International Journal of Economics, Business and Management Research

Vol. 8, No.10; 2024

ISSN: 2456-7760

Moderating Effect of Central Bank of Kenya Regulations Compliance on the Relationship Between Predatory Loan Practices and Loan Performance Among Commercial Banks in Kenya

Majory Nyaga
Dedan Kimathi University of Technology, Institute of Technical and Professional Studies, P. O Box Private Bag, Dedan Kimathi, Kenya;

doi.org/10.51505/IJEBMR.2024.81012 URL: https://doi.org/10.51505/IJEBMR.2024.81012

Received: Sep 07, 2024 Accepted: Sep 17, 2024 Online Published: Oct 13, 2024

Abstract

Commercial banks in Kenya play a vital role in the country's financial system. In 2023, Commercial banks contributed approximately 6.6% to Kenya's GDP. They perform a wide range of functions essential to the economy, such as accepting deposits, advancement of loans, payment and settlement services, safekeeping or custodian services, foreign exchange services, and financial advisory services, among others but the most critical function of commercial banks is acting as intermediaries between savers and borrowers, mobilizing savings from individuals and institutions and channelling these funds into productive investments by lending to businesses, governments, and consumers. The primary source of income for commercial banks is interest from performing loans. Non-performing loans arise when the borrowers fail to make the scheduled payments of principal and interest within the agreed time, usually for 90 days. Recent statistics by CBK indicate that the Kenya commercial banks' gross non-performing loans rose to Kes 630 billion by April 2024, translating to a rise in the ratio of NPLs to Gross Loans from 14.8% in December 2023 to 16.15% by April 2024. The objective of this study was to analyze the moderating effect of Central Bank of Kenya regulations compliance on the relationship between predatory loan practices and loan performance among commercial banks in Kenya. The study applied a post-positivism research philosophy and a mixed research design. The sampling frame and unit of analysis was a list of the 39 solvent commercial banks in Kenya (CBK, 2023). The unit of response was a list of 234 managers of the 39 solvent commercial banks. A closed-ended questionnaire was used to collect primary data for the predictor and predict and. For triangulation, a secondary data collection sheet was used to collect secondary data for the regress and. The stability and construct validity of instrumentation was assessed using the Cronbach alpha coefficient and Kaiser-Meyer-Olkin coefficients, respectively, using data from managers of the three largest Micro Finance Banks in Kenya and based in Nairobi. After testing the data for Gaussian distribution, linearity, and independence, simple linear regression was used for inferential analysis. The study found a positive but not statistically significant influence of central bank regulations compliance on the relationship between predatory loan practices and loan performance among commercial banks in Kenya. The moderated model explained an additional 0.3% in the variations of loan performance from the un-moderated model of 58.3% to 58.8% after moderation.

Vol. 8, No.10; 2024

ISSN: 2456-7760

Keywords: Triangulation, CBK Regulations Compliance, Predatory, Moderation, Loan Performance

1. Introduction

1.1Background of the Study

Globally, financial institutions are used as the barometer of the economy due to their critical role in facilitating economic activities and reflecting broader economic trends. A vibrant banking sector is essential in the realization of at least 4 out of the 17 global Sustainable Development Goals (SDGs), that is, attainment of decent work and economic growth (Goal 8); Industry, innovation, and infrastructure (Goal 9); reduced inequality (Goal 10) and sustainable cities and communities (Goal 11). A sound banking sector is required to fuel the attainment of at least 8 out of the 20 aspirations of the African Agenda 2063, that is, high living standards, a blue economy for accelerated economic activities, modern agriculture for increased productivity, transformed economies; stable continental financial institutions; world-class infrastructure; empowered youths and self- financing economies. A stable banking sector is also expected to promote the Vision 2030 economic growth rate of 10% and the Bottom-Up Economic Transformation Agenda by the Kenya Kwanza government, including sustainability of economic growth, employment creation, and living standards. However, non-performing loans threaten the financial well-being of banks. Erdas and Ezanoglu (2022) conducted a study on how bank-specific factors impact NPLs and found that the rising demand for loans and banks' eagerness to meet these demands by assuming higher risks elevates the likelihood of loans turning into NPLs. They described NPLs as a metric for evaluating a bank system's performance and profitability. The study recommended an effective loan monitoring policy to regulate banks' performance. High levels of non-performing loans or bank failures could signal underlying economic problems. International Monetary Fund (2020) noted that loan defaults have been integral to the bank lending process. The first case of loan default was reported in Latin America in 1820. Another wave followed between 1830 and 1840, nearly bringing the global economy to a halt. A series of NPLs followed, one in the early 1880s and another in the 1890s, also toppling Argentina's and Greece's economies. The default episodes continued, with global financial institutions reportedly losing about Kes. 35 trillion annually due to non-performing loans.

1.2 Problem Statement.

World Bank (2022) reported a world ratio of NPLs to gross loans at 8.78%, based on data from 111 countries from 2010 to 2022. Equatorial Guinea had the highest value at 55.41%, followed by Ukraine at 38.12 %, Chad at 27.70%, Ghana at 14.79%, and the Central African Republic at 14.51%. The United States and Sweden had the lowest at 0.72% and 0.3% respectively. Kenya was ranked number eight of countries in the world with a high ratio of NPLs to gross loans at 11.11 %. Moody (2024) sounded a warning that the debt levels in Kenya had hit the highest level in 12 years of over 15% NPLs to Gross loans, which he attributed to the deterioration of the general economic difficulties facing borrowers, including higher interest rates, inflation, piling pending bills, and reduced demand for goods and services. Njiraini (2020) reported that the African level of NPLs was three times higher than the global median at 11.66%. Kenya was ranked number six (6) of African countries with a high debt ratio at an average of 11.11 % for

Vol. 8, No.10; 2024

ISSN: 2456-7760

data between 2006 -2022. CBK (2024) report shows that the banking sector's gross non-performing loans (NPLs) increased by 25.67 % to Kes.635.8 billion ($4.37 billion) in November 2023, from Kes.505.9 billion ($3.48 billion) for the same period in 2022. The ratio of NPLs to gross loans had increased by 150 basis points to 15.3% by April 2024. The bank attributed the increase in NPLs to the high cost of borrowing due to changes in the interest rates and the weak business environment. Property on sale in the Daily Newspaper due to loan defaults fills up over nine pages daily. Kigamwa and Mutwiri (2023) in a study that sought to establish the relationship between the macroeconomic factors and non-performing loans in Kenyan Banking Industry, pointed toward the rising trend in the ratio of non-performing loans in Kenya from 4.96% in 2013, 5.9% in 2014, 8.97% in 2015, 9.02% in 2016, 10.9% in 2017, 12.7% in 2018, 12.5% in 2019, 14.5% in 2020, 14.1% in 2021 and to 13.9 % in 2022.CBK (2024) in their annual bank supervisory report indicated the ratio had risen from 13.9% by December 2022 to 15.6% by December 2023. The change was attributed to a challenging business environment. From 2020 to 2023, the four-year average was 14.5 %, greater than the World Bank's recommended rate of 5%.

1.3 General Objective

The general objective of the study was to analyze the moderating effect of Central Bank of Kenya regulations compliance on the relationship between predatory loan practices and loan performance among commercial banks in Kenya.

1.4 Literature Review

1.4.1 Legal Theory of Finance

Katharina (2013) indicated that finance and law were inextricably linked; thus, the legal theory of finance could help better understand the financial markets. According to this theory, financial markets were legally formed and inhabited a hybrid space between state and market, public and private. At the same time, financial markets had dynamics that could frequently bring them into direct conflict with legal or contractual responsibilities, particularly during the financial crisis when the complete execution of legal commitments resulted in the self-destruction of the financial systems. Further, he noted that when the financial system's survival was under threat, the choice would be to suspend the full power of the law to adapt. Kwasi and Deodutt (2019) studied the legal theory of finance, mainly focusing on evidence drawn from global financial networks. They found out that the law of finance and prices had a misconstrued assumption of being equal before the law, a position that directly conflicted with finance, which is hierarchical. The modern financial system was incompatible with equality before the law. The study recommended regulating the global financial system to enforce stricter standards for the most critical countries to guarantee global financial system stability. McCluskey et al. (2017) urged that the legal theory of finance held that financial markets were subject to rules with minimal room for diverging from the set rules. The law in finance should be flexible, and legal minds should not be allowed to bring their limited concentration to contribute to financial crises by reinforcing faith in markets' ability to deliver optimal outcomes with minimal regulation. This erroneous belief highlighted the need for a new economic understanding of the law that considers theories of financial instability and other macroeconomic variables. This theory supported this

Vol. 8, No.10; 2024

ISSN: 2456-7760

study that sought to analyze the moderating effect of CBK regulations on the relationship between predatory loan practices and loan performance among commercial banks in Kenya.

1.4.2 Empirical Literature

Wiley and Navickas (2021) sought the effect of financial regulation on the performance of the banking sector in the United States of America. The study was literature-based and found that financial regulation had both positive and negative effects on the performance of the banking system in the United States of America. A few of the negative impacts included greater loan prices and a probability of higher loan defaults. The research concluded that government regulations were key in determining the performance of the banking sector in the country. The study recommended that the government offer financial systems that were favorable for financial regulation and that all the commercial banks in the USA comply fully with the stipulated regulations. The federal bank was to ensure that all banks complied. Compliance was expected to bring positive effects of stabilizing the banking sector and thus averting a financial crisis in the country.

Bradlow and Park (2020) highlighted the growing importance of central banks due to their global role in handling international dollars. They cited the role they played during the COVID-19 Pandemic when they responded swiftly by injecting trillions of dollars into the global economies to support both corporate and household customers against the effects of the pandemic. Aizenman et al. 2021 however were skeptical about this significant role arguing that central banks have a focus primarily on domestic rather than global concerns. Consequently, central banks, in their cross-border activities, tend to allocate their resources to countries and entities that are systemically important or that they view as having a significant impact on their domestic monetary and financial situation rather than to those most in need. They recommended for development of standards that would be used to guide central banks in their global governance activities. Thamae and Odhiambo (2022) reviewed theoretical and empirical international literature on the impact of bank regulation on bank lending. The study found that the impact of bank regulatory measures on lending was ambiguous with some studies showing a negative impact and others a positive impact. The study concluded that policy recommendations regarding the appropriateness and efficacy of bank regulatory measures in influencing bank lending cannot be implemented uniformly across different regions or countries; hence domesticated policies.

Ofori-Sasu et al. (2023) examined the impact of central bank regulatory policies on market power in Africa. The study used a representative sample of 52 African economies over the period 2006–2020. The study showed that the individual regulatory policies of the central bank enhanced banks' market power. Also, it revealed that central bank regulatory policies were better coordinated, as complements, in achieving greater market power of banks in countries with strong central bank independence (CBI) framework. Alber and Ramadan (2022) investigated the effect of applying banking regulations on banking performance. The study was based on 19 Middle East and North Africa (MENA)region countries namely; Egypt, Sudan, Lebanon, Libya, Iraq, Tunisia, Algeria, Morocco, Qatar, United Arab Emirates, Saudi Arabia, Bahrain, Palestine, Oman, Djibouti, Turkey, Kuwait, Jordan, and Mauritania, every year over the period from 2008 to 2018. Banking regulations measured capital adequacy requirements, liquidity requirements,

Vol. 8, No.10; 2024

ISSN: 2456-7760

legal reserve requirements, leverage requirements, and provisions policy. In contrast, bank performance was measured by banking efficiency using operational efficiency ratio, banking stability, profitability, and credit risk (non-performing loans & provisions for non-performing loans). Results indicated that there was a significant effect of applying banking regulations on each of the following four parameters namely; banking efficiency, banking stability, credit risk, and profitability.

Mburu et al. (2020) sought to establish why commercial banks in Kenya had higher levels of non-performing loans than the recommended rate despite the country having the most stable and developed banking system in the East and Central Africa region. The study examined the moderating role of central bank regulations on the relationship between credit management practices and loan performance. The underpinning theory of the study was the credit risk theory. The study used an explanatory research design and the research philosophy adopted was positivism. The target population was 44 commercial banks in Kenya and a census approach was used. Both primary and secondary data were collected on the loan amount advanced and non-performing loans for a period of four years from 2015-2018. Multiple regression analysis was used to test the study hypothesis. The study found that Central Bank Regulations had no significant moderating effect on the relationship that existed between credit management practices and loan performance. Therefore, the study concluded that the moderating role of central bank regulations could not be confirmed. The study recommended that the Central Bank of Kenya continuously assess and update credit management practices and the central bank regulations. The Government through regulating bodies was to establish credit policies that regulate traditional and emerging credit practices among financial institutions.

The Competition Authority of Kenya (CAK) (2021) reviewed home loan contracts for 27 banks and found the information provided to consumers by 12 banks was incomplete, unclear, and unfavourable. The banks were found to have been charging hidden mortgage costs, including valuation, origination, booking, mortgage and title transfer, commissions, brokers' fees, legal fees, insurance, and stamp duty, exceeding the recommended threshold of 10 % over and above the mortgage rate, with some charging as high as 20%. Carter et al. (2020) urged that governments use capping interest rates and loan fees to protect consumers from predatory lenders. They further indicated that in 2019, lenders undertook every effort through jurisdictions to encourage lawmakers to repeal or reduce consumer protections. They cited the usage of monthly percentage rates on loans to result in higher loan prices than loans charged on annual percentage rates. The study recommended government regulation to ensure loan rates were presented on annual percentage rates, a law on a prohibition on unfair loan terms such as loan flipping, post-dated cheques, balloon payments, interest-only terms, extended loan terms, and outlawing the sacrament of personal bankruptcy. Moody (2020) indicated that removing interest rate capping no longer constrained lending as banks could better price their risks without a rate cap and increased borrowing to segments of the economy that had subdued growth and access to credit, primarily by small and mid-sized enterprises.

Emre et al. (2019) sought to analyze the influence of interest rate regulations in Kenya by examining the impact of loan interest rate regulations on loan performance. They found that the

Vol. 8, No.10; 2024

ISSN: 2456-7760

interest rate control statute yielded the opposite effect from what the legislators anticipated. They noted that interest rate capping had led to the downfall of bank lending to MSMEs as small banks' loan books shrunk. It negatively influenced financial institutions such as commercial banks because they shifted the private sector towards the public sector. One of the study's recommendations was to raise the credit ceiling to reach higher-risk borrowers and other plans to overcome high credit costs. Kavwele et al. (2018) assessed the moderating effect of CBK rates on the association between interest rates and NPL in commercial banks in Kenya. Data was gathered for study variables for 4 quarters of the financial year before and 4 quarters after the introduction of capping. Results found that interest rate capping significantly but negatively influenced Kenya Commercial Banks' performance, particularly from interest earnings whose negative effect could not be reimbursed by a decrease in interest expense or rise in non-interest income, reducing profits.

Further, the study found that CBK rates had a substantial moderating influence on the association between the rate of interest and NPL performance in commercial banks. Banking Act (2017) requires financial institutions to consider the level of consumer indebted when entering a loan agreement. A consumer is said to be over-indebted if the available information at the time of determination shows that the consumer could not promptly satisfy all the obligations under the credit agreements. CBK Act (2017), in their consumer protection guidelines on prepayment penalty, provides that a borrower shall be entitled to prepay a portion of the outstanding loan balance on any scheduled repayment date or a monthly basis without prepayment charge or penalty. Further, the guidelines required that the lender had a duty in law to inform the consumer of his right to take some time (cooling-off period) to think over the proposed transaction before signing the contract or committing himself to take the product or use the service. CBK Act (2017), on the provision of marketing and promotions of bank products, requires the lending institution to ensure that all advertising and promotional materials are fair, transparent, and not misleading. The information should be written in simple language and a legible, easily readable font. All printed advertising and promotional materials for financial products or services referred to interest rates to include the total cost of credit, whether the interest rate was charged per annum or month, and whether the interest rate was fixed or variable- the total cost of credit to be prominently displayed. Therefore, based on the literature reviewed, it was hypothesized that CBK regulations compliance does not have a statistically significant moderating effect on the relationship between predatory loan practices and loan performance among commercial banks in Kenya.

Vol. 8, No.10; 2024

ISSN: 2456-7760

1.5 Conceptual Framework

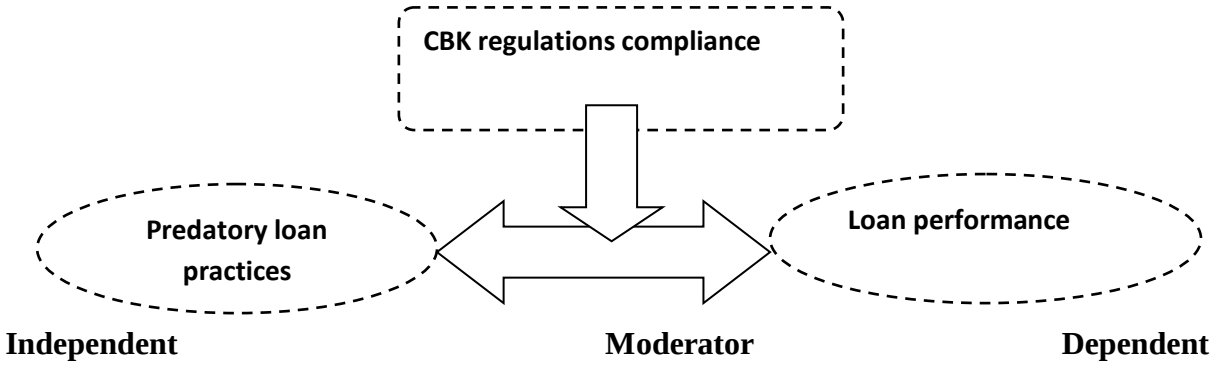

Figure 1: Conceptual Framework for CBK Regulations Compliance and the Relationship between Predatory Loan Practices and Loan Performance

1.6 Research Gaps

Numerous studies have been conducted on the relationship between CBK regulations and loan performance among financial institutions. Studies done by The Competition Authority of Kenya (CAK) (2021), Carter et al. (2020), Kavwele et al. (2018), Banking Act (2017), and CBK Act (2017) on CBK regulations compliance alluded to the likelihood of poor laws contributing to poor loan performance. These studies considered factors such as non-disclosure of all terms in loan agreements, capping of interest rates, presentation of loan rates in monthly rates rather than annual percentage rates, unfair loan terms, the creditworthiness of a borrower at the point of loan acquisition, prepayment penalties, cooling –off period, marketing and promotion of bank products, moderating effect of the association between the rate of interest and NPL Performance in commercial banks and Central Bank rates among others. Therefore, based on the reviewed literature, it was hypothesized that the moderating effect of CBK Regulation Compliance does not have a statistically significant influence on the relationship between predatory loan practices and loan performance among commercial banks in Kenya.

2.0 Research Methodology

2.1 Research Design

The researcher adopted a positivist research philosophy when testing the hypotheses to predict the influence of the CBK regulations compliance on the relationship between predatory loan practices and loan performance among commercial banks in Kenya. This study collected data from the 39 commercial banks in Kenya using a generalized questionnaire and then analyzed the data to generate conclusions drawn from the findings. A descriptive research design was used in this study. The unit of response was six (6) head office bank managers: branch manager, branch operations manager, sales manager, credit manager, relationship manager, and risk manager. On the other hand, the population was thirty-nine (39) solvent-licensed commercial banks in Kenya (CBK, 2022). Census approach to data collection was used since it is considered the best method when the source of information is a small population (Baffour et al.., 2020). Primary data was collected using a structured questionnaire. As such, a five-point nominal scaled tool was used

Vol. 8, No.10; 2024

ISSN: 2456-7760

with the equivalences of strongly disagree (1) on one side with a scale, followed by disagree (2), neutral (3), agree (4), and strongly agree (5) on the other side of the scale (Charandrakandan, Venkatapirabu, Sekar & Anandakumar 2011). The measure for loan performance was triangulated in measurement by using a secondary measure in addition to a primary measure. The study used the Statistical Package for Social Sciences (SPSS) version 21 to analyze data. SPSS was preferred due to its systematic capabilities in various statistical analyses and presentations (Porter & Gujarat, 2009).

2.2 Consistency of Instrumentation

The stability of the instrumentation was assessed using the Cronbach Alpha Coefficient. This approach to testing the reliability of a data collection instrument is documented to be among the most widely used. Internal consistency test results are presented in Table 1.

Table 1: Internal Consistency Test Results

Variable	**Number of Items**	**Cronbach Alpha Coefficient**
Central Bank of Kenya Regulations Compliance	9	0.931

The results in Table 1 show that the reliability of this construct using Cronbach was 0.931. A Cronbach's coefficient of 0.7 should be acceptable as a rule of thumb (Koshy (2010); Mertens, (2010); Bonett and Wright (2015).

2.3 Data Analysis and Presentation of Results

The mean and standard deviations of the nine (9) parameters of CBK regulations compliance were generated for preliminary evaluation. This was followed by a test of regression assumptions and, finally, inferential analysis. Hypothesis testing was done using the Bivariate Linear Regression (BLR) model. Model R-Square, ANOVA statistics (F Statistic and associated p-value), and regression coefficients (Beta and associated p-value) were extracted. The equation used in the study was in the form $Y = \beta 0 + \beta 1X1M+\beta 2X2M+\beta 3X3M+ \varepsilon$. Where Y = loan performance, β0 is a constant; β1, β2 β3 are coefficients for Z*predatory loan practices, X1 is the aggregate mean of the borrower's practices, X2 is the aggregate mean of the lender's practices, X3 is the aggregate mean of loan processing practices and INT (Z*XiM) coefficients.

3.0 Findings

3.1 Response Rate

A total of 234 (54 to large commercial banks, 54 to medium-sized commercial banks, and 126 to small peer commercial banks) questionnaires were distributed to the three (3) peer category banks.

Vol. 8, No.10; 2024

ISSN: 2456-7760

Table 2: Response Rate

Bank Size	Questionnaires Distributed	Questionnaires Received	% Response
Small Bank	126	96	76.19
Medium Bank	54	48	88.89
Large Bank	54	46	85.19
Total	**234**	**190**	**81.20**

Table 2 shows the response rate of 85.19%, 88.89%, and 76.19% were received, respectively, giving a composite response rate of 81.2%. This was considered adequate for a descriptive study as it was a strong indicator that the results were generalizable and inferences could be drawn from the analysis. The response rate was attributed to anonymity and self-administration of the instrument. (Charandrakandan, Venkatapirabu, Sekar & Anandakumar, 2011).

3.2 Test of Regression Assumptions

Shevlin & Miles (2011) and Chatterjee & Simonoff (2013) stated that before data analysis is done, it is important to assess some statistical assumptions. As such, the study tested for the normality of loan performance, independence of predatory loan practices, and linearity of the independent variables and loan performance. The first test measured loan performance (LP) using primary and secondary data for 2017-2021. Average LP measures were computed for the five years and termed "secondary measures of LP". The primary data measuring loan performance was also weighted for the four (4) parameters used to measure the same: the number of non-performing loans, the frequency of reported non-performing loans, the amount of non-performing loans reported, and finally, the number of branches reporting non-performing loans. The resulting scores were labelled loan performance (primary data measures). The third measure of loan performance was a "composite measure" computed by weighting the primary measure scores for loan performance and the secondary measure scores for the loan performance. This combined measure was labelled the "weighted loan performance" measure. Kolmogorov-Smirnov and Shapiro-Wilk statistics for numerical tests of normality for LP are presented in Table 3.

Table 3: Normality Test for Composite Loan Performance Measures

	Kolmogorov-Smirnov			Shapiro-Wilk		
	Statistic	Df	Sig.	Statistic	Df	Sig.
LP: Primary data Measure	.160	36	.200*	.955	36	.152
LP: Secondary Data Measures	.144	36	.159	.938	36	.143
LP: Weighted Measures	.133	36	.111	.958	36	.184

a. Lilliefors Significance Correction: *. This is a lower bound of the true significance.

Table 3 further shows that the statistics were statistically insignificant with p-values of Kolmogorov – Smirnov coefficients values of .200*, .159, and .111 for the three loan

Vol. 8, No.10; 2024

ISSN: 2456-7760

performance measures of loan performance, that is, primary data measures, secondary data measures, and the weighted scores, respectively. Similarly, the Table shows that the coefficient of Shapiro–Wilk statistics was .955 for the case of primary data measures, .938 in the case of secondary data measures, and .958 in the case of weighted score for loan performance. These three statistics indicate that the three measures of loan performance were normally distributed in general, implying that the data was adequate for a linear regression subject to satisfactory tests of other assumptions (Shapiro & Wilk, 1965; Garson, 2012); Tabachnick & Fidell (2014). Secondly, in the case of the test of independence for CBK regulations compliance, Durbin-Watson d statistics d- statistic of 1.983 was extracted. This was within the recommended range of 1.5 and 2.5 for an acceptable level of no autocorrelation in a variable measure. Based on this statistic, the assumption of the absence of autocorrelation in the parameters measuring the study variables was achieved (Bhattacharyya, 2011; (Argyrous, 2011). Thirdly, Pearson's correlation coefficient (r) of .477** was generated at a p-value of .003 to test for linearity between the regressors and the regressand. This statistic indicated a linear relationship between CBK regulatory compliance and loan performance. Based on this coefficient, a simple linear model was deemed appropriate for testing the study hypothesis (Chatterjee & Simonoff 2013)

4. Discussion

4.1 Hypothesis Testing

This study tested the null hypothesis H05: Central Bank of Kenya regulations compliance does not moderate the relationship between predatory loan practices and loan performance among commercial banks in Kenya. Testing of the study hypothesis was undertaken through two separate regressions. The first was the weighted and not moderated model, and the second was the weighted and moderated model.

a) **First Regression Model: Un-Moderated Weighted Model**

In the first model, the three measures of predatory loan practices, borrower practices, lender practices, and loan processing practices, were combined into one measure, "weighted predatory loan practices", by applying a one-third weight against each variable. The weighted scores of predatory loan practices were regressed against the dependent variable loan performance in a linear regression model. The results of the linear model, that is, model fitness, ANOVA statistics, and the associated regression coefficients, were computed. The results of the Model summary are presented in Table 4.

Table 4: Model Fitness for Weighted Predatory Loan Practices.

Model Summary				
Model	**R**	**R Square**	**Adjusted R Square**	**Std. Error of the Estimate**
	.765	.585	.572	.2092236

Table 4, shows a moderate correlation, r=0.765, between the weighted predatory loan practices and loan performance in commercial banks in Kenya. Further, the Table shows that R2=0.585 means that approximately 58.5% of the corresponding variation in loan performance can be

Vol. 8, No.10; 2024

ISSN: 2456-7760

explained by a unit change in the combined measure for the three predatory loan practices. This is because the R- square for each weighted model and the R- Square for the unweighted model are equal at 58.5%. This model fitness shows that the model for the weighted predatory loan practices is as good as the combined and not weighted predictors of loan performance.

Table 5: ANOVA for Weighted Predatory Loan Practices.

ANOVA Table

Source	Sum of Squares	df	Mean Square	F-value	p-value
Regression	2.094	1	2.094	47.838	.000
Residual	1.488	34	.044		
Total	3.582	35			

Table 5 shows the ANOVA for the weighted scores of predatory loan practices and loan performance. The resulting linear regression model robustness test was significant at a 95% confidence level with F=47.838, the p-value of 0.000, which is less than the level of significance set as 0.05. Based on these results, this study confirmed a positive and statistically significant influence of the three predatory loan practices on loan performance in commercial banks in Kenya. The standardized regression coefficients were computed to evaluate the significance of beta coefficients in the Model fitness, and the resulting model's beta coefficients are shown in Table 6.

Table 6: Regression Coefficient for Weighted Predatory Loan Practices.

Coefficients

	Unstandardized Coefficients		Standardized Coefficients		
Coefficients	B	Std. Error	Beta	t-value	p-value
Constant (β_0)	-1.225	.321		-3.813	.001
Weighted PLP(β_1)	.783	.113	.765	6.916	.000

Table 6 shows the beta coefficients of the resulting model showing that the constant β0 =-1.225 is statistically significantly different from zero, with a p-value less than 0.05. The coefficient for the weighted predatory loan practices was β1=.783 with an associated p-value of 0.000, which was less than 0.05. It is also significant in the simple linear regression model for the weighted three predatory loan practices. The resistant weighted simple linear regression Model for the weighted predatory loan practices will be in the form;

Loan Performance = -1 225 + .783 Predatory Loan Practices + εi …. Unmoderated

Vol. 8, No.10; 2024

ISSN: 2456-7760

b) Second Regression: Weighted Moderated Model

In this model, new values of weighted predatory loan practices were computed through a data transformation process of centering the predatory loan practices' values, moderating variable values, and generating Z-scores for the weighted measure for predatory loan practices and the Z-scores for the moderating variable. Secondly, an interaction term was estimated by multiplying the Z-scores for weighted predatory loan practices with the Z-scores of the moderating variable. As such, the interaction term determined was the resultant variable for (ZPLP*Z Moderating variable). Thirdly, a moderated regression model was generated by regressing the variables, Z-predatory loan practices scores, interaction term (Z-PLP*Z-Moderating variable), on the weighted loan performance. ANOVA and a simple linear regression model were then fitted as shown in Table 7.

Table 7. Model Fitness Moderated Regression for Predatory Loan Practices.

Model Summary				
Model	**R**	**R Square**	**Adjusted R Square**	**Std. Error of the Estimate**
	.766	.588	.563	.2116106

Table 7 shows the results of the Model summary indicating a moderate correlation, r=0.766, between the predictors in the model and loan performance in commercial banks in Kenya. Further, the coefficient of determination R2=0.588 implied that approximately 58.8% of the corresponding variation in loan performance could be explained by the change in the combined measure for the regressor-centered weighted predatory loan practices and the interaction term. The moderated model explained an additional 0.3% in the variations of loan performance compared to the un-moderated model.

Table 8: ANOVA for Moderated Weighted Predatory Loan Practices.

ANOVA Table						
Model	**Source**	**Sum of Squares**	**df**	**Mean Square**	**F-Value**	**p-value**
1	Regression	2.105	2	1.052	23.501	.000
	Residual	1.478	33	.045		
	Total	3.582	35			

Table 8 shows the ANOVA for the weighted scores of predatory loan practices and loan performance. These results show that the resultant linear regression model robustness test is significant at a 95% confidence level with F=23.501, a p-value of 0.000, which is less than the level of significance set as 0.05. Based on these results, the study confirms at a 95% level that the moderated weighted predatory loan practices model is significant for predicting loan performance in commercial banks in Kenya. The model is as good as the un-moderated model as both are significant at a 5% significance level.

Vol. 8, No.10; 2024

ISSN: 2456-7760

Table 9: Regression Coefficients for Moderated Predatory Loan Practices

Coefficients						
		Unstandardized Coefficients		Standardized Coefficients		
Coefficients		B	Std. Error	Beta	t-value	p-value
1	(Constant)	.978	.037		26.133	.000
	Z score (WeightedPLP)	.246	.036	.769	6.855	.000
	INT	.016	.032	.055	.487	.629

Loan Performance = .978 +. 246 Predatory Loan Practices + εi …. Moderated

Table 9 shows the beta coefficients of the resulting moderated model, showing that the constant β_0= .978 is statistically significantly different from zero, with a p-value of 0, which is less than the p-value of 0.05. The coefficient for the weighted predatory loan practices was β_1=.246 and an associated p-value of 0.000, which was less than a p-value of 0.05, meaning that it is significant in the moderated linear regression model for weighted three predatory loan practices. However, it is noted that the coefficient reduced from a high of .783 but the reduction was not statistically significant. These results also show that the beta coefficient for the interaction was 0.016, with an associated p-value of .629. The p-value is greater than the p-value of 0.05, meaning that the moderating variable does not significantly affect the relationship between predatory loan practices and loan performance among commercial banks in Kenya. Based on these results, the study failed to reject the null hypothesis that "Central Bank of Kenya Regulations compliance does not moderate the relationship between predatory loan practices and loan performance among commercial banks in Kenya".

The study found some gaps in the CBK regulations which probably are some of the reasons behind their minimum impact on loan performance. The CBK regulations were found to be lacking clear guidelines on payment for legal fees and brokerage fees on property. This could be interpreted to mean that commercial banks are left with the flexibility and liberty to determine the legal and brokerage charges charged to their customers. It further implied that in the case of property loan(s), the rate was bank-specific and not a general industry rate(s) which means that one expects a variation from one bank to the next. Without regulation, the borrower remained exposed and had minimal options other than getting locked into the bank-prescribed rate. The practice can and, more often than not, has the ability to push a loan from repayment rates that were initially affordable to rates that turn out to be unaffordable to the borrowers. Unfortunately, the borrower has very little to negotiate as they are ordinarily "note and take" basis. The overall possible effect of this dilutes a borrower's ability to pay leading to a possibility of loan default.

Vol. 8, No.10; 2024

ISSN: 2456-7760

Similarly, the study found that customers in default were exposed, through a statement that sought to establish the level of defaulting customer protection under the Central Bank of Kenya guidelines. The response from the respondents indicated that typical defaulting- borrower in Kenya has minimal recourse when they find it difficult to honour loan repayment(s). The implication is that they remain exposed if the borrower was tricked into a loan through outright deception or fraud. This scenario presents a conducive environment for predator-lenders to thrive. The effect of this was unfavourable loan performance among commercial banks. Equally, the study found that CBK regulations do not limit the number of loans banks could give to a customer. This implied that, as a practice, a commercial bank customer could borrow as many loans as possible, which could result in a possible constraint on the ability to pay. Therefore, a policy gap was identified that justified the findings that CBK regulations compliance does not have a moderating effect on the relationship between predatory loan practices and loan performance of commercial banks in Kenya.

The results agreed with Mburu et al. (2020) whose study concluded that the moderating role of central bank regulations could not be confirmed hence recommended that the Central Bank of Kenya continuously assess and update credit management practices and the central bank regulations. Equally, Emre et al. (2019) and Kavwele et al. (2018), found that the law on interest rate control yielded the opposite impact from the one intended. They further noted that interest rate capping led to the downfall of bank lending to MSMEs as small banks' loan books shrunk due to banks denying them credit on the grounds of anticipated default. However, the results disagreed with Alber and Ramadan (2022) whose study results showed a significant effect of applying banking regulations on each of the following four parameters namely; banking efficiency, banking stability, credit risk, and profitability. Similarly, Carter et al. (2020), argued that governments use capping interest rates and loan fees to protect consumers from predatory lenders. The study recommended using government regulations to ensure loan rates were presented on annual percentage rates. A law was needed to prohibit unfair loan terms such as loan flipping, post-dated cheques, balloon payments, interest-only terms, and extended loan terms and outlaw the sacrament of personal bankruptcy.

4.2 Conclusions and Recommendations

4.2.1 Conclusions

The study computed the first model or weighted predatory loan practices and loan performance, which showed that the resultant model explained 58.5% of the variations in loan performance. This weighted model was significant at a 5% level of significance. The coefficient for the weighted predatory loan practices was $\beta 1=.783$ and an associated p-value of 0.000, which was less than a p-value of 0.05, meaning that it is significant in the simple linear regression model for the weighted three predatory loan practices and loan performance. The second model was termed the moderated model. The moderated model's R-square was 58.8%, implying that the increase from the un-moderated model was approximately 0.3%. This means that central bank regulations compliance has a very weak enhancing moderating effect on the relationship between the three predatory loan practices and loan performance among commercial banks in Kenya. These results also showed that the beta coefficient for the interaction was .016, with an associated p-value of

Vol. 8, No.10; 2024

ISSN: 2456-7760

0.629. The p-value was greater than .05, meaning that the moderating variable did not have a statistically significant enhancing effect on the relationship between predatory loan practices and loan performance among commercial banks in Kenya.

4.2.2 Recommendations

The study found that central bank regulations compliance did not significantly enhance the relationship between predatory loan practices and loan performance. This is because these institutions play a pivotal role in any economy. As such, it is recommended that bank management and the regulator progressively monitor practices, such as continuously ensuring that the loan performance is improved and sustained within the commercial banking sector. There was a need for both of them to re-look into some of the existing policies that have gaps contributing to high levels of non-performing loans. Banks should review their Know Your Customer and Due Diligence tools for proper credit scoring while the regulator should enhance their regulatory policies.

Acknowledgment

I want to express my most profound appreciation and gratitude to Prof. David Kiragu, Ass. Professor, School of Business Management and Economics, Dedan Kimathi University of Technology, for the guidance, expertise, and support accorded to me while writing this paper. His dedication and commitment to excellence have been instrumental in shaping the direction and quality of this paper.

References

Aizenman J., H. Ito, and Pasricha, G., (2021). "Central Bank Swaps in the Age of Covid-19", VoxEU https://voxeu.org/article/ central-bank-swaps-age-covid-19.

Alber, N., & Ramadan, H., (2022). The Effect of Applying Banking Regulations on Banking Performance of MENA Region Countries. European Journal of Business and Management Research, 7(1), 170–185.

Banking Act (2015-2021).Laws of Kenya. Chapter 488

Banking Act Chapter 488 (2019). The National Council for Law Reporting With the Authority of the Attorney-General, Kenya.

Bonett, D. G., & Wright, T. A. (2015). Cronbach's alpha reliability: Interval estimation, hypothesis testing, and sample size planning. Journal of Organizational Behaviour, 36(1), 3-15.

Bradlow D.D. and Park S.K., (2020). "A Global Leviathan Emerges: The Federal Reserve, COVID-19, and International Law", American Journal of International Law, vol. 114, no. 4, pp. 657-65.

Carter, C., Saunder, L., and Saunder, M. (2020). Predatory Lending in the States. National Consumer Law Center.

CBK (2018). Key Highlights On The Impact Of Interest Rate Caps On The Kenyan Economy.

CBK (2019). Kenya Banking Sector Charter, Laws of Kenya.

CBK (2021). FinAcess Household Survey.FinAccess Management Partners.

CBK Act (2019). Mortgage Refinance Companies, Laws of Kenya.

Central Bank of Kenya (2019). KNBS and Financial Sector Deepening-Kenya (FSD-K). Fin Access Household Survey 2019 for Kenya. Nairobi. CBK, KNBS and FSD-K

Central Bank of Kenya (2022, 2021, 2020, 2019, 2018). Bank Supervision Annual Report. CBK, Nairobi.

Central Bank of Kenya Act (2014-2021). Banking Act. (Cap. 461). Government Printer, Nairobi.

Central Bank of Kenya Act (2021). Banking Act. (Amendment Bill). Government Printer, Nairobi.

Chatterjee S. & Simonoff J.S., (2013). Handbook of Regression Analysis, John Wiley & Sons, Hoboken, New Jersey.

Communications Authority of Kenya (2021). Annual Report for 2020/2021. Nairobi.

Emre, A., Benedict J. Clements, N. A. Hobdari, and Rafel, M. (2019). Do Interest Rate Controls Work? Evidence from Kenya. 9781498313957/1018-5941

Erdas, M. and Ezanoglu, Z. (2022). How do bank-specific factors impact Non-performing Loans? Evidence from G20 Countries. Journal of Central Banking Theory and Practice, Central Bank of Montenegro, Vol. 11(2), pages 97-122.

Garson, D. (2012). Testing statistical assumptions. Statistical Associates Publishing.

Gujarati, D.N. and Porter, D.C. (2009) Basic Econometrics. 5th Edition, McGraw Hill Inc., New York.

International Monetary Fund (2018-2022).World Economic Outlook. Bretton Woods, New Hampshire, USA

Katharina, P. (2013). A Legal Theory of Finance, Journal of Comparative Economics, vol. 41, no. 2, 315–30.

Kavwele, D. T., Ariemba, J. M., & Evusa, Z. (2018). Effect of Interest Rate Capping on the Financial Performance of Commercial Banks in Kenya. International Journal of Business Management and Economic Research, 9(1), 1182-1190.

Kigamwa, J., Mutwiri, N. (2023). Macroeconomic factors and non-performing loans in the Kenyan banking industry. International Academic Journal of Economics and Finance, 3(8), 279-291.

Koshy, V. (2010). Action Research for Improving Educational Practice. (2nd Edn). Sage Publications

Kwasi, P. & Deodutt, J. (2019). Legal Theory of Finance: Evidence from Global Financial Networks. Cogent Economics & Finance, 7:1, DOI: 10.1080/23322039.2019.1593071.

Mburu, M. I., Mwangi, L. W., & Muathe, S. M., (2020). Changing Landscape in Credit Management and Loan Performance: The Role of Central Bank Regulations in the Context of Commercial Banks in Kenya. International Journal of Academic Research in Business and Social Sciences, 10(12), 116– 127.

McCluskey, M., Pasquale, F. & Taub, J. (2017). Law and economics: Contemporary approaches. Yale Law & Policy Review, 35(1), 297 - 308.

Mertens, D.M. (2010). Research and evaluation in education and psychology: Integrating diversity with quantitative, qualitative, and mixed methods. (3rd Ed.) Thousand Oaks, CA: Sage.

Moody (2020). African Banking Outlook Report. Kenya's Loan Outlook for 2021. https://kenyanwallstreet.com/moodys-sets-outlook-for-2021

Vol. 8, No.10; 2024

ISSN: 2456-7760

National Treasury (2023). The Bottom-up Economic Transformation Agenda for Inclusive Growth. Budget Policy Statement. Nairobi, Kenya

Njiraini, J. (2020). African Banks: Non-Performing Loans Prove To Be A Struggle. Global Finance.

Ofori-Sasu, D., Agbloyor, E. K., Sarpong-Kumankoma, E., & Abor, J. Y., (2023). Central bank coordinated policies and bank market power: an insight from the African context. Cogent Economics & Finance, 11(1).

Shapiro, S.S. and Wilk, M.B. (1965) An Analysis of Variance Test for Normality (Complete Samples). Biometrika, 52, pg. 591-611.

Shevlin, M., and Miles, J. (2011). Applying Regression and Correlation. A Guide for Students and Researchers. New Delhi: Sage Publication Inc.

Stuart N. (2019) Research paradigms and the politics of nursing knowledge: A reflective discussion, Nursing Philosophy, 10.1111/nup.12260.

Tabachnick, B. & Fidell, L. (2014) Using multivariate Analysis. Boston, Pearson Education Inc.

Thamae, R. and Odhiambo, N., (2022). "The impact of bank regulation on bank lending: a review of international literature," Journal of Banking Regulation, Palgrave Macmillan, vol. 23(4), pages 405-418.

The Competition Authority of Kenya (2021). CAK flags 12 banks with hidden mortgage charges. Business News Daily, Nov. 23. BusinessNewsDaily @BNDarticles.

Wiley, B. J., & Navickas, J. (2021). Effect of Financial Regulation on Performance of Banking Sector in the United States of America. Journal of Finance and Accounting, Stratford, 5(3), 11–21.

World Bank (2022). The Non-Performing Loans at World Level. The Global Economy. Business and Economic data for 200 countries.

World Bank. (2021). Global Financial Development Report 2019/2020: Bank Regulation and Supervision a Decade after the Global Financial Crisis. Washington.