz, 2010). For example, the Dodd-Frank Wall Street Reform in the United States and Basel III regulations were instigated to ensure risk management in banks and a more stable IRS (Bank for International Settlements, 2011). In the European Union, the European Central Bank monitors IRS as part of its macroprudential oversight (European Central Bank, 2015).

In Ghana, the central bank's role is significant in shaping IRS. After the Banking Sector Clean-Up in 2018-2019, which led to the revocation of licenses for several banks and other financial institutions, Ghana's central bank has been paying close attention to IRS (Addison, 2019). This Clean-Up aimed at ensuring a more robust financial sector, but IRS has remained relatively high compared to global averages. Some scholars attribute the high IRS in Ghana to operational inefficiencies and a lack of competition (Amidu & Wolfe, 2013). Moreover, the high risk of

lending in Ghana due to credit defaults also contributes to the higher IRS, reflecting an economy grappling with risk management challenges.

On the other hand, Tanzania has a growing financial sector with increasing foreign bank entry. The country has enjoyed relative stability compared to its neighbors but still experiences a high IRS (Mwega, 2014). One unique feature of Tanzania's IRS is the considerable variance between urban and rural regions. Rural areas often experience higher IRS due to infrastructural challenges and lack of financial literacy (Randall, 2011). Given that Tanzania is aiming to become a middle-income economy by 2025, the high IRS remains an obstacle to achieving more inclusive economic growth (United Republic of Tanzania, 2015).

In contrast, the African perspective, with a specific focus on Kenya, presents a different set of challenges and implications. Despite liberalization of the financial sector in the 1990s, the IRS remains high. This is indicative of inefficiencies in the market, which in turn hampers the growth of the economy (Were & Wambua, 2014). Such trends can be a significant deterrent to foreign direct investment, which is critical for economic development. This high IRS also reflects broader issues in sub-Saharan Africa, where countries like Nigeria and South Africa have also struggled with financial sector inefficiencies despite several reforms (Folawewo & Tennant, 2008).

In Kenya, high interest rate spreads in commercial banks have become an emerging policy issue due to the banking sector's significant role in economic growth. Despite the financial liberalization and market depth that has occurred, these high spreads persist, often attracting public and policy debates (Were & Wambua, 2014). This situation is particularly significant given that the financial sector, dominated by banking, plays a crucial role in mobilizing savings and providing credit (Folawewal and Tenant, 2008).

Financial liberalization, which involves removing restrictions like fixed interest rates and credit rationing, has been adopted to spur growth in many developing countries. These policy changes aim to deepen the financial sector, making it more competitive and efficient (Folawewol & Tennant, 2008). Commercial banks play a critical role in this liberalized environment by fostering economic efficiency through financial intermediation (Tarus et al., 2012).

Interest rates, controlled by the Central Bank of Kenya (CBK), serve as economic levers affecting growth. They are part of the toolkit used by the CBK to manage inflation and stimulate economic development (Corb, 2012). The need to control interest rates is driven by the overarching objective to manage economic patterns that have significant societal impact. High interest rates set by central banks invariably lead other financial institutions to charge high rates on their financial products, given their profit-oriented nature (Giovanni, 2006).

In summary, the effective functioning of commercial banks as financial intermediaries is critical for economic stability and growth. Interest rate spreads, which are subject to various macroeconomic and policy influences, have a direct impact on this effectiveness and, by extension, the economic health of a nation. This is particularly true in developing economies like Kenya, where financial liberalization policies have been implemented to boost economic development but have yet to fully address the issue of high interest rate spreads.

## **1.2 Statement of Problem**

The dilemma surrounding interest rate spreads in commercial banks carries both broad and specific economic consequences. At the macroeconomic level, larger spreads can stymie a nation's economic growth. For example, elevated lending rates often bar access to credit for potential investors, particularly impacting smaller enterprises, domestic ventures, and rural sectors—key

components for achieving balanced economic development and poverty reduction in low-income nations (Were & Wambua, 2014).

Simultaneously, at the microeconomic level, higher lending rates paired with lower deposit rates can adversely affect consumer behavior. The discouragement of potential savers due to low returns reduces the aggregate funds available for lending, exacerbating the challenge of securing affordable credit (Ngetich, 2011).

Furthermore, the issue is complicated by banks' profit-maximization goals, which often lead them to widen interest rate spreads, thereby disincentivizing both savings and loans. This strategy may paradoxically result in a liquidity crunch in the financial market, jeopardizing long-term bank sustainability (Tarus et al., 2012).

In the specific context of Kisii town, this prevailing situation represents a complex issue where banks might find themselves ensnared in a cycle of short-term profit gains at the expense of long-term stability and economic growth (Were & Wambua, 2014).

Therefore, this research aims to probe these intricate relationships in Kisii town in depth. It intends to assess the various impacts of interest rate spreads on the financial health of local commercial banks, providing data and analysis that could serve as valuable insights for larger, more generalized contexts.

### **1.3 Purpose of the Study**

The purpose of the study was to assess the effects of spreading interest rates on financial performance of commercial banks in Kisii town.

### **1.4 Objectives of the Study**

The study was guided by the following objectives

1. To establish the effect of cash lending on financial performance of commercial banks in Kisii town.
2. To evaluate the effects of loan repayment on financial performance of commercial banks in Kisii town.
3. Examine the outcome of domestic savings on financial performance of commercial banks in Kisii town.

### **1.5 Research questions**

1. What is the effect of cash lending on financial performance of commercial banks in Kisii town?
2. What is the effect of loan repayment on financial performance of commercial banks in Kisii town?
3. What is the effect of domestic savings on financial performance of commercial banks in Kisii town?

### **1.6 Significance of the study**

This research is anticipated to offer substantial benefits across multiple stakeholders in Kenya's financial sector. For commercial banks, the study aims to elucidate the nuanced relationship between interest rate spreads and overall financial performance. By doing so, it could offer strategic insights into optimal interest rate management for sustainable growth and profitability.

For regulatory authorities like the Central Bank of Kenya (CBK), this research could serve as an empirical basis for devising well-informed policies concerning interest rate control within the industry. A deeper understanding of these dynamics may enable the CBK to develop more

effective regulations and guidelines concerning interest rates that balance the needs of both banks and consumers. This could assist the CBK in its role as an overseer by allowing it to more efficiently monitor the rates being charged to borrowers and provided to depositors.

Additionally, the findings of this study are expected to enrich the existing body of academic literature on the subject. Students, scholars, and researchers interested in the impact of interest rate spreads on financial institutions could find the outcomes useful for further inquiry and academic discourse.

Thus, the significance of this study extends beyond immediate policy implications to provide a foundation for future research, while addressing immediate concerns for both commercial and regulatory bodies within Kenya's financial landscape.

### **1.7 Scope of the study**

The study concentrated on the effect of interest rate on financial performance of commercial banks.

The study was carried out in commercial banks in Kisii town.

### **1.8 Limitations of the study**

The main limitation of study was its inability to include all banks in Kenya other than commercial banks in Kisii town. The researcher ensured proper sampling is done in order to minimize the effect that may arise from not sampling all the bank accounts. The sensitivity of information on bank performance may influence the respondents not divulge some information. The researcher assured them of the confidentiality and the purpose of the information given.

### **1.9 Assumption of the Study**

The research presupposed several key assumptions that were instrumental for the validity and applicability of its findings. Firstly, it was assumed that the sample selected for the study adequately mirrored the broader population of interest, ensuring the generalizability of the results. Secondly, the study relied on the integrity of the respondents, assuming that they would provide candid and accurate answers. It was also assumed that these respondents possessed sufficient awareness of the complex interplay between interest rates and commercial bank performance to offer meaningful insights. Another assumption was that the various 'performance factors' under examination either facilitated or impeded the impact of interest rates on bank performance in distinct ways. The study posited that these factors were not uniformly impactful, thereby making it crucial to identify which among them correlated most strongly with performance. By clearly delineating these assumptions, the study aimed to provide a robust framework for its analyses and conclusions, setting the stage for both immediate application and future research endeavors.

## 1.10 Operational definition of terms

**Bank Performance:** As a measure of commercial banks' overall health, this metric looks at their total assets. Increasing a bank's overall assets suggests they'll do better. We are interested in learning how the interest rate spread has impacted the success of Kenya's banking industry.

**Exchange Rate:** This is the current exchange rate of the Kenyan shilling vs other major international currencies. For the purposes of this research, we will be focusing on the effect of the aggregate exchange rate on the success of the Kenyan banking sector, despite the fact that Kenya has employed a variety of strategies throughout the years to establish the rate at which the shilling exchanges to other currencies. The necessity to adjust for this variable stems from the fact that changes in exchange rates have far-reaching effects on the financial services sector's performance.

**Gross Domestic product:** This is the sum total of all products and services produced in an economy. This is the common stand-in for economic expansion. To measure the impact of economic expansion on the financial sector, this metric will be implemented. On the other hand, this variable will serve as a control.

**Interest Rate Spread:** The interest rate spread analyzed herein is defined as the percentage by which a bank's lending rate exceeds its deposit rate. Bank-specific variables, industry/market-specific factors, and macroeconomic factors are all thought to contribute to this rate variability.

**Interest rates:** This is the cost or benefit of using monetary resources. Interest is often stated as a yearly percentage of the loan's principal.

**Investment performance:** The total amount of capital expenditures relative to the cost of capital that have been borrowed and repaid by the debtor.

**Lending rate:** Costs associated with borrowing periodicals



## **CHAPTER TWO**

### **LITERATURE REVIEW**

#### **2.0 Introduction**

This chapter contains literature on the bank financial management, theoretical review, empirical literature review, conceptual framework and literature gap.

#### **2.1 Theoretical Framework**

The theoretical framework of this study is based on two theories namely, the Profit maximization theory extended by Klein (1971) and Monti (1972), the Dealership theory of Ho and Saunders (1981).

##### **2.1.1 Profit maximization theory**

In scrutinizing the financial performance of commercial banks in Kisii town, it becomes imperative to explore theoretical frameworks that can illuminate the underlying dynamics. One such framework is the Monopoly, or Klein-Monti model, which posits that banks possess monopolistic power in both deposit and lending markets (Klein, 1971; Monti, 1972). According to this model, banks can set their prices, in this case, interest rates, above their marginal costs (Samahiya & Kaakunga, 2014). The application of this model to the Kisii town context could reveal whether larger banks use their monopolistic power to manipulate interest rate spreads, which is a key component of cash lending activities and, by extension, financial performance.

Researchers such as Collins and Wanjau (2011) have emphasized that the objective of a commercial bank varies depending on the market structure and risk management. In a monopolistic setting, it is suggested that firms could be optimizing either the expected utility of profits or the

profits themselves. Therefore, understanding the market structure within Kisii town is crucial for analyzing the relationship between cash lending and financial performance.

The Monopoly model's premise suggests that banks with significant monopolistic power could exercise control over smaller banks in the same market, affecting interest rate spreads (Samahiya & Kaakunga, 2014). Consequently, the lending rates determined by these larger banks would have a ripple effect on the smaller banks. Smaller banks, eager to carve out a niche in a competitive market, might adopt risky lending practices, offering high-interest loans to riskier clients in a bid to increase their market share. Such a dynamic could have a substantial impact on the financial performance of these banks, providing an important context for the study.

Moreover, the impact of market structure and regulatory environment should not be underestimated. According to Afanasieff et al. (2006), the development of the financial sector is closely tied to overall economic growth, making the role of commercial banks in economic development pivotal. In economies with repressed financial sectors, banks tend to offer less competitive rates, which could impact their profitability and growth prospects (Folawewol & Tennant, 2008).

Banks in Kisii town, therefore, operate not just within the domestic regulatory framework but also within an increasingly interconnected global financial system. Researchers like Giovanni (2006) and Corb (2012) have elaborated on how central banks use interest rates as tools for macroeconomic stabilization. These rates have a domino effect on the entire financial system, impacting profitability and financial performance. In other African countries like Nigeria and South Africa, challenges such as fluctuating exchange rates, unstable inflation, and socio-political factors have similarly influenced the financial performance of banks (Oke & Adeusi, 2013; Naude & Coetzee, 2019).

In summary, applying the Monopoly model to the study's objective of understanding the effect of cash lending on the financial performance of commercial banks in Kisii town could offer valuable insights. The model enables a deeper exploration into how monopolistic power influences interest rate spreads, cash lending practices, and ultimately, financial performance. By situating this within both a local and global financial landscape, the study aims to provide a comprehensive understanding that could be beneficial for stakeholders ranging from regulatory bodies to individual banks and researchers.

### **2.1.2 Dealership theory**

The Dealership model serves as an insightful lens for understanding the complex dynamics within commercial banking. At the core of this model is the role of the bank as an intermediary that facilitates transactions between borrowers and lenders. This intermediary role comes with its own set of challenges and uncertainties. Primarily, these uncertainties can be categorized into two broad types: interest rate risks and default risks (Samahiya & Kaakunga, 2014).

When applying the Dealership model to the financial milieu of Kisii town, it is essential to explore how these risks impact loan repayment and subsequently, the financial performance of commercial banks. Firstly, the lack of synchrony between loans given out and deposits received creates a volatile interest rate environment. Secondly, banks must grapple with the uncertainty of borrowers defaulting on loans. The confluence of these risks often compels banks to increase the interest rate spread as a protective measure against potential financial loss. There's an implied positive relationship between a widened interest rate spread and an increase in Non-Performing Loans (NPLs), which can detrimentally impact a bank's financial standing.

Collins and Wanjau (2011) delve further into this by discussing various factors that can aggravate the NPL situation, such as regulatory frameworks, the cost structure of assets, and inherent credit risks. Regulatory frameworks are designed to restrain banks from undertaking irresponsible financial behaviors like setting exorbitant interest rates or indulging in insider lending. However, these regulations can also impede a bank's agility in adjusting to market conditions, potentially affecting loan repayment rates and overall profitability.

Asset costs are another pivotal element. The interest rate spread effectively captures the profitability gap between short-term borrowing costs and long-term lending returns. When asset costs rise, banks often transfer these costs to borrowers, potentially creating a vicious cycle of increased loan default rates, thus affecting the financial performance negatively.

Credit risk, the likelihood of default by borrowers, adds another layer of complexity. Various events can trigger defaults, ranging from delayed repayments and restructuring to outright bankruptcy. The riskier the credit profile, the higher the potential for non-repayment, which again affects the bank's financial health.

The relevance of these factors to Kisii town's banking sector is not merely academic but has real-world implications for both financial performance and regulatory practice. In the increasingly interconnected world of global finance, understanding these dynamics can offer actionable insights for local banks and policy-makers alike. As such, evaluating the effects of loan repayment on the financial performance of Kisii's commercial banks becomes an exercise in balancing risk and reward in an uncertain environment.

By integrating the Dealership model into the study, it is possible to create a more nuanced understanding of how banks in Kisii town might maneuver these uncertainties. This could be

particularly useful for regulators and bank management in developing strategies to improve financial performance while ensuring a healthy loan repayment culture.

### **2.1.3 Financial Intermediation Theory**

The Financial Intermediation Theory provides a comprehensive framework for examining the impact of domestic savings on the financial performance of commercial banks in Kisii town. This theory, originally propounded by Gurley and Shaw (1955), posits that financial intermediaries like commercial banks play a crucial role in channeling funds from savers to borrowers, thereby facilitating economic growth and development.

In the context of Kisii town, the theory elucidates how commercial banks act as conduits that transform domestic savings into productive loans. The more efficient this intermediation process, the higher the financial performance of the banks, as measured through metrics like Return on Assets (ROA) and Return on Equity (ROE). This importance is magnified in developing regions where financial markets are not fully matured, hence banks become the primary channel for mobilizing domestic savings (Ghosh, 2016).

The Financial Intermediation Theory also suggests that the interest rate spread—i.e., the difference between the interest rate on loans and the interest rate paid to depositors—is a key determinant of a bank's profitability. According to Demirgüç-Kunt and Huizinga (1999), a wider interest rate spread often indicates a bank's effectiveness in financial intermediation. In Kisii town, the need for wider spreads might be magnified due to operational costs and credit risk associated with lending in less developed markets. However, it is critical to balance this against the economic implications such as reduced access to credit for potential borrowers (Mishkin, 1999).

Moreover, the theory warns about the implications of regulatory constraints. For instance, stringent capital requirements or restrictions on interest rates can impede the bank's ability to leverage domestic savings efficiently (Barth, Caprio & Levine, 2004). This is particularly relevant for commercial banks in Kisii town, which operate in a regulatory environment defined by the Central Bank of Kenya.

Methodologically, the implications of this theory can be empirically tested using econometric models that examine how variations in domestic savings rates affect different financial performance indicators. Multiple regression analysis, for instance, can be employed to isolate the impact of domestic savings from other variables such as inflation rates, government policies, and external economic conditions (Levine, Loayza & Beck, 2000).

In summary, the Financial Intermediation Theory offers a robust analytical lens for understanding how domestic savings could impact the financial performance of commercial banks in Kisii town. Future empirical studies may leverage this theoretical framework to generate actionable insights that can guide policy interventions aimed at optimizing the financial performance of banks through domestic savings mobilization.

## **2.2 Empirical Review**

The following sections describe the empirical literature reviewed as per each objective of the study.

### **2.2.1 Effect of cash lending on financial performance of commercial banks**

Making choices about the lending of securities for reinvestment is referred to as cash lending. Keane (2013) conducted research on the implications of reinvestment risk brought on by cash-collateralized securities loans. According to what he discovered, the most common kind of

transaction involving the lending of securities is one in which the loan is secured by a cash deposit. The purpose of the study was to suggest that the conventional pay plan for securities lending agents, which in most cases allows for agents to partake in earnings but does not allow them to share in losses, generates incentives for such agents to take on an excessive amount of risk. Additionally, it brings to light the need for a more in-depth investigation and comprehension of cash reinvestment techniques, particularly in the context of the experiences of investors. In his study, he came to no conclusions about the rate of return on investments.

Borrow and cash contributes its own funds to the lending institution as a kind of collateral. This is by far the most prevalent kind of investing in the performance of a firm. This program utilizes a tailored term loan in the form of a portfolio of securities as its funding source. Because of the individualized nature of the transaction, it is difficult to provide a comprehensive explanation of how it should be used. Having said that, debtors have the ability to negotiate a yearly fee in exchange for the right to borrow assets from the beneficial owner's whole portfolio. According to Lipson (2012), the yearly charge may be considered a fair deal for the lender or borrower of the assets that are kept in that portfolio. In his conclusion, he contends that risk seeking incentives in agent remuneration structures are the cause of cash market reinvestment activities. This is an awkward mix, but it did lead to transactions in the process of sourcing particular assets for assured market transactions. Although it may be tempting to advise doing away with the practice of lending securities in exchange for cash collateral, such a policy reaction may be too severe. An increase in data openness, in particular about options for capital reinvestment, is expected to minimize the potential of fair costs to bear if it is successful in mitigating financial systemic disruption.

Andrian, Begalle, Copeland, and Martin (2011) conducted research at the Federal Reserve Bank of New York to investigate the impacts of Securities and Repo Lending. He conducted a descriptive analysis and concluded that market participants should consider the societal advantages of enhanced transparency and the importance of adjusting standard compensation models for agents. This approach aims to minimize the risk of agents in the securities for cash sector pursuing improper incentives, with the industry meticulously monitoring investment returns as a key measure of performance. This is not a typical form of securities loan transactions. He came to the conclusion that cash providers, in situations where the transaction was not driven by the inherent worth of the collateral, should closely supervise the loan transaction as a credit extension. A counterparty that advances a significant quantity of cash will want to have a solid grasp of the reinvestment activity that the cash facilitates. Given that currency is fungible and cash borrowers or security lenders may have incentives to reveal a believable but erroneous description of an asset to invest in, it is feasible that such due diligence might prove to be difficult or even impossible in reality. Vermeulen and Fuss (2006) investigated how the reactions of a company's investments and financing to negative cash shocks were analyzed. The function of bank connections inside the European Central Bank was the focus of the study's primary objectives. His primary objective was to investigate the consequences that monetary restraints, loan relationships, business investments, and firm financing had. He came to the conclusion that his economic theory indicated that loan connections are helpful in addressing asymmetric information difficulties between creditors and their customers. He came to this conclusion after finding that his economic theory had recommended that.

As a consequence of this, businesses who have established strong lending ties have favorable credit circumstances. It is specifically in terms of unfavorable cash flow, he argues, that financial restrictions are more likely to be binding, and that enterprises more strongly need external capital. As a result, firms are required to cut expenditure, including investment spending, in order to satisfy these financial constraints. Both enterprises with a single bank connection and those with numerous bank relationships exhibit the same investment responsiveness to cash flow in times of negative cash flow shocks. When things are difficult, having a connection with only one bank is not very useful in easing the pressures caused by financial limits. In the end, he looked into the factors that determined how likely it was for him to receive further bank loans. It was shown that the chance of acquiring bank credit during unfavorable cash flow shock times is greater the bigger the business and the smaller the initial leverages are. This is in contrast to the situation where a single bank has a reduced probability of obtaining bank credit. According to the data, it was determined that the factor that significantly inhibits investment in times of poor cash flow conditions is the accumulation by companies of a decrease in cash flow and a contraction of external bank credit. It is the size of the company as well as its initial leverage that are more important factors to consider than the number of bank partnerships.

Establishing a financial institution with the intention of providing financial services in order to generate a profit is the primary motivation for doing so. The degree of profit that a firm generates is directly proportional to how well it will be able to continue operating in the future. Banks, on the other hand, are financial entities that provide their customers various financial services with the intention of making a profit. As part of the position of economic intermediary that they perform in an economy, banks provide credit to their clientele in the form of loans; however, these loans

come with a cost in the form of interest. Ngugi (2001) pointed out the significance of charging interest on borrowed money, highlighting that the value of the borrowed sum could diminish over time. Consequently, the interest rate serves as a fee for borrowing assets and mirrors market expectations about shifts in money's purchasing power or anticipated inflation. Essentially, the interest rate represents the cost of using borrowed resources. The mobilization of funds, the diversification and pooling of risk, and the distribution of resources are all made easier by the presence of financial institutions. Intermediaries such as banks suffer some costs as a result of the fact that the receipt for deposits is not always synchronized with that of loans (Ngugi 2001). As a result of this, financial institutions impose a cost on their customers in exchange for the financial mediation services they provide, and they also determine the rate of interest that applies to both deposits and loans.

Rhyne (2002) describes the intermediation cost as the gap between the total cost of borrowing and the net earnings from a loan. This cost also encompasses several elements such as costs related to information, transactions, administration, defaults, and operations. Moreover, the interest rate set by each financial institution for loans is influenced by the level of risk they are prepared to accept. The degree of risk that risk-averse banks are willing to incur enables them to maintain a narrow interest spread while yet being profitable. This is nevertheless owing to the fact that increased risk aversion causes an increase in the optimum interest rate of banks and a reduction in the quantity of loan supplied.

As to Emmanuelle's (2003) findings, macroeconomic variables such as monetary and fiscal policy actions have an effect on the real spread, which encompasses the pure spread. Emmanuelle asserts

this. Another factor influencing the interest spread that the banks provide is the market structure within which they operate. It is predicted by Ng'etich and Wanjau (2011) that the banking industry would maximize either the expected profit or the expected utility of profit, depending on the market structure and risk management. Whichever is deemed to be maximized, this is still the case. Furthermore, they state that the expected market structure determines the variable component of the interest rate spread. For example, one must first assume that there is a deposit rate and market power in the lending market in order to trace the interest rate spread using the change in loan rate. The term "interest rate spread" refers to the difference between the lending rate and the deposit rate when a corporation has a dominant market position in both of these categories.

An independent research by Chand (2002) and ADB (2001) states that a number of factors have been found to be in charge of the excessive interest rate spreads. A lack of sufficient competition, scale diseconomies brought on by the market's small size, high fixed and operating expenses, high transportation costs, higher communication costs, the presence of regulatory restrictions, and perceived market risk are a few of these factors. We want to look at how the interest rate differential impacts the total profitability of the Kenyan banking industry within the parameters of this research. In order for the researcher to accomplish this goal, he or she will investigate the overall performance of all of the commercial banks located in Kisii town throughout the course of the years 2015-2018. This time period was chosen because it corresponds to when interest rate capping was implemented in Kenya; as a result, it will provide an accurate depiction of the impact that interest spread has had on the Kenyan banking sector during this time period. In addition, it is presumed that Kenya has implemented some decent financial reforms over this time period.

Abiodun and Tennant (2008) are just some of the researchers who have looked at the determinants of interest rate spread both inside and outside of Nigeria. However, none of these researchers have actually investigated the effect that interest spread has on the overall performance of the banking industry. The majority of these research have looked at the elements that determine the interest rate spread, with the goal of determining the causes that are to blame for the large interest spread. Both an independent study conducted by Chand, (2002) and one conducted by the Asian Development Bank, (2001) have compiled a list of the several factors that contribute to the region's significant interest rate spread. They go on to say that the reasons that were discussed above contribute to high intermediation costs, which in turn result in large spread. In particular, these research have uncovered one of the expenses that is connected with the capability of enforcing debt contracts, which is considered to be one of the most visible costs. Small debtors who don't have any property rights don't have anything to present as collateral. As a consequence of this, many see them as high-risk borrowers. These types of borrowers are hit with exorbitant interest rates due to the significant processing fees involved in the loan process. In the same vein, Chand (2002) calls attention to problems associated with governance. It has been shown that a lack of security is a source of high transaction costs, which in turn results in big intermediation costs. The latter comprises the preservation of law and order, as well as the supply of essential transport and social infrastructure. All of these things have an impact on security. According to Chand (2002), when there is a high intermediation cost, which is represented in a large interest rate spread, the borrower may be unable to repay his or her loan due to the cost of such borrowings.

Abiodun and Tennant (2008) investigated the variables influencing the spreads between banks' deposit and lending rates in SSA countries from both a market and a macroeconomic standpoint

using a dynamic panel data estimation technique. The study's conclusions, which were based on annual data from 33 countries and indicated that various markets and macroeconomic policy issues contribute significantly to the explanation of variations in IRS throughout the region, imply that the data were utilized to cover 33 countries. The paper shows, among other things, that the degree to which the government stifles competition in the banking industry, public sector deficits, the discount rate, the level of inflation, the amount of money supply, the reserve requirement, the degree of economic development, and the population size are significant factors that affect interest rate spreads in SSA countries.

### **2.2.2 Effects of loan repayment on financial performance of commercial banks**

Loan repayment schedules, which can be segmented into short-term and long-term phases, significantly impact borrower behavior and the effectiveness of financial institutions. A deeper examination of the studies by Godquin, Santiago and Francisco, Fishman and Love, Cock, and Hopenhayn reveals complex dynamics that influence the repayment of loans and investment decisions.

Godquin's (2004) study on the effectiveness of MFI borrowers in Bangladesh provides critical insights into how loan structuring can affect repayment behavior. His research demonstrated that loans with refined repayment periods are associated with lower incidences of delinquency compared to standard loans. This finding is crucial as it suggests that properly structured loans, which consider the repayment capacity and income cycles of borrowers, can significantly reduce the risk of default. The study supports the notion that a reduction in the number of loan repayment clients, potentially through more tailored loan products, can enhance the overall efficiency and performance of MFIs (Godquin, 2004). This aligns with broader microfinance principles that

emphasize the importance of understanding the unique financial situations of borrowers to design better financial products that can mitigate default risks.

Santiago and Francisco (2008) investigated the effects of bank lending and financial constraints on the investment activities of SMEs. Their findings indicate that businesses not under financial constraints do not exhibit a significant relationship between their investment activities and bank loans. This suggests that for these unconstrained firms, investment decisions are likely influenced by factors other than immediate access to bank loans, such as internal cash flows or alternative financing sources. Moreover, the study found that unconstrained businesses often use bank loans to anticipate investment needs and to provide trade credit to other businesses, highlighting a strategic use of financing to maintain liquidity and support supply chain relationships (Santiago & Francisco, 2008). This behavior underscores the multifaceted role of bank loans in business operations, extending beyond simple capital acquisition to include financial planning and risk management.

Fishman and Love (2004) explored the influence of bank loans on investment valuation using a novel assessment approach. Their research revealed that simplifying the lending process encourages more businesses to take loans and subsequently repay them. This finding is important as it emphasizes the role of streamlined loan processes in promoting borrowing and investment activities. However, Fishman and Love did not explore the implications of interest rates on investment, which is a critical gap in their study. Interest rates directly affect the cost of borrowing and can significantly influence a firm's decision to take on debt for investment purposes (Fishman & Love, 2004). Future research could benefit from examining how varying interest rates impact the relationship between bank loans and investment to provide a more comprehensive understanding of the factors driving investment decisions.

Cock (2002) conducted a study on micro-businesses and social capital, focusing on the duration of loan terms and their impact on repayment behavior. He observed that if the loan duration is too short, borrowers may struggle to generate sufficient income to meet repayment schedules, leading to higher default rates. Conversely, excessively long loan terms can lead to borrower complacency and financial mismanagement, ultimately resulting in defaults. This finding highlights the need for a balanced approach in setting loan durations to optimize repayment outcomes. Loans should be structured to allow borrowers enough time to generate income while maintaining a sense of urgency to repay the loan, thus preventing extravagance and financial indiscipline (Cock, 2002). This balance is crucial for micro-businesses, which often operate with thin margins and variable income streams.

Hopenhayn (2006) examined the determinants of bank loans and investment, focusing on constrained enterprises. His research indicated that the amount of requested loans often exceeds the amount provided, reflecting a significant unmet demand for financing in these businesses. Additionally, Hopenhayn found that the level of investment in constrained firms could be predicted based on the amount of desired loans, suggesting that access to adequate financing is a key determinant of investment capacity. However, Hopenhayn did not address the impact of interest rates on investment, which remains a critical factor in understanding how financial constraints affect investment decisions (Hopenhayn, 2006). High interest rates can deter borrowing and investment, particularly for constrained firms that already face significant financial hurdles.

In conclusion, the structuring of loan repayment schedules and the availability of financing play crucial roles in borrower behavior and the investment decisions of businesses. The studies reviewed highlight the importance of understanding the unique financial needs of borrowers, the strategic use of bank loans, and the impact of loan terms on repayment and investment outcomes.

For policymakers and financial institutions, these insights underscore the need to design loan products and lending processes that support sustainable financial practices and promote economic growth. Future research should continue to explore the interplay between loan terms, interest rates, and investment to provide a more comprehensive understanding of the factors influencing financial behavior and performance.

### **2.2.3 Effect of domestic savings on financial performance of commercial banks**

Demirguc-Kunt et al. (1998), Moore et al. (2000), and Sologoub (2006) claim that bank-specific variables are the main determinants of interest rate spreads. These variables include the bank's size, ownership structure, loan portfolio, capital sufficiency, operational and administrative expenses, and proportions of fixed and liquid assets. In point of fact, Beck et al. (2006) are in agreement with this and go on to emphasize that the primary factor influencing interest rate spreads in Uganda is the size of the bank, in addition to administrative expenses and the sectoral compositions of loans. In their analysis of the elements that are unique to the sector and market, Samuel et al. (2006) found that greater spreads are the outcome of an oligopolistic market structure. This finding is consistent with the findings of Hannan et al. (1993) and Barajas et al. (1999), who discovered that bigger spreads are positively correlated with greater industrial concentration.

In their study, Van Leuvensteijn, Kok-Srensen, Bikker, and van Rixtel (2006) evaluated the influence of loan market competition on the interest rates applied by euro area banks to loans and deposits over the 1994-2004 periods. They did this by using a unique measure of competition known as the Boone indicator. The study's findings showed that competition in the loan market

had an effect on the interest rates. They discover data that supports the hypothesis that increased levels of competition should result in much reduced bank spreads across the majority of loan market goods. The conclusion that can be drawn from their findings is that increased levels of competition lead to both reduced interest rates charged by banks and a more robust transmission of shifts in market interest rates. The error correction model (ECM) that they developed for bank rates provided this glaring piece of evidence. In addition, they found that regions with more intense competition in the loan market had bigger bank spreads (or, alternatively, lower bank interest rates) on current accounts and time deposits. The ECM calculations support the conclusion that time deposit rates have decreased. However, the level of competitive pressure in the market for loans is far higher than the level of competitive pressure in the market for deposits; hence, in order for banks to compensate for a drop in revenue from the loan market, they reduce the interest rates on deposits they charge. They went on to note that bank interest rates in more competitive markets react more strongly and (for short-term loans to companies) more quickly to changes in market interest rates. This was a further observation that they made.

When Ngugi (2001) analyzed the interest rate in Kenya, he discovered that after interest rate liberalization, there was a widening interest rate spread. This spread was characterized by high implicit costs and was associated with restrictive monetary policy, which was accomplished via higher reserve and cash ratios and reduced non-performing assets. According to research conducted by Maudos and Fernández de Guevara (2004), a rise in banks' market strength (also known as a decrease in the amount of pressure exerted by competitors) leads in larger net interest margins. In addition, Corvoisier and Gropp (2002) provide an explanation for the disparity between the interest rates offered by banks to their retail customers and the rates offered by the

money market by referring to the product-specific concentration indices offered by banks. According to their research, highly concentrated markets had much higher retail lending rates, while having significantly lower deposit rates.

According to Demirguc-Kunt and Huizinga (1997), the interest spread shifts as a result of the changing proportion of debt to equity financing. Banks raise their deposit rates to compete for cash from the general public when the equities market grows and offers competitive returns. As a result of the expanding market, the banking industry is exposed to less risk, and as a result, banks are able to charge competitively lower loan rates, which results in a reduction in the interest rate margin. The elasticities of deposit and credit demand also have an impact on the interest rate spread under monopolistic (or oligopolistic) structures. Under a competitive market system, however, the interest rate spread is not produced from any source other than central bank factors (such as reserve requirements, interest on liquid assets on deposit with the central bank, and discount window loans). He also found that the market strength of the credit market was higher than the deposit market. Elkayam (1996) noted that in a monopolistic market, an increase in the money supply under elastic demand reduces the spread more than in a competitive market. This was discovered when monetary policy was taken into consideration. In their study from 1997, Demirguc-Kunt and Huizinga showed that countries with less corruption, more effective contract enforcement, and more efficient legal systems were related with smaller realized interest margins. This is as a result of the decreased risk premium that is tied to the loan rate offered by the bank.

Ng'etich and Wanjau (2011) used a different approach in their research, looking at how interest rate spread affected the overall quantity of non-performing assets held by Kenyan commercial

banks. Descriptive research methodology was used in their study, which included a representative sample of Kenya's 43 operational commercial banks. They acquired data from primary data sources via the use of questionnaires, and they collected secondary data from the Bank Supervision Report in order to supplement the conclusions of the main data sources. When analyzing the data for their study, the researchers employed both quantitative and qualitative approaches. Their objective was to ascertain the nature of the relationship between loan default and the interest rate spread. They concluded that since the interest rate spread increases the cost of loans imposed on borrowers, it affects performing assets in banks. They also came to the conclusion that interest rate rules have a significant impact on assets that are underperforming. These laws set the interest rate spread in banks and lessen the moral hazard that results from non-performing assets (NPAs). Credit risk management strategies have little effect on the value of a bank's interest rate spread since interest rates are benchmarked against the associated non-performing assets, and non-performing assets are linked to high loan costs.

As noted by Barajas and Salazar (1998), it is crucial to remember that a compromise may always be reached when doing a spread analysis. It is true that a large spread may lead to substantial bank profits, which might support system safety and stability if they are invested in the system's capital basis. It is true that a high spread may cause a high level, even if high levels are often symptomatic of inefficiency, excessive risk-taking, or a lack of competition in the banking industry. This has particular importance when considering developing countries, since the implicit government rescue promise often leads to a situation of moral hazard inside the financial system. From a society perspective, it is unclear whether banking system would be preferable—one with low spreads and a low capital base that would need government assistance, or one with huge spreads and a high

capital basis that would not. This might also be seen as a challenge to the bank's franchise value, which has been shown to be a crucial element in limiting moral hazard and taking unwarranted risks (Caprio and Summers, 1993; Hellman, Murdock, and Stieglitz, 1998). [Hellman, Murdock, and Stieglitz, 1998; Caprio and Summers, 1993]. A bank crisis may be less likely than it would be in the case of a competitive system with smaller spreads if big spreads are the outcome of market dominance, which in turn indicates a high brand value.

There aren't many research in Nigeria in this area, however Muhammad (2012) found the variables that affect the cost of financial intermediation (CFI) in a few selected listed banks in Nigeria. It was discovered that these elements were loan loss provision, operating expenditures (OE), and financial intermediation. Regardless of whether the differences are measured using narrow or wide interest rate spread definitions, he contends that these factors should be prioritized in the effort to understand the variations in the costs that commercial banks bear when offering financial mediation. Olajide (2012) uses the premise that interest rates are a combination of a domestic rate under autarky and the uncovered interest parity rate in a fully open economy to investigate and reexamine the Nigerian banking industry. He does this by reexamining and x-raying the banking sector in Nigeria. He concluded that Nigeria's low infrastructure, returns on foreign investments, and inflation rate all had an impact on interest rate spread.

It is important to remember that, although though this area of study has seen a lot of research, very few of those studies have looked at how interest spread affects the performance of the banking industries. Ng'etich and Wanjau (2011) used a descriptive research design to examine the impact of interest rate spread on the productivity of the Kenyan banking industry. To make inferences

regarding the link between the two variables, this was done. They concluded that the performance of Kenya's banking sector is influenced by variations in interest rates. Wensheng, Lai, Leung, and Shu (2003) investigate the impact of an interest rate shock on the overall performance of the Hong Kong banking industry in their research. None of the studies, in spite of their abundance, have looked at the relationship between the rate of interest spread and the growth of the Nigerian economy. With their work, the researcher intends to close this gap.

#### **2.2.4 Bank Financial Performance**

Evaluating performance in the banking sector entails a multi-faceted approach that transcends straightforward financial metrics. While conventional indicators such as Return on Investment (ROI) and Return on Assets (ROA) remain pivotal in assessing a bank's financial health, they are part of a more comprehensive tapestry (Ho & Saunders, 2001; Chenn, 2011). This holistic view also encompasses a gamut of other metrics such as earnings before and after tax, asset depreciation and appreciation rates, and broader asset-based developments.

A thorough performance analysis necessitates the dissection of various financial statements, including the statement of cash flows, the statement of changes in owner's equity, and the income statement. These financial documents serve as the empirical bedrock for conducting a Strengths, Weaknesses, Opportunities, and Threats (SWOT) analysis (Chenn, 2011). According to Quarden (2004), such an analytical framework is indispensable for both short-term and long-term financial planning, as it allows for predictive analytics regarding future investment opportunities and risks. Financial analysts employ a myriad of performance indicators to evaluate a bank's financial standing. The analysis traditionally incorporates operational efficiency ratios such as the asset efficiency ratio and the deposit-to-loan ratio. Other critical ratios include the Non-Performing

Loans (NPL) to total loans ratio, liquidity ratios, financial efficiency ratios, profitability ratios, and solvency and coverage ratios (Bekana, 2011). These composite metrics offer an integrative view of a bank's financial health, enabling stakeholders to make informed decisions (Demirgüç-Kunt & Huizinga, 1999).

Furthermore, the empirical literature on banking performance often underscores the interrelatedness of these variables. For instance, a study by Barth, Caprio, and Levine (2004) posited that a strong regulatory framework is essential for enhancing the efficiency ratios, thereby indirectly affecting the ROI and ROA. Similarly, a study by Levine, Loayza, and Beck (2000) found that higher deposit-to-loan ratios correlate with better profitability ratios, suggesting an interdependence among different performance metrics.

Notably, modern banking environments necessitate an understanding of these interconnected financial parameters in real-time. As illustrated by Berger and Humphrey (1997), banks are increasingly leveraging data analytics and machine learning techniques to optimize their performance measures, adding an extra layer of complexity to traditional financial performance evaluation.

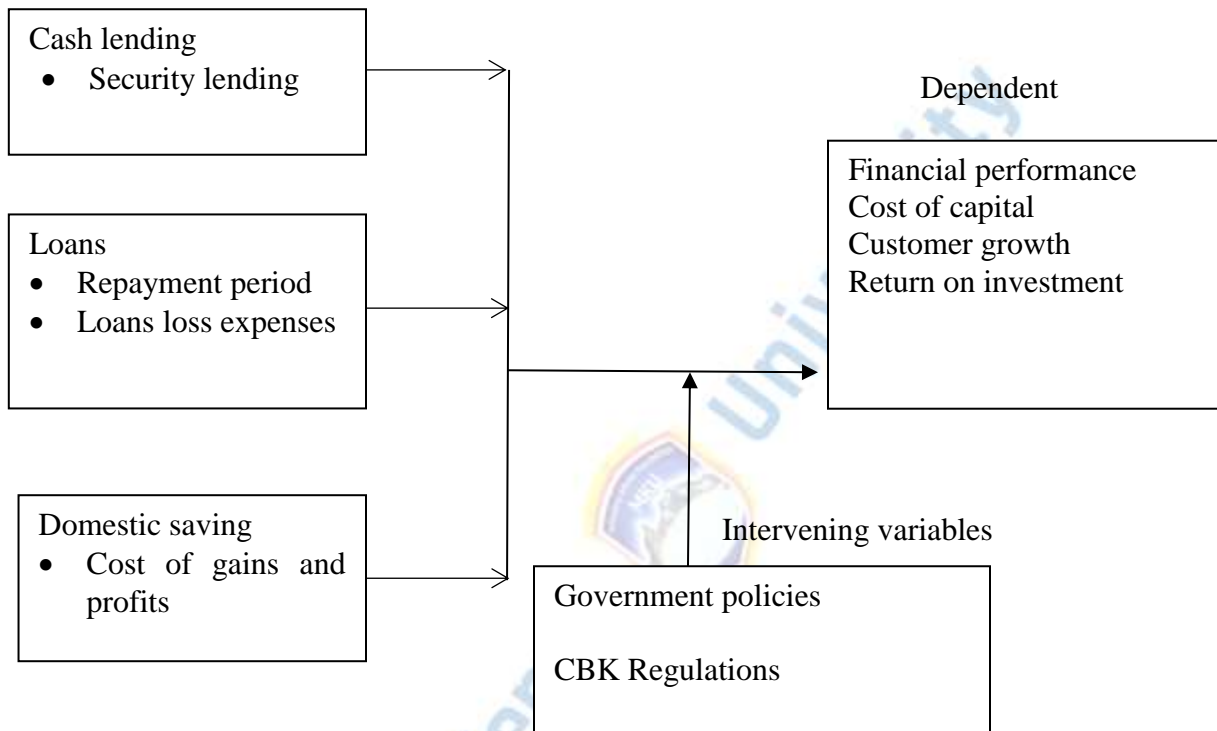
In summary, assessing a bank's performance is a complex task requiring a nuanced approach that integrates various financial metrics and ratios. Empirical literature increasingly supports a multi-dimensional perspective that includes both traditional indicators and innovative analytics techniques, substantiating the intricacy and interconnectedness of the metrics used for evaluation.

### **2.3 Conceptual Framework**

The diagrammatic representation of conceptual framework shows how the variables are related. Cash lending, Loan repayment period, and domestic savings are independent variables but

investment performance is a dependent variable. This is summarized in Figure 1 where a relationship between variables is shown.

Independent variables



**Figure 1: A conceptual framework showing the relationship between variables**

**SOURCE: AUTHOR 2018**

## 2.4 Literature Gap

In the existing literature, it is evident that credit repayment significantly impacts various types of financial institutions. Tomaki's (2013) research concentrated on the bank-specific variables influencing lending behaviors among Turkish commercial banks. His study revealed that factors such as bank size, capital adequacy, and profitability significantly influence lending decisions.

However, Tomaki's analysis did not adequately explore broader determinants such as the savings behaviors of depositors, which can also affect the availability of loanable funds and ultimately influence lending practices (Tomaki, 2013). A comprehensive examination of these broader factors could provide a more holistic understanding of the lending behavior in Turkish commercial banks. In another study, Kinyanjui (2010) examined how gender impacts loan repayment practices among commercial banks in Kisii District. Kinyanjui's research found that female borrowers had a higher loan repayment rate compared to their male counterparts, attributing this to women's generally more cautious financial behavior. While important, the study could have been more comprehensive by considering additional borrower characteristics such as age, educational background, and occupation, which could also influence repayment practices (Kinyanjui, 2010). Including these variables might provide a more nuanced understanding of the factors that affect loan repayment behaviors across different demographic groups.

Similarly, Bhatt and Tang (2002) investigated the factors affecting loan repayment in U.S. microcredit programs. Their study highlighted the role of situational variables such as borrower income levels, employment status, and access to business support services in influencing loan repayment outcomes. Bhatt and Tang's work underscores the ongoing debate among scholars concerning the situational variables that influence loan repayment, including country-specific, bank-level, and regulatory considerations (Bhatt & Tang, 2002). These debates suggest a need for more rigorous quantitative analyses to clarify these variables further and to understand their interplay in different economic contexts.

Moreover, two related Kenyan studies by Mwangi (2012) and Wanjira (2010) focused on the impact of non-performing loans on the financial outcomes of commercial banks. Mwangi's study emphasized the negative impact of high levels of non-performing loans on banks' profitability and

liquidity, while Wanjira's research explored the causes of non-performing loans, including poor credit risk management and economic downturns (Mwangi, 2012; Wanjira, 2010). However, both of these works largely confined their analysis to variables specific to commercial banks, without considering the broader economic and regulatory environment that could also affect non-performing loan levels.

Notably absent in the existing literature is a focus on the effects of interest rate spreads on the financial performance of commercial banks. Interest rate spreads, defined as the difference between the interest rates charged on loans and the interest rates paid on deposits, are a critical determinant of bank profitability. This gap in the literature is significant because interest rate spreads can influence the cost of borrowing, the availability of credit, and ultimately the repayment behavior of borrowers. By concentrating on this overlooked area, this study aims to fill a critical research gap and provide new insights into the complex relationships among interest rate spreads, credit repayment, and overall financial performance (Tomaki, 2013; Kinyanjui, 2010; Bhatt & Tang, 2002; Mwangi, 2012; Wanjira, 2010).

Expanding on Tomaki's (2013) findings, future research could explore how savings behaviors influence the lending capacity of banks. Savings behaviors determine the pool of funds available for banks to lend, which in turn affects their lending practices. A comprehensive analysis that includes both savings and lending behaviors could provide a more holistic understanding of the financial ecosystem within which banks operate (Tomaki, 2013).

Building on Kinyanjui's (2010) work, further studies could incorporate a wider range of borrower characteristics to understand their impact on loan repayment. For instance, age could influence repayment behavior as younger borrowers might have different financial priorities and risk profiles compared to older borrowers. Educational background could affect financial literacy and thus

repayment practices, while occupation might influence income stability and the ability to repay loans (Kinyanjui, 2010).

Bhatt and Tang's (2002) study could be extended by examining how different regulatory environments impact loan repayment in microcredit programs across various countries. Such an analysis could reveal how country-specific regulations and economic conditions influence borrower behavior and loan performance. Additionally, exploring the role of bank-level factors, such as credit risk management practices and institutional support, could provide deeper insights into the determinants of successful loan repayment (Bhatt & Tang, 2002).

Mwangi's (2012) and Wanjira's (2010) research could be enhanced by examining the broader economic and regulatory factors that contribute to non-performing loans. For instance, macroeconomic stability, regulatory oversight, and the legal framework for credit enforcement could all play significant roles in determining the levels of non-performing loans in the banking sector. By incorporating these factors, future studies could provide a more comprehensive analysis of the causes and consequences of non-performing loans (Mwangi, 2012; Wanjira, 2010).

Addressing the research gap related to interest rate spreads, future studies could investigate how variations in interest rate spreads impact the financial performance of commercial banks. This could involve analyzing how changes in monetary policy, competitive dynamics within the banking sector, and global financial conditions influence interest rate spreads. Understanding these relationships could help policymakers and financial institutions design strategies to optimize interest rate spreads and enhance financial stability and performance (Tomaki, 2013; Kinyanjui, 2010; Bhatt & Tang, 2002; Mwangi, 2012; Wanjira, 2010).

In conclusion, the existing literature provides valuable insights into various aspects of loan repayment and financial performance in different institutional contexts. However, there are

significant gaps that need to be addressed to gain a more comprehensive understanding of these issues. By expanding on the existing studies and incorporating broader determinants such as savings behaviors, borrower characteristics, regulatory environments, and interest rate spreads, future research can provide deeper insights into the complex dynamics of credit repayment and financial performance. These insights are crucial for designing effective policies and practices that promote financial stability and sustainable economic growth.



## **CHAPTER THREE**

### **RESEARCH METHODOLOGY**

#### **3.0 Introduction**

This section provides a comprehensive overview of the research framework and techniques that will be employed for this investigation. Specifically, it delves into the research approach, the targeted study population, the methodology for sample selection, the tools and procedures for gathering data, and the strategies for data interpretation and the dissemination of results. By offering a meticulous outline of these elements, this chapter sets the foundation for a rigorous and systematic inquiry into the research question at hand.

#### **3.1 Research Design**

To address the research questions, this study employed a descriptive research design, a methodology well-suited for capturing data and attributes related to the population or specific subject under investigation. As articulated by Mugenda and Mugenda (2003), a descriptive research approach serves as a mechanism for gathering data with the primary purpose of characterizing an identified phenomenon, without necessitating any manipulation of variables. In the context of this study, focusing on interest rate spreads, the descriptive design offered several advantages.

First, the descriptive research design enabled a comprehensive portrayal of the current conditions, ensuring that the data collection process was carried out with minimal bias. This thoroughness was crucial for reducing interpretive errors when analyzing the collected data. Second, a descriptive approach aligned with formal research paradigms, in that it commonly relied on well-defined hypotheses and research questions, adding rigidity and methodological structure to the

investigation. As noted by Coopers and Schindler (2011), studies adopting a descriptive framework tended to have clearly outlined hypotheses and research questions, enhancing the robustness and credibility of the findings.

Therefore, given the need for an in-depth, unbiased examination of the effect of interest rate spreads on the financial performance of commercial banks, a descriptive research design offered a suitable and efficient methodological framework for this study.

### **3.2 Study location**

The research took place in Kisii town, a hub for banking activity with a total of 17 commercial banks in operation. These financial institutions encompassed a diverse range of banks, including but not limited to Family Bank, Kenya Commercial Bank, Cooperative Bank, Equity Bank, and Barclays Bank. Additionally, the banking landscape in the town featured smaller or specialized financial institutions such as Chase Bank, Sidian Bank, Credit Bank, Jamii Bora, and Housing Finance Corporations. Completing the list were Post Bank, Diamond Trust Bank, Chartered Finance Corporation, Bank of Africa, National Bank, I&M Bank, and NiC Banks.

Given this rich diversity of banking institutions, Kisii town presented an ideal setting for investigating the effects of interest rate spreads on the financial performance of commercial banks. Each of these banks offered a unique blend of services, market strategies, and customer bases, thereby providing a comprehensive landscape for in-depth analysis. Furthermore, the variety of these financial institutions enabled a multifaceted exploration of how different banks responded to interest rate spreads, allowing for an enriched understanding of the research subject.

This choice of location not only offered a real-world scenario where commercial banks operated under different strategies and market conditions but also afforded a comprehensive view of the

complexities and dynamics surrounding interest rate spreads in the banking sector. Consequently, findings derived from this setting were likely to offer actionable insights that could be generalized to other similar urban banking environments.

### **3.3 Target Population**

According to Coopers and Schindler's 2014 definition, a "population" encompasses the entire set of elements for which the research aims to draw conclusions. In this context, the population referred to specific individuals within the organization who were integral to the research focus. The study aimed to involve those individuals who were directly responsible for strategic decision-making related to financial performance and interest rate spreads in the commercial banks in Kisii town.

For this study, the targeted population included three key groups within these banking institutions: branch managers, credit officers, and section heads. Specifically, there were 17 branch managers, 78 credit officers, and 132 section heads, totaling 227 professionals who were crucial in shaping and implementing financial strategies in these banks. A detailed breakdown of the study's target population was outlined in Table 1.

This targeted population was instrumental in providing insights that helped answer the research questions, offering a robust basis for meaningful analysis. Their roles in financial decision-making within their respective organizations made them ideal participants for this study.

**Table 1: Target Population**

<b>Employee type</b>	<b>Number of employees</b>	<b>Percentages (%)</b>
Bank Managers	17	7.0
Loan Officers	78	34.0
Section heads	132	58.0
<b>Total</b>	<b>227</b>	<b>100.00</b>

**Source: Commercial banks in Kisii town (2018)**

### **3.4 Sampling size and sampling procedures**

Mugenda and Mugenda (1999) describe a sampling frame as a comprehensive list of all the units from which a sample is drawn. It consists of a directory of elements selected for sampling. When the target population is extensive, strategies are implemented to help the researcher pinpoint every member of that population. This representative population makes up the sampling frame. Given that the target population is not too big to manage, the researcher will use the census method to determine the sample size. This implies that the entire targeted group will be the study's sample size.

**Table 2: Sample size and sampling procedures**

<b>Employee type</b>	<b>Number of employees</b>	<b>Percentages (%)</b>	<b>Sampling procedure</b>
Bank Managers	17	7.0	Census
Loan Officers	78	34.0	Census
Section heads	132	58.0	Census
<b>Total</b>	<b>227</b>	<b>100.00</b>	

### **3.5 Research Instruments**

The researcher will use questionnaires and interview schedules to collect the data.

#### **3.5.1: Questionnaires for loan officers and section heads**

As articulated by Kombo and Delno in 2006, a questionnaire serves as a tool for collecting data across an expansive sample size. It consists of a series of questions focused on specific topics, which the respondents are expected to answer. The unique feature of using a questionnaire is that it offers respondents full autonomy to complete it according to their own schedule. This flexibility makes it a convenient method for gathering data. Questionnaires are very useful and cost-effective in terms of finances regarding data collection.

Zikmund (2010) believes questionnaires and interviews are the most widely used research instruments in educational research since they inquire into the feelings, attitudes, and experiences of the respondents. The merits of a questionnaire are that it generates huge amounts of quantitative

data, enabling researchers to obtain a wider coverage of descriptive data in comparatively less time. According to Orodho (2003), the use of questionnaires ensures a standardized approach to question formulation, enabling straightforward comparison of responses across different participants. This uniformity enhances the reliability and validity of the collected data.

### **3.5.2: Interview schedules for branch managers**

The researcher collected data from the top-level management using interview schedules through face-to-face interactions. These instruments were structured with open-ended items. The use of interview schedules had the advantage of yielding more information from respondents compared to questionnaires, as it allowed for clarification and in-depth exploration of responses.

### **3.5.3: Document analysis**

The researcher used secondary literature sources during document analysis, which, according to Greener (2008), are sources available in the public domain, including published books, articles in journals, news media, and published business, government, and international body publications. Consequently, the researcher requested the branch managers to provide a summary of how the banks had been performing over the past five years.

## **3.6 Validity and Reliability of Instruments**

According to Orodho and Kombo (2002), a pilot test serves as an initial, scaled-down exploration aimed at assessing the practicality and statistical relevance of a research design. In this study, a pilot test was executed with Kenya Commercial Bank branches in Kisii town to evaluate the precision and reliability of the data collection tools. The choice of Kenya Commercial Bank for

the pilot was strategic, as it boasts the most extensive branch network among all banks in the town, thereby offering a representative sample for initial testing.

### **3.6.1 Validity of the data collection instruments**

According to Kothari (2008), validity refers to the extent to which the results derived from data analysis authentically mirror the subject matter being investigated. In essence, validity measures how well the empirical quantification of a concept genuinely captures the essence of that concept. In this instance, the validity of the questions in the questionnaire will be assessed by independent parties. The validity of the instruments will be achieved by consulting the supervisors.

### **3.6.2 Reliability of the data collection instruments**

Reliability refers to the degree to which an assessment tool produces stable and consistent results over repeated uses (Orodho, 2012). Following the initial pilot study, the reliability of the instrument will be assessed using the Cronbach Alpha coefficient, a commonly utilized metric in research. Gliem and Gliem (2003) suggest that an acceptable Cronbach Alpha value should generally be 0.70 or higher to indicate a reliable scale.

### **3.6.3 Establishing Credibility of the Research Instruments**

Credibility is the value of being believable or reliable; it is the quality or power of inspiring belief. Consequently, credible sources should be reliable, providing evidence that can be believed to be true. According to O'Keefe (2016), credibility is a judgment that readers make about how believable the writer is. It is important because participants frequently decide to respond to a persuasive message based not on the content but on their perception of the communicator.

### **3.7 Data collection procedure**

Upon receiving approval for the research proposal from Mount Kenya University, the researcher was issued an official introduction letter from the university. This letter was then used to secure a research permit from the National Commission for Science, Technology and Innovation (NACOSTI), as mandated by Kenyan research guidelines. This step ensured that the research was conducted in a manner that was ethically and procedurally sound, aligning with national research standards. Consequently, permission was sought from the management of the involved commercial banks before proceeding with the data collection exercise.

The researcher personally administered the questionnaires and ensured adequate time was accorded to each respondent to fill out the questionnaire comfortably. The respondents were requested to complete the questionnaires at their own convenience within a period of two weeks before the researcher collected them. The participants had the option of identifying themselves or remaining anonymous in the questionnaires. Anonymity was intended to inspire confidence in the respondents, encouraging them to provide more accurate and honest responses.

### **3.8 Data analysis procedure**

Following the gathering of survey data, the questionnaires will undergo a meticulous process of sorting, editing, categorizing, coding, and tabulation. The analytical framework for the study will employ quantitative methodologies, specifically utilizing both descriptive and inferential statistical approaches.

In the descriptive statistical phase, the focus will be on providing a condensed yet comprehensive summary of the raw data. Techniques such as frequency distributions and percentage calculations will be employed to bring clarity and organization to the mass of collected information. This will

offer an initial understanding of general patterns and trends within the dataset, essentially painting a vivid portrait of the current state of affairs regarding the subject matter.

When it comes to inferential statistics, chi-square analysis will serve as the selected technique for this study. This will allow for the evaluation of relationships between variables and provide deeper insights beyond the descriptive metrics. The chi-square test is especially suited for comparing observed data with expected data based on a specific hypothesis. This adds an additional layer of rigor to the study, as it allows for statements regarding the generalizability of the findings.

Through this integrated approach, combining both descriptive and inferential statistics, the study aims to offer a nuanced and robust analysis pertinent to its objectives. It is hoped that the use of these statistical techniques will lead to meaningful conclusions that can inform future research and policy decisions in the area under study.

### **3.9 Ethical Clearance**

Research ethics act as a guide to the behavior of the researcher when doing a study. They either help them or acceptably conduct the analysis considering the participants' rights. The researcher focused on some ethical issues that was considered before, during, and after the data collection.

The researcher observed the following ethical guidelines: informed consent; confidentiality and privacy; anonymity; mien and decorum; storage of data; and plagiarism, as explained below:

The participants gave information voluntarily. Informed consent is derived from the participant's right to freedom and to make their own decisions. It means that approval allows the participant to decide and puts some part of the responsibility on the respondent should a problem or challenge arise during the study (Louis et al., 2011). According to Ary (2010), informed consent ensured that participants are well aware of the risks of being part of the study and the consequences involved.

In this study, the researcher ensured that the participants who agree to participate are aware of the research goals. The participants also had the right to participate in the study or decline.

Respect for privacy is at the heart of ethical research with human participants (Ary, 2010). In this study, the researcher ensured the participants' privacy by securing data in the computer with a password to ensure that other people cannot access it without the researcher's consent. The researcher additionally grouped the respondents' responses so that each participant's score cannot be identified in the grouped data. The participants were assured that any data they provide was given out or shared with any other person, but rather it was used purely for research. Confidentiality ensured that the only time the source of the collected data is revealed to someone is when the researcher obtained the participant's consent (Ary, 2010).

Anonymity refers to the process of protecting the identity of specific individuals. In any research, the participants have the right to remain secret. The researcher ensured that the questionnaires did not contain the names of the participants to provide complete and total secrecy.

The information gathered from the participants was stored in extreme confidentiality to avoid leakage to illegal people. It was preserved in both hard and soft copies. The investigator did not disclose any gathered material to anyone for any reason.

The researcher uploaded her work into the TURNITIN software to ensure that clean work is plagiarism-free. It was done before each defense. The percentage index remained at most 15 %. It included the references. If the percentage is higher, the proposal document was cleaned and returned to the program until 15% or less.

## CHAPTER FOUR

### RESEARCH FINDINGS AND DISCUSSIONS

#### 4.1 Introduction

In this chapter, presented and discussed the research findings on the effects of spreading interest rates on the financial performance of commercial banks in Kisii town. The chapter is structured according to the research objectives, and includes detailed analysis and interpretation of the data collected.

#### 4.1 Response Rate

The study respondent rate was 207 constituting of 91.19% from a total of 227 in sample size. this means 20 respondents constituting of 8.81% of the respondents did not participate in this study. According to Patten (2016), a response rate of sixty percent or above is adequate in the field of research while completing a questionnaire. On the other hand, according to the findings of the Pew Research Center 2021, a response rate of fifty percent or higher on a questionnaire is considered to be very good, a response rate of sixty percent to seventy percent is considered to be good and a response rate of seventy percent or higher is considered to be excellent. According to the findings of the research, a response rate of ninety-eight point one percent is enough and even great for the analysis.

#### 4.2 Demographic Information

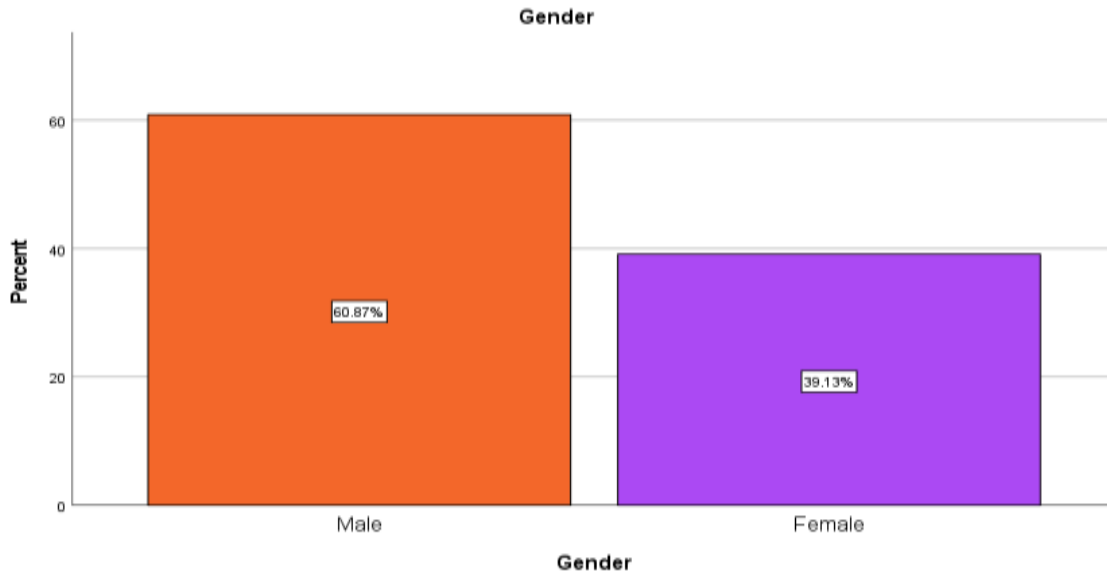
This section analyzes the demographic characteristics of the respondents. This section presents the descriptions of the respondents in terms of their gender, age and level of education of respondents.

#### 4.2.1 Gender Representation of Respondents

According to the findings, the majority of the respondents were male, which were 126 respondents constituting of 60.9% of the respondents, while 81 respondents constituting of 39.1% of the respondents were female. This indicates that males constituted the predominant group of respondents in this study. The cumulative percentage shows that male respondents alone account for 60.9% of the sample, and when combined with female respondents, the total reaches 100%. From these findings, we can deduce that the survey captured a diverse range of perspectives, although with a higher representation of males. This gender distribution is crucial for understanding the dynamics within the commercial banking sector in Kisii town, as it may reflect the demographic characteristics of bank clients or employees in this region. The data ensures that both male and female viewpoints are considered, albeit with a stronger male influence, which may be reflective of broader socio-economic patterns in the area. There is a also a figure included showing the distribution of Male and Females.

**Table 2 : Gender Representation of Respondents**

		<b>Gender</b>			
		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Male	126	60.9	60.9	60.9
	Female	81	39.1	39.1	100.0
<b>Total</b>		<b>207</b>	<b>100.0</b>	<b>100.0</b>	



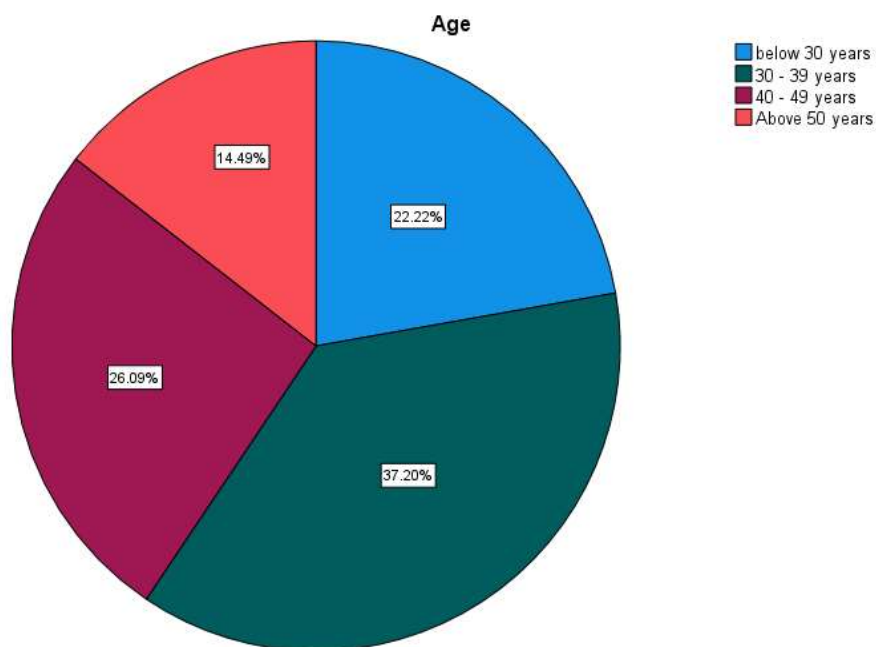
**Figure 1 : Gender Representation of Respondents**

#### 4.2.2 Age

According to the findings, the age distribution of respondents is varied. The largest age group is 30 to 39 years, comprising 37.2% of the respondents which is 77 individuals. This is followed by the 40 to 49 years age group, which makes up 26.1% of the respondents which are 54 respondents. Respondents below 30 years account for 22.2% of the respondents which are 46 respondents, while those above 50 years constitute 14.5% of the respondents which are 30 respondents. The cumulative percentage shows that 59.4% of the respondents are under 40 years of age, and 85.5% are under 50 years. This indicates that a significant majority of the respondents are relatively young, which may reflect the age demographic of the workforce or bank clients in Kisii town. This age distribution ensures that the data collected incorporates perspectives from various stages of life, with a notable emphasis on younger to middle-aged adults, likely providing insights based on a mix of emerging and established financial experiences. There is also a pie chart provided for the distribution of the ages.

**Table 3 : Age**

		Age		Valid	Cumulative
		Frequency	Percent	Percent	Percent
Valid	below 30 years	46	22.2	22.2	22.2
	30 - 39 years	77	37.2	37.2	59.4
	40 - 49 years	54	26.1	26.1	85.5
	Above 50 years	30	14.5	14.5	100.0
	Total	207	100.0	100.0	



**Figure 2 : Age**

#### **4.2.3 Department of operation**

According to the findings, the majority of the respondents work in the credit department, which accounts for 50.7% of the sample which are 105 respondents. This is followed by the finance department, with 39.6% of the samples which are 82 respondents. The ICT department is represented by 3.9% (8 respondents), and the human resource department by 3.4% (7 respondents). The management department has the least representation, with only 2.4% (5 respondents). The cumulative percentage shows that by the time we include respondents from the credit department, we have covered 96.6% of the total respondents, and including human resources brings it to 100%. From these findings, we can deduce that the majority of insights regarding the effects of spreading interest rates on the financial performance of commercial banks in Kisii town come from individuals working directly in finance and credit departments. This distribution suggests that the data heavily reflects the perspectives of those who are closely involved with financial operations and credit management, which are critical areas for understanding financial performance. This ensures that the responses are highly relevant to the research objectives, as these departments are integral to the operations affected by interest rates.

**Table 4 : Department of operation**

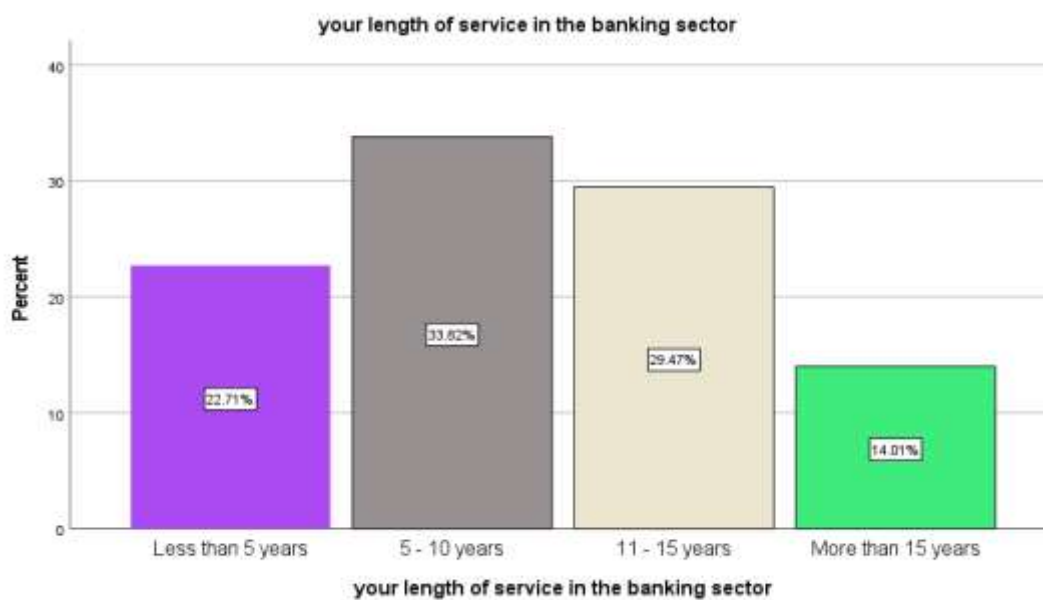
	Frequency	Percent	Valid Percent	Cumulative Percent
Valid management	5	2.4	2.4	2.4
finance	82	39.6	39.6	42.0
ICT	8	3.9	3.9	45.9
credit	105	50.7	50.7	96.6
Human Resource	7	3.4	3.4	100.0
Total	207	100.0	100.0	

#### 4.2.4 Length of service in the banking sector

The distribution of respondents across different departments within commercial banks in Kisii town reveals valuable insights into the organizational perspectives on the effects of spreading interest rates on financial performance. Among the surveyed departments, the finance department emerges as the most represented, comprising 39.6% (82 individuals) of the sample. This significant representation underscores the crucial role of financial operations, encompassing tasks such as financial analysis, budgeting, and reporting, in understanding and responding to interest rate fluctuations. Following closely behind is the credit department, with 50.7% (105 individuals) of respondents. This highlights the substantial involvement of professionals responsible for assessing credit risk, managing loan portfolios, and ensuring compliance with lending policies. Their perspectives are pivotal in gauging the impact of interest rate changes on lending practices and credit quality within commercial banks. In contrast, the ICT department and human resource department exhibit relatively smaller proportions of respondents, accounting for 3.9% (8 individuals) and 3.4% (7 individuals) respectively. While their contributions are essential, particularly in managing technological infrastructure and human capital, their representation suggests a lesser focus on these areas in the context of interest rate dynamics. Notably, the management department demonstrates the lowest representation, with only 2.4% (5 individuals) of respondents. Despite their limited numbers, the perspectives of senior management personnel are indispensable in shaping overarching strategies and policies in response to interest rate fluctuations. Overall, the distribution of respondents across different departments provides a comprehensive understanding of the varied organizational viewpoints within commercial banks. The prevalence of finance and credit professionals underscores their central role in navigating the financial implications of interest rate changes, while the involvement of other departments contributes diverse perspectives to inform holistic decision-making processes.

**Table 5 : Length of service in the banking sector**

C					
		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Less than 5 years	47	22.7	22.7	22.7
	5 - 10 years	70	33.8	33.8	56.5
	11 - 15 years	61	29.5	29.5	86.0
	More than 15 years	29	14.0	14.0	100.0
	Total	207	100.0	100.0	



**Figure 3 : Length of service in the banking sector**

## **4.3 Descriptives**

### **4.3.1 Effect of cash lending on financial performance of commercial banks**

On average, respondents perceived the availability of cash lending options to be relatively low, with a mean score of 1.6618 and a standard deviation of 1.11983. This suggests that while some respondents may find the options adequate, there is significant variability in their perceptions, indicating a potential gap in meeting diverse financial needs.

Respondents expressed moderate satisfaction with the competitiveness of interest rates offered by banks, as indicated by a mean score of 2.1208 and a standard deviation of 1.50723. However, there was notable variability in opinions, suggesting that while some find the rates competitive, others may perceive them differently.

The mean score for the efficiency and convenience of the cash lending process was 2.0628, with a standard deviation of 1.45846. This indicates a moderate level of satisfaction with the process, although opinions varied considerably among respondents. Some may find the process efficient and convenient, while others may encounter challenges or inefficiencies.

Respondents expressed relatively higher satisfaction with the terms and conditions associated with cash lending, with a mean score of 3.7585 and a standard deviation of 1.57333. This suggests that, on average, respondents find the terms and conditions satisfactory. However, there is considerable variability in opinions, indicating that some may have concerns or preferences regarding specific terms.

The mean score for the statement regarding the contribution of cash lending to financial well-being was 2.0483, with a standard deviation of 1.47391. This suggests moderate satisfaction with the financial impact of cash lending services, but with significant variability in perceptions among

respondents. While some may feel that cash lending positively contributes to their financial well-being, others may have differing views based on their individual circumstances.

Overall, the descriptive statistics reveal a nuanced picture of respondents' satisfaction and perceptions regarding cash lending services. While certain aspects, such as terms and conditions, elicit relatively higher satisfaction levels, there are areas, such as the availability of lending options and competitiveness of interest rates, where improvements may be warranted to better meet the diverse needs and expectations of customers.

**Table 6 : Effect of cash lending on financial performance of commercial banks**

	Descriptive Statistics				
	N	Minimum	Maximum	Mean	Std. Deviation
The bank provides sufficient cash lending options to meet my financial needs.	207	1.00	5.00	1.6618	1.11983
The interest rates offered by the bank for cash lending are competitive.	207	1.00	5.00	2.1208	1.50723
The bank's cash lending process is efficient and convenient.	207	1.00	5.00	2.0628	1.45846
I am satisfied with the terms and conditions associated with cash lending from the bank.	207	1.00	5.00	3.7585	1.57333

Cash lending from the bank has positively contributed to my financial well-being.	207	1.00	5.00	2.0483	1.47391
Valid N (listwise)	207				

#### 4.3.2 Effects of loan repayment on financial performance of commercial banks

The mean score for the manageability and flexibility of the loan repayment process was 2.1739, with a standard deviation of 1.50362. This indicates a moderate level of satisfaction, but with considerable variability in opinions among respondents. While some may find the process manageable and flexible, others may encounter challenges or limitations.

Respondents expressed moderate satisfaction with the bank's provision of assistance or guidance in case of difficulty with loan repayment, as indicated by a mean score of 2.4638 and a standard deviation of 1.61528. However, there is notable variability in opinions, suggesting that while some may feel adequately supported, others may perceive a lack of assistance.

Respondents indicated relatively higher satisfaction with the positive impact of loan repayment on their credit score or financial standing, with a mean score of 3.5121 and a standard deviation of 1.67175. This suggests that, on average, respondents perceive loan repayment as beneficial to their creditworthiness or financial status, although opinions vary among individuals.

The mean score for overall satisfaction with the loan repayment experience was 2.2899, with a standard deviation of 1.59278. This indicates a moderate level of satisfaction, but with significant variability in perceptions among respondents. While some may be satisfied with their overall experience, others may have encountered challenges or shortcomings.

Overall, the descriptive statistics reveal a nuanced picture of respondents' satisfaction and perceptions regarding various aspects of loan repayment processes with commercial banks. While

certain aspects elicit relatively higher satisfaction levels, such as the positive impact on credit score, there are areas, such as clarity of information and overall satisfaction, where improvements may be warranted to enhance the loan repayment experience and meet the diverse needs of customers.

**Table 7 : Effects of loan repayment on financial performance of commercial banks**

<b>Descriptive Statistics</b>					
	N	Minimum	Maximum	Mean	Std. Deviation
The bank provides clear information regarding loan repayment schedules and options.	207	1.00	5.00	1.8213	1.27787
I find the loan repayment process with the bank to be manageable and flexible.	207	1.00	5.00	2.1739	1.50362
The bank offers assistance or guidance in case of difficulty with loan repayment.	207	1.00	5.00	2.4638	1.61528
Loan repayment from the bank has positively impacted my credit score or financial standing.	207	1.00	5.00	3.5121	1.67175

I am satisfied with the overall loan repayment experience with the bank.	207	1.00	5.00	2.2899	1.59278
Valid N (listwise)	207				

#### 4.3.3 Effect of domestic savings on financial performance of commercial banks

Respondents indicated moderate satisfaction with the attractiveness of interest rates for domestic savings accounts, with a mean score of 2.7053 and a standard deviation of 1.63550. This suggests that, on average, respondents find the interest rates offered by the bank somewhat appealing, although there is notable variability in their perceptions.

The mean score for satisfaction with the range of domestic savings products offered by the bank was 2.9275, with a standard deviation of 1.69223. This indicates a moderate level of satisfaction, but with considerable variability in opinions among respondents. While some may find the range of products satisfactory, others may desire more diverse options.

Respondents expressed moderate satisfaction with the role of domestic savings in helping them achieve their financial goals, as indicated by a mean score of 2.1932 and a standard deviation of 1.54899. However, there is notable variability in opinions, suggesting that while some may feel that savings have been beneficial, others may not perceive significant progress towards their goals.

The mean score for convenient access to domestic savings account services was 2.1787, with a standard deviation of 1.57095. This indicates a moderate level of satisfaction, but with significant variability in perceptions among respondents. While some may find access to services convenient, others may encounter challenges or limitations in accessing their savings.

Respondents indicated moderate satisfaction with the positive contribution of domestic savings to the stability of their financial situation, as indicated by a mean score of 2.5749 and a standard

deviation of 1.61994. This suggests that, on average, respondents perceive savings as playing a positive role in enhancing financial stability, although opinions vary among individuals.

Overall, the descriptive statistics reveal a nuanced picture of respondents' satisfaction and perceptions regarding various aspects of domestic savings services. While certain aspects elicit relatively higher satisfaction levels, such as satisfaction with the range of products, there are areas, such as interest rates and achievement of financial goals, where improvements may be warranted to better meet the diverse needs and expectations of customers.

**Table 8 : Effect of domestic savings on financial performance of commercial banks**

<b>Descriptive Statistics</b>					
	N	Minimum	Maximum	Mean	Std. Deviation
The bank provides attractive interest rates for domestic savings accounts.	207	1.00	5.00	2.7053	1.63550
I am satisfied with the range of domestic savings products offered by the bank.	207	1.00	5.00	2.9275	1.69223
Domestic savings with the bank have helped me achieve my financial goals.	207	1.00	5.00	2.1932	1.54899
The bank offers convenient access to domestic savings account services (e.g., online banking, ATM).	207	1.00	5.00	2.1787	1.57095

I believe that domestic savings with the bank have positively contributed to the stability of my financial situation.	207	1.00	5.00	2.5749	1.61994
Valid N (listwise)	207				

#### 4.4 Inferential analysis

##### 4.4.1 Reliability

The reliability analysis conducted on the survey items pertaining to domestic savings satisfaction indicates a high level of internal consistency. The calculated Cronbach's Alpha coefficient of 0.856 suggests that the items measuring respondents' satisfaction with domestic savings services demonstrate strong reliability, indicating that they consistently measure the same underlying construct. This high level of internal consistency is further corroborated by the Cronbach's Alpha coefficient based on standardized items, which yielded a similar result of 0.857.

With a total of three items contributing to the calculation, the reliability analysis underscores the robustness of the survey instrument in capturing respondents' perceptions regarding domestic savings services provided by commercial banks in Kisii town. The high Cronbach's Alpha coefficient indicates that the survey items effectively measure the overarching construct of domestic savings satisfaction, providing reliable insights into respondents' attitudes and experiences in this domain. This reliability ensures the validity and trustworthiness of the survey

findings, enhancing the credibility of the research outcomes and enabling informed decision-making regarding domestic savings offerings within the banking sector.

**Table 9 : Reliability**

<b>Reliability Statistics</b>		
Cronbach's Alpha	Cronbach's Alpha Based on Standardized Items	N of Items
.856	.857	3

#### 4.4.2 ANOVA

The ANOVA results, incorporating Friedman's Test, offer a comprehensive analysis of the variations in responses observed among respondents across different survey items. The examination reveals several key findings: Firstly, the analysis highlights the presence of significant differences in responses among individuals, as indicated by a substantial sum of squares between people (11178.580) with 206 degrees of freedom. This suggests diverse perceptions among respondents regarding the survey items. Secondly, within respondents, variations across survey items are evident, demonstrated by the sum of squares within people between items (91.942) with 2 degrees of freedom. These findings underscore the nuanced differences in perceptions among respondents regarding the various aspects measured by the survey items. Furthermore, the significant Friedman's Chi-Square statistic (11.532) with a p-value of .003 indicates that these differences in responses across survey items are statistically significant. In essence, while there may be agreement or disagreement among respondents on certain aspects measured by the survey items, overall, there is notable variability in perceptions. The residual sum of squares (3208.725) with 412 degrees of freedom represents unexplained variability in responses, suggesting that factors beyond differences among individuals or survey items may influence respondents' perceptions. Collectively, these findings elucidate the complex landscape of respondent

perceptions, highlighting areas of divergence and convergence and providing valuable insights for further analysis and interpretation.

**Table 10 : ANOVA**

<b>ANOVA with Friedman's Test</b>						
		Sum of Squares	df	Mean Square	Friedman's Chi-Square	Sig
Between People		11178.580	206	54.265		
Within People	Between Items	91.942 <sup>a</sup>	2	45.971	11.532	.003
	Residual	3208.725	412	7.788		
	Total	3300.667	414	7.973		
Total		14479.246	620	23.354		
Grand Mean = 12.1643						
a. Kendall's coefficient of concordance $W = .006$ .						

#### 4.4.3 Correlations

The correlation analysis examined the relationships between perceptions of cash lending, loan repayment, and domestic savings among respondents.

A strong positive correlation exists between perceptions of cash lending and loan repayment, with a Pearson correlation coefficient of 0.710 ( $p < 0.001$ ). This indicates that individuals who view cash lending services favorably are also likely to have positive perceptions of loan repayment processes, and vice versa. The significant correlation suggests that satisfaction in one area of banking services tends to align with satisfaction in the other.

Similarly, there is a strong positive correlation between perceptions of cash lending and domestic savings, with a Pearson correlation coefficient of 0.648 ( $p < 0.001$ ). This indicates that individuals satisfied with cash lending options are also likely to have positive perceptions of domestic savings

services, and vice versa. The correlation underscores the interconnectedness of satisfaction levels across different banking services.

There is also a strong positive correlation between perceptions of loan repayment and domestic savings, with a Pearson correlation coefficient of 0.643 ( $p < 0.001$ ). This suggests that individuals content with loan repayment processes are also likely to view domestic savings services favorably, and vice versa. The significant correlation highlights the mutual influence of satisfaction with loan repayment and domestic savings services.

Overall, these findings reveal strong positive associations between satisfaction levels across various aspects of banking services. The correlations indicate that individuals tend to have consistent perceptions of satisfaction across cash lending, loan repayment, and domestic savings services. This suggests that efforts to enhance customer satisfaction in one area of banking services may positively impact perceptions and experiences across other areas, ultimately contributing to overall customer satisfaction and loyalty.

**Table 11 : Correlations**

		<b>Correlations</b>		
		Cash Lending	Loan Repayment	Domestic Savings
Cash Lending	Pearson Correlation	1	.710**	.648**
	Sig. (2-tailed)		.000	.000
	N	207	207	207
Loan Repayment	Pearson Correlation	.710**	1	.643**
	Sig. (2-tailed)	.000		.000
	N	207	207	207

Domestic Savings	Pearson Correlation	.648**	.643**	1
	Sig. (2-tailed)	.000	.000	
	N	207	207	207

#### 4.4.4 Model summary

The model summary presents the performance of the regression model in predicting the dependent variable based on the included predictors. In Model 1, the correlation coefficient (R) is 0.698, indicating a moderately strong positive relationship between the predictors (Loan Repayment and Cash Lending) and the dependent variable. The coefficient of determination (R Square) is 0.487, suggesting that approximately 48.7% of the variance in the dependent variable can be explained by the predictors in the model. The adjusted R Square, which considers the complexity of the model, is 0.482. The standard error of the estimate is 3.52935, indicating the average distance between the observed and predicted values of the dependent variable. The predictors, along with a constant term, collectively contribute to the predictive power of the model. While the model demonstrates a significant association between the predictors and the dependent variable, it's important to interpret the results cautiously and consider other potential factors that may influence the dependent variable beyond those included in the model.

**Table 12 : Model summary**

<b>Model Summary</b>				
Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.698 <sup>a</sup>	.487	.482	3.52935

a. Predictors: (Constant), Loan Repayment, Cash Lending

#### **4.5 Discussions of findings**

The study reveals a strong positive correlation between perceptions of cash lending services and overall customer satisfaction. This indicates that cash lending plays a significant role in shaping the financial performance of commercial banks in Kisii town. By offering competitive interest rates, efficient lending processes, and convenient access to cash lending options, banks can enhance customer satisfaction and loyalty. The findings suggest that improvements in cash lending services can lead to increased customer satisfaction, ultimately contributing to the financial performance of commercial banks.

The regression analysis demonstrates that factors related to loan repayment, alongside cash lending, significantly contribute to overall customer satisfaction. This highlights the importance of efficient and manageable loan repayment processes in driving customer satisfaction and, consequently, the financial performance of commercial banks in Kisii town. By providing clear information, guidance, and support during loan repayment, banks can enhance customer satisfaction levels and foster loyalty. These findings emphasize the need for banks to prioritize improvements in loan repayment processes to positively impact their financial performance.

The study identifies a strong positive correlation between perceptions of domestic savings services and overall customer satisfaction. This underscores the significance of domestic savings in driving customer loyalty and satisfaction, thereby contributing to the financial performance of commercial banks in Kisii town. By offering attractive interest rates, a diverse range of savings products, and convenient access to domestic savings account services, banks can enhance customer satisfaction levels. These findings suggest that improvements in domestic savings services can lead to increased customer satisfaction and ultimately drive the financial performance of commercial banks.

The findings highlight the interconnectedness of various banking services, including cash lending, loan repayment, and domestic savings, in shaping customer satisfaction and, consequently, the financial performance of commercial banks in Kisii town. By addressing the objectives outlined in the study and prioritizing improvements in these key areas, banks can enhance customer satisfaction, foster loyalty, and drive their financial performance in a competitive market environment.



## CHAPTER FIVE

### SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

#### 5.0 Introduction

In this final chapter, we summarize the key findings of the study, draw conclusions based on these findings, and provide recommendations for stakeholders in the banking sector. Building upon the objectives outlined in the study, we offer insights into the effects of spreading interest rates on the financial performance of commercial banks in Kisii town. By synthesizing the findings, we aim to provide actionable recommendations that can inform strategic decision-making and improve the overall performance of commercial banks in the region.

#### 5.1 Summary

Guided by the study's first objective, which aimed to establish the effect of cash lending on the financial performance of commercial banks in Kisii town, the findings indicate that the bank provides sufficient cash lending options to meet financial needs, with a mean score of 1.66 and a standard deviation of 1.12. The competitiveness of interest rates offered by the bank for cash lending was reflected in a mean score of 2.12 and a standard deviation of 1.51. The efficiency and convenience of the cash lending process were rated with a mean score of 2.06 and a standard deviation of 1.46. Additionally, satisfaction with the terms and conditions associated with cash lending from the bank had a higher mean score of 3.76 and a standard deviation of 1.57. The overall impact of cash lending on financial well-being was reported with a mean score of 2.05 and a standard deviation of 1.47. These results suggest that improvements in cash lending services can positively influence the financial performance of commercial banks by enhancing customer satisfaction.

Guided by the second objective, which sought to evaluate the effects of loan repayment on the financial performance of commercial banks in Kisii town, the study found that clear information regarding loan repayment schedules and options had a mean score of 1.82 with a standard deviation of 1.28. The manageability and flexibility of the loan repayment process were rated with a mean score of 2.17 and a standard deviation of 1.50. Assistance or guidance provided by the bank in case of difficulty with loan repayment received a mean score of 2.46 and a standard deviation of 1.62. The positive impact of loan repayment on credit score or financial standing was reflected in a higher mean score of 3.51 and a standard deviation of 1.67. Overall satisfaction with the loan repayment experience had a mean score of 2.29 and a standard deviation of 1.59. These findings indicate that efficient loan repayment processes significantly contribute to customer satisfaction and, consequently, the financial performance of commercial banks.

Guided by the third objective, which aimed to examine the outcome of domestic savings on the financial performance of commercial banks in Kisii town, the study revealed that the attractiveness of interest rates for domestic savings accounts had a mean score of 2.71 and a standard deviation of 1.64. Satisfaction with the range of domestic savings products offered by the bank was indicated by a mean score of 2.93 and a standard deviation of 1.69. The role of domestic savings in helping customers achieve their financial goals had a mean score of 2.19 and a standard deviation of 1.55. Convenience of access to domestic savings account services, such as online banking and ATMs, was rated with a mean score of 2.18 and a standard deviation of 1.57. The belief that domestic savings contribute to financial stability was reflected in a mean score of 2.57 and a standard deviation of 1.62. These results suggest that enhancing domestic savings services can positively impact the financial performance of commercial banks by fostering customer satisfaction and financial stability.

## 5.2 Conclusion

This study aimed to investigate the effects of spreading interest rates on the financial performance of commercial banks in Kisii town, focusing on three key areas: cash lending, loan repayment, and domestic savings. The findings provide valuable insights into how these aspects influence customer satisfaction and, consequently, the financial performance of banks.

The study found that cash lending services significantly impact customer satisfaction. Banks that offer sufficient cash lending options, competitive interest rates, and efficient lending processes tend to achieve higher levels of customer satisfaction. Satisfied customers are more likely to remain loyal and engage more with the bank, which positively affects the bank's financial performance. Therefore, enhancing cash lending services is crucial for improving the overall financial health of commercial banks in Kisii town.

Efficient loan repayment processes are critical for customer satisfaction and financial performance. The study highlighted that clear communication regarding repayment schedules, flexibility, and support during repayment difficulties are essential factors that contribute to customer satisfaction. Customers who have a positive loan repayment experience are more likely to maintain a good relationship with the bank, which can lead to better financial performance through continued business and positive word-of-mouth referrals.

Domestic savings services also play a significant role in customer satisfaction and financial performance. The study showed that offering attractive interest rates, a diverse range of savings products, and convenient access to savings services enhances customer satisfaction. Customers who find value in their savings accounts are more likely to save more and stay with the bank, contributing to the bank's financial stability and growth.

The financial performance of commercial banks in Kisii town is closely linked to how well they manage their cash lending, loan repayment, and domestic savings services. By focusing on these areas and ensuring high levels of customer satisfaction, banks can improve their financial performance. The interconnected nature of these services means that improvements in one area can positively impact the others, creating a synergistic effect that enhances overall bank performance. Therefore, commercial banks should adopt a holistic approach to service improvement, ensuring that all aspects of their offerings are aligned with customer needs and expectations.

### **5.3 Recommendation**

Based on the findings of this study, several recommendations can be made to improve the financial performance of commercial banks in Kisii town by enhancing customer satisfaction in key areas such as cash lending, loan repayment, and domestic savings.

- 1.** Banks should regularly review and adjust their interest rates for cash lending to ensure they remain competitive within the market. Offering attractive rates can draw more customers and improve overall satisfaction.
- 2.** Banks should provide detailed and easy-to-understand repayment schedules. Using multiple communication channels (e.g., email, SMS, in-app notifications) can ensure that customers are well-informed.
- 3.** Regularly reviewing and offering competitive interest rates for domestic savings accounts can attract more customers. Promotional rates for new accounts or higher balances can also be beneficial.
- 4.** Banks should implement systems to regularly collect customer feedback on their services. This feedback should be used to make continuous improvements.

**5.** Regular training programs for bank employees on customer service excellence can help improve interactions with customers.

By implementing these recommendations, commercial banks in Kisii town can enhance their service offerings, improve customer satisfaction, and ultimately strengthen their financial performance. These strategic improvements can help banks build stronger relationships with their customers, foster loyalty, and maintain a competitive edge in the market.

#### **5.4 Recommendation for further study**

While this study has provided valuable insights into the effects of spreading interest rates on the financial performance of commercial banks in Kisii town, there are several areas where further research could be beneficial. Future studies could explore the following.

Conducting a longitudinal study to track changes in financial performance over time in relation to modifications in cash lending, loan repayment, and domestic savings services could provide deeper insights into the long-term effects of these factors. This would help in understanding the sustainability of improvements and the long-term impact on customer satisfaction and loyalty.

Comparing the financial performance of commercial banks in Kisii town with those in other regions could help identify regional differences and best practices. Such a comparative study could highlight unique challenges and opportunities faced by banks in different geographic locations, providing a broader perspective on effective banking practices.

Investigating the role of technological advancements, such as mobile banking, fintech solutions, and digital payment systems, on the financial performance of commercial banks could offer insights into how technology can be leveraged to enhance customer satisfaction and operational efficiency. This study could examine customer adoption rates, satisfaction levels, and financial outcomes related to technological innovations.

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## APPENDICES

### Appendix I: Consent Form

I am **Ronald Khaggayi Ngala** a post graduate student at Mount Kenya University and carrying out a study on the effects of spreading interest rates on financial performance of commercial banks in Kisii town. Being one of the respondents; you have been selected to participate in this study. If you consent to answering the questionnaire or giving an interview, you will be treated with utmost confidentiality and will be used for academic purposes only. The study will not cause any disadvantage to your bank or to you as a bank employee. If you agree to participate in the study you will be doing so professionally and voluntary and there will be no any monetary returns. Any benefits of the research will largely be to contribute knowledge and evidence in order to improve policy and practice on interest rates in the banks in Kenya. You are free to ask any question before, during and after filling the questionnaire or interview. You are also at liberty not to respond to questions you do not feel comfortable answering. The filling of the questionnaire/ interview will take approximately 30 minutes. Kindly note that if you have any queries as far as ethical issues are concerned do not hesitate to contact The Chairman, MKU ERC, P.O Box 342-0100 Thika.

Thank you

**RONALD KHAGGAYI NGALA**

## Appendix II: Questionnaire for Credit Managers/ Section heads

Please fill out the questionnaire to support our research. This study aims to explore how varying interest rates impact the financial performance of commercial banks in Kisii town. The information collected will be used solely for academic purposes and will be kept strictly confidential.

Your cooperation will be highly appreciated.

*Please tick (√) in the box next to the most appropriate answer.*

1. Gender

Male  Female

2. Age

Below 30 years  30 – 40 years  40 – 50 years

Above 50 years

3. Kindly indicate your department of operation

Department	√
Management	
Finance	
ICT	
Audit	
Credit	
Human Resources	

4. What is your length of service in the banking sector?

Below 5 years  5 – 10 years  10 – 15 years  over 15 years

5. To what extent do you think spreading interest rates has an effect on the financial performance of your bank?

None [ ] Low extent [ ] Moderate extent [ ] High extent [ ]  
Very high extent [ ]

6. The following are aspects and attributes of spreading interest rates and financial performance in commercial banks. Kindly indicate whether you agree or disagree with the statements.

Key: Strongly Disagree (SD) -1; Disagree (D)-2; Undecided (U) - 3 Agree (A) – 4; Strongly Agree (SA) - 5

#### Effect of Cash Lending on Financial Performance

No.	Statements	Strongly Disagree	Disagree	Neutral	Agree	Strongly Agree
1.	The bank provides sufficient cash lending options to meet my financial needs.					
2.	The interest rates offered by the bank for cash lending are competitive.					
3.	The bank's cash lending process is efficient and convenient.					
4.	I am satisfied with the terms and conditions associated with cash lending from the bank.					
5.	Cash lending from the bank has positively contributed to my financial well-being.					

#### Effects of Loan Repayment on Financial Performance

No.	Statements	Strongly Disagree	Disagree	Neutral	Agree	Strongly Agree
1.	The bank provides clear information regarding loan repayment schedules and options.					

2.	I find the loan repayment process with the bank to be manageable and flexible.					
3.	The bank offers assistance or guidance in case of difficulty with loan repayment.					
4.	Loan repayment from the bank has positively impacted my credit score or financial standing.					
5.	I am satisfied with the overall loan repayment experience with the bank.					

### Outcome of Domestic Savings on Financial Performance

No.	Statements	Strongly Disagree	Disagree	Neutral	Agree	Strongly Agree
1.	The bank provides attractive interest rates for domestic savings accounts.					
2.	I am satisfied with the range of domestic savings products offered by the bank.					
3.	Domestic savings with the bank have helped me achieve my financial goals.					
4.	The bank offers convenient access to domestic savings account services (e.g., online banking, ATM).					
5.	I believe that domestic savings with the bank have positively contributed to the stability of my financial situation.					

### **Appendix III: interview schedule for bank branch managers**

1. As a bank how do you define innovation?
2. Do you consider interest rate spread as a precursor to better financial performance in the banking sector?
3. What is the process of deriving interest ideas in the bank?
4. What is the most innovative decision the bank has ever made on interest rate spread and why?
5. How would you rate interest rate spread as determinants of financial performance in the banking industry?
6. What do you consider to be the limiting factor affecting financial performance in your organization
7. Do you consider low spreading interest rates as a threat to deposit mobilization in commercial banks?
8. How do you rate the spread of interest rate as a determinant of loan repayment in your organization
9. How does the level of deposit affect the spread of interest in regards to financial performance of your organization?
10. Do you agree that uncertainties in regards to loan repayments affect the lending rates?

Appendix IV: A map showing the position of Kisii town in Kenya



EFFECTS OF SPREADING  
INTEREST RATES ON FINANCIAL  
PERFORMANCE OF  
COMMERCIAL BANKS IN KISII  
TOWN

*by* RONALD KHAGGAYI

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## EFFECTS OF SPREADING INTEREST RATES ON FINANCIAL PERFORMANCE OF COMMERCIAL BANKS IN KISII TOWN

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