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ABSTRACT

The governments used interest caps for economic and political reasons; the most common involves providing support to specific area of the industry or economic area. It can be used when the government identifies market failure in a certain industries, or that the interest rate cap attempts forcing more focus on the financial resources in the same sector than what a market can determine. The study specific objectives of this study were to establish the effect of Re-organization on interest rates capping on financial performance and to establish the effect of downsizing strategies on interest capping on financial performance. The classical theory of interest and loan funds theory were used for the study. Empirical studies were on Re-organization and downsizing. Descriptive survey research design was used with population of 43 Finance Managers and 43 Business Development Managers. Census was employed for the study with 86 respondents. Questionnaire was the main data collection instrument. Pilot study was conducted to test validity of the questionnaires. The gathered data was analyzed through the use of descriptive and inferential statistics through SPSS while tables and figures were used for data presentation. The study found out that interest rates capping has led to Re-organization among commercial banks in Kenya. Interest rates capping was found to lead to reduction of workforce among commercial banks in Kenya.

Key Words: *Downsizing, Re-organization*

INTRODUCTION

The governments used interest caps for economic and political reasons; the most common involves providing support to specific area of the industry or economic area. It can be used when the government identifies market failure in a certain industries, or that the interest rate cap attempts forcing more focus on the financial resources in the same sector than what a market can determine. The main examples are the loans in the agricultural sector aimed at boosting productivity in agriculture and the loans to SMEs which are credit constrained (Ngugi, 2016). It is often argued that ceilings in interest rate are justified on financial institutions making excess profits through the charge of exorbitant interest rates to customers (Kim, 2014).

Kenyan banks for the past 20 years have enjoyed interest rate spread at the rates of 11.4% on the average, which more than the global average of 6.6%. The CBK governor Dr. Patrick Njoroge has been acknowledging that this was too high but fails to advocated for pegging on interest rate as it is likely to cause financial systems rigidity and this is likely to introduce many shadow banking and the shylocks as the people who have no access to credit from commercial banks due to lower credit quality may be priced out in the market (Hualan, 2011). The full impact of the recent capping of interest rates will take time to unravel. With loan interest capped at four per cent of the base rate, and deposits at 70 per cent of the same rate, the interest rate spread or margin is about 6.8 per cent. Data from the World Bank shows the average interest rate spread in lower middle-income countries is 6.8 per cent, decreasing to 6.6 per cent for middle income and 6.3 per cent for the upper middle-income countries. With Kenya regarded as a lower middle-income economy, the maximum spread set by the capping of interest rates could therefore be regarded as reasonable in comparison (Norden, Roosenboom & Wang, 2013).

Interest rate which is allowed to fluctuation, but that cannot surpass the stated cap on interest rate. An example of a loan of 10-years can be issued at 6% to a borrower, but with 9% capped rate. Interest rate thus fluctuates up and down, but may never go more than 9% capped rate. A hybrid of a fixed and variable rate loan should be provided by the capped rates (Martins, Serra & Martins, 2016). The fixed part may come from the capped rate itself, while a variable part come from the ability of the loan moving up or down through market fluctuations (Lathif & Aktharsha, 2016).

Statement of the Problem

The capping of interest rates in Kenya was a very noble objective, but in practice has ended up with very adverse consequences such as lower levels of financial inclusion indicators (Palley, 2012). The net result of capping of interest rates has been reduced credit supply, exit of lenders due to high operational costs and risk, increase in informal lending channels like 'shylocks', and an increase in the total cost of loans through additional fees and commissions (Corb, 2014). Commercial banks in Kenya have come up with strategies to mitigate against interest rates capping such as re-organization, downsizing, and withdrawal of credit to low income earners and reduced number of credit products; however these strategies have resulted to negative consequences. Studies by Ngugi (2016) & Hualan (2014) do not indicate the extent of the impact, that is does interest rate capping have strong or weak relationship to banks financial performance. There is few known study in Kenya that has been conducted on this area and therefore the need to carry out the study on Kenya Commercial Banks strategic responses to interest rates capping by central bank. It is in this context that this study sought to determine the Kenya commercial banks strategic responses to interest rates capping by Central Bank.

Study Objectives

The study sought to achieve the following specific objectives:

- To establish the effect of re-organization strategies on financial performance of Commercial Banks in Kenya
- To establish the effect of downsizing strategies on financial performance of commercial banks in Kenya

LITERATURE REVIEW

Theoretical Review

The study was anchored on 2 theories which were highlighted here under. The Classical Theory of Interest indicates the interest, is real terms, this is a reward for use productively of capital; this is equal to marginal productivity of the physical capital. In money driven economy, however, the physical capital be purchased through monetary funds, the interest rate is taken as the annual rate of return over the invested money capital in a physical assets capital (Hualan, 2011). According to Keynes, the true classical theory of the interest rates is savings theory of investment. Basically, theory hold a proposition based on a theory of general equilibrium that interest rates can be determined through the intersection of a demand and the capital supply. Bekan (2011) argues that interest rates equilibrium can be determined at the point through which capital demands equals the supply. Capital demands stems from investment decisions of an entrepreneurial class.

Loanable Funds Theory assumes that the interest rates can be determined through loan able funds supply and credit demands. The theory of loan able funds attempts improving upon the theory of classical interest. It recognizes that money plays a disturbing role in processes of investment and saving thereby causing variations in income levels (Frenkel & Razin, 2011). Thus, the approach is monetary the interest rates theory, as it is distinguished from classical economists theory. The theory of loan able funds synthesizes both monetary and the non -monetary aspect a problem (Irresberger et al., 2015). The theory of loan able funds theory, the interest rates is a price which equates the supply of loanable funds demand. At the level of equilibrium where the demands equals the loan able funds savers supply and the investors are as happy as possible.

Empirical Review

The study reviewed several key empirical literatures from the local context as well as foreign markets. Ngugi (2016) studied effects of interest rates capping on corporate re-organization strategy in KCB Nairobi region. Were & Wambua (2015), focused on strategic change implementation influencing factors at Development Bank of Kenya. Ng`etich & Wanjau (2016) carried out a study on how re-organization impacts on the performance of developed financial institutions. Ngugi (2016) studied how re-organization influence job satisfaction and empowerment of employees; a case study of Kenya Railways Corporation. Frenkel & Razin (2010) carried out a study on how re-organization impacts on the mobile service provider's performance. Corb (2012) carried out a survey to find out the relationship between the performance of practices of performance appraisal, the motivation and the job satisfaction of KCB employees and Aburime (2008) conducted a survey on the styles of supervision and satisfaction of employees in Kenyan Commercial Banks.

Hualan (2011) studied on whether interest rates caps and form the strategies of re-organization and impacts on the performance of the economy. The study found out those re-organization finances improves performance economically. The study argued that this was possible since re-organization was the most focused, explicitly focused on performance of the economy. However, author's cautions that not every financial re-organization works well, but best results can be obtained from management and leveraged buyouts. They concluded that best performance results were obtained from the portfolio re-organization, with the spin offs which gives the higher returns followed by the sell offs. On organization re-organization, Bowman et al contends that it impacts on the performance depending on the circumstances under which it has been initiated (Ng`etich & Wanjau, 2016).

Were & Wambua (2015) studied how survivors' perception on the downsizing as the interest rates capping results as the financially effective, the inevitable, and the liberating for the victims affects their satisfaction at the work place. The collected data was from 150 survivors from 8 operating banks in Makurdi metropolis. The Pearson correlation product and regression data analysis tools were used. The study found out that the perception of the survivors' on downsizing as effective financially and negatively inevitable affecting their job satisfaction. The relationships between the perception of the survivors' on downsizing as the liberating for the victims and the job satisfaction had positive statistical significant (Were & Wambua, 2015).

Kozak (2016) investigated the how interest rate capping affects the commercial banks operating performance in Ghana. An Exploratory study was directed by three specific objectives namely: the effect of capping of interest rate on credit uptake performance of the banks, the effect of interest rate capping on bank profitability of commercial banks and the effect on performance of the portfolio of non-performing loans in commercial banks. The scope of the study was limited to commercial banks in Ghana (Kozak, 2016).

Palley (2015) conducted a study on the impact of the interest rate capping law in Kenya. It was found that under the interest rate capping environment, monetary policy produces perverse outcomes. Secondly, there is evidence of reduced financial intermediation by commercial banks, as exemplified by the significant increase in the average loan size arising from declining loans accounts, mainly driven by the large banks, thus shunning the smaller borrowers. Thirdly, banks have shifted lending to Government and the large corporates. Whereas demand for credit immediately increased following the capping of lending rates, credit to the private sector has continued to decline. Fourthly, while the structure of revenue of the banks has started to shift away from interest income, some banks have exploited the existing approval limits to increase fees on loans in a bid to offset loss in interest income. Fifth, although the banking sector remains resilient, small banks have experienced significant decline in profitability in recent months, which may complicate their viability. Sixth, rationing out Micro, Small and Medium Enterprises (MSMEs) from the credit market by the commercial banks is estimated to have lowered growth in 2017 by 0.4 percentage points. However on the other side, banks have started adjusting their business models towards enhancing efficiency.

METHODOLOGY

The research design adopted was a descriptive survey design. This ensures collections and descriptive analysis of data from the population of study. Finance Managers and Business Development Managers formed the unit of analysis. The sampling frame was Finance and Business development departments from where the population was drawn. The sample frame ensured that respondents gave accurate information which helped in achieving the objective of the study. The population of study in this research was all the 43 commercial banks in Kenya. Commercial banks are banks that meet the capital criteria set by central bank of Kenya which were 43 in total as at December 2016. The current study used census, census was appropriate for this study since the population of commercial banks was too small. Therefore the sample size for the study was 86 respondents. The data collected was first edited through ensuring that it is complete and correct which reduced biases, increases precision and achieves consistency. Data was analyzed using multiple regression analysis and descriptive analysis (percentages, means and standard deviations) with the aid of sciences (SPSS) software version 22.0. Data presentation was in the form of graphs, tables and charts.

FINDINGS

Interest rates capping had led to re-organization among commercial banks in Kenya by (M=1.79, SD=0.899). Re-organization had improved operating efficiency among commercial banks by (M=1.83, SD=0.83). Banks had recast their organizational structure due to interest rates capping by (M=1.73, SD=0.68).Commercial banks had laid-off staff due to interest rates capping by (M=2.19, SD=0.99). Commercial banks had changed organizational management team by (M=2.46, SD=0.95). Re-organization equipped the banks with the requisite competences needed to capture opportunities by (M=3.19, SD=0.11).

Interest rates capping had led to reduction of workforce among commercial banks in Kenya by (M=1.32, SD=0.58). Downsizing had led to improved financial performance among commercial banks in Kenya by (M=1.90, SD=0.92). Downsizing had led to improved cost of operation among commercial banks in Kenya by (M=3.08, SD=1.31), this showed that downsizing aimed at reducing the operational cost among commercial banks. Downsizing had improved productivity among commercial banks in Kenya by (M=3.27, SD=1.20). Downsizing had enabled commercial banks in Kenya re-organize their operations by (M=3.75, SD=1.09), this showed that interest rates capping had led to changes in the operations of commercial banks in Kenya.

Interest rate capping affected the commercial banks operating performance by (M=4.46, SD=0.65). Interest rate capping decreased credit uptake by (M=4.40, SD=0.59). Interest rates capping led to reduction in the number of approved loan facilities by (M=4.40, SD=0.59). Interest rates capping led to reduced profitability by (M=4.71, SD=0.51). Interest rates capping led to increase of non-performing loans due decline of new approved loans by (M=4.41, SD=0.52).

Inferential Analysis

In view of correlation analysis, the two variables re-organization and downsizing factors had significant and strong correlation coefficients of 0.370 and 0.972 respectively. The correlation coefficients are significant with p-values only re-organization was found to have a p-value of more than 0.05.

Discussion

Interest rates caps was found to make commercial banks to re-organize their business operations. The findings agreed with Were & Wambua (2015) has viewed re-organization the stage in implementing strategy where the management attempts recasting their organization structure, culture, leadership and the reward system can be changed through ensuring competitiveness in cost and demanded quality through strategic requirements that are unique. Re-organization among commercial banks improved efficiency and reduced the cost of doing business, the findings agreed with Hualan (2011) who argued that re-organization required a high level of operation effectiveness and efficiency of an organization.

Downsizing reduced cost and improved the overall financial performance of banks. The findings agreed with Hualan (2011) who found out that there was on the effect of evidence of downsizing was a good corporate strategy aimed at improving shareholder's wealth. Downsizing aimed at improving productivity among commercial banks in Kenya. The findings agreed with Ng`etich &Wanjau (2016) who argued that downsizing weakened top management commitment to quality workforce and undermined the basic premises underlying workforce quality management.

CONCLUSIONS AND RECOMMENDATIONS

Interest rates caps have made the banks change the way they conduct they operations most of them opting for re-organizing their business operations as interest caps has affected most banks profitability. Most banks re-organize to improve efficiency and reduce the cost of doing business. Banks reorganized their organizational structure to reduce the cost of operations. Interest rates capping has led to job loss among staff in the banking sector. Interest rates caps have led to change in organizational management among commercial banks. Re-organization helped banks to equip their staff with competences.

Interest capping has reduced profitability of most commercial banks, this has led to many banks downsize their workforce. Downsizing has reduced cost and improved the overall financial performance of banks. Downsizing aimed at reducing the operational cost among commercial banks. Downsizing aimed at improving productivity among commercial banks in Kenya. Interest rates capping has led to changes in the operations of commercial banks in Kenya.

Interest rates have been uncontrolled for a long time in Kenya as banks charged high interest rates which translated to high profitability. Introduction of interest rates caps has reduced the profitability of commercial banks in Kenya. Interest rates capping had a negative effect on how commercial banks in Kenya operated. Interest rates capping negatively affected credit uptake among commercial banks in Kenya. Interest rates capping negatively affected number of approved loans among commercial banks in Kenya. Interest rates capping negatively affected the overall profitability of commercial banks in Kenya. Interest rates capping has led to increased number of non-performing loans among commercial banks.

Recommendations

Commercial banks should re-organize their operations with the aim of increasing profit. Re-organization should not result to job loss. Re-organization should aim at creating more job opportunities, make better use of the talents while reducing the cost of doing business. Re-organization should aim at incorporating new technology in the banking sector. Re-organization should aim at increasing competiveness in the banking sector.

Downsizing should be well communicated to staff in good time. Downsizing should not affect the best performing employees. Downsizing should aim at eliminating more repetitive tasks. Downsizing should aim at reducing cost, increasing banks stability and improving creativity in the banking sector. Downsizing should aim at increasing productivity among staff.

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