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Interest Rate Capping and Performance of Commercial Banks in Bangkok, Thailand

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Abstract

Interest rate capping is a regulatory mechanism designed to limit the maximum interest rates that banks can charge on loans and credit products, with the primary aim of protecting consumers from usurious practices. However, this practice presents a complex challenge as it can impact the profitability of commercial banks by constraining their interest income. To thrive in this regulatory environment, banks should balance profitability concerns with the imperative to provide fair and accessible financial services to their customers while complying with interest rate caps. The study adopted the descriptive research design. The target population was 25 commercial banks in Bangkok, Thailand. The study did sampling of 20 respondents that were chosen from the target population of 25 commercial banks in Bangkok, Thailand. Questionnaires were used to gather the data. In conclusion, the relationship between interest rate capping and the performance of commercial banks in Bangkok, Thailand is a delicate balancing act. While interest rate capping seeks to protect borrowers and promote financial stability, it can also pose challenges to the profitability of commercial banks. The ultimate success of this regulatory practice hinges on the ability of banks and regulators to collaborate in creating a regulatory environment that safeguards the interests of consumers, maintains financial stability, and fosters a competitive and sustainable banking sector. The study recommended that Thailand should implement a flexible regulatory framework that allows for periodic reviews and adjustments of interest rate caps based on economic conditions. Commercial banks should focus on effective risk management, adopting advanced credit assessment tools and diversifying revenue streams through innovative financial products to mitigate the impact of reduced interest income. Additionally, promoting financial education and enhancing consumer protection measures will empower borrowers to make informed financial decisions while ensuring transparent lending practices in a regulated environment.

Keywords: *Interest Rate Capping, Performance, Commercial Banks, Thailand*

Stratford Peer Reviewed Journals and Book Publishing
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1.0 Background of the Study

Interest rate capping, a regulatory mechanism imposed by government authorities, is designed to limit the maximum interest rates that commercial banks can charge on loans and credit products (Heng, Chea & Heng, 2021). This measure is often implemented to protect consumers from exorbitant interest rates and ensure financial stability. In Bangkok, Thailand, interest rate capping has been a subject of debate, with proponents arguing that it safeguards borrowers while opponents claim it can hinder the performance of commercial banks. Thailand's economy is export-driven, with significant exposure to external shocks and volatility. Commercial banks play a pivotal role in providing financing to businesses, which, in turn, fuels economic growth (Zheng, Siddik, Masukujjaman, Fatema & Alam, 2021). High-interest rates can stifle business activities, making the regulatory environment crucial for ensuring stability.

Interest rate capping in Thailand typically takes the form of maximum interest rate limits on various types of loans and credit products, such as personal loans, credit cards, and mortgages (Saengchote & Samphantharak, 2022). These caps are imposed to protect consumers from usurious practices and to maintain the stability of the financial system. The impact of interest rate capping on the performance of commercial banks in Bangkok can be multifaceted. It can limit the banks' ability to charge higher interest rates, potentially reducing their interest income and profitability. Also it can lead to a more stable lending environment, with lower default rates and decreased credit risk. Interest rate capping often leads to reduced profitability for commercial banks, as they are unable to charge as much interest on their loans and credit product (Aslanishvili & Omadze, 2019). This can result in tighter profit margins, making it more challenging for banks to cover their operational expenses and generate profits.

Interest rate capping can also encourage competition among commercial banks in Bangkok (Chen, He, Haga & Fan, 2023). Since interest rates are capped, banks may differentiate themselves through other means, such as offering superior customer service, innovative financial products, or more efficient lending processes. Interest rate capping can mitigate risks for commercial banks. By preventing them from charging exorbitant interest rates, it can reduce the likelihood of borrowers defaulting on their loans. This, in turn, can lead to a more stable and lower-risk loan portfolio for the banks. Interest rate capping can promote financial inclusion by making credit more accessible to a broader segment of the population. With lower interest rates, individuals and small businesses may find it easier to obtain loans and credit, which can stimulate economic growth (Yemelyanov, Petrushka, Symak, Trevoho, Turylo, Kurylo & Lesyk, 2020). For borrowers, interest rate capping can be beneficial, as it protects them from predatory lending practices and high-interest burdens. It ensures that credit remains affordable and reduces the risk of falling into a debt trap.

Commercial banks in Bangkok should navigate the regulatory environment while ensuring their lending practices align with interest rate caps (Li, Xu, Shen & Zhong, 2021). This requires banks to develop innovative strategies and financial products to maintain profitability while staying compliant with the law. Analyzing specific case studies of commercial banks in Bangkok can provide insights into how different banks adapt to interest rate capping. Some may focus on

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Stratford Peer Reviewed Journals and Book Publishing
Journal of Finance and Accounting
Volume 7||Issue 10 ||Page 1-11||November||2023|
Email: info@stratfordjournals.org ISSN: 2616-4965

reducing costs and streamlining operations, while others may diversify their revenue streams through non-interest income. Interest rate capping in Bangkok, Thailand, has a significant impact on the performance of commercial banks. While it can reduce their profitability and require adaptation to regulatory compliance, it also promotes financial inclusion and risk mitigation. The overall success of interest rate capping depends on how well it is balanced with the needs of both borrowers and lenders, and how effectively banks respond to the changing regulatory landscape (Pinitjitsamut & Suwanprasert, 2022). In the complex economic context of Thailand, interest rate capping remains a crucial tool to maintain financial stability and protect consumers.

1.1 Statement of the Problem

Interest rate capping, as a regulatory tool, has been widely discussed in the context of the performance of commercial banks in Bangkok, Thailand. The problem at the core of this analysis lies in the potential tension between consumer protection and the financial health of the banking sector. One of the primary concerns is that interest rate capping can negatively impact the profitability of commercial banks. By imposing maximum interest rate limits on various types of loans and credit products, banks may face reduced interest income, leading to tighter profit margins. This raises questions about the sustainability of their operations and their ability to cover operational costs. While the aim of interest rate capping is to shield borrowers from exorbitant interest rates and usurious practices, it poses a dilemma for commercial banks as they navigate the fine line between remaining profitable and complying with regulatory requirements. This problem is particularly significant in Bangkok, where commercial banks are crucial drivers of economic growth and stability.

Interest rate capping also raises concerns about its potential impact on competition within the banking sector. With capped interest rates, banks may seek alternative ways to differentiate themselves, potentially resulting in a more competitive landscape. However, this competition could influence the overall profitability and stability of the sector. The problem extends to the risk profile of commercial banks. By capping interest rates, regulators aim to reduce the risk of borrowers defaulting on their loans. However, commercial banks need to find a balance between offering credit at reasonable rates and managing the risk inherent in their loan portfolios. Striking this balance is a complex challenge for banks in Bangkok. Finally, the problem of interest rate capping in Bangkok must be examined through the lens of financial inclusion. While lower interest rates can make credit more accessible to a broader segment of the population, there is a potential issue of banks becoming more risk-averse in their lending practices, which may inadvertently exclude certain borrowers from accessing credit. Thus, the problem encompasses the need to ensure that regulatory measures do not hinder access to financial services for those who need them.

2.0 Literature Review

Nguyen, Nguyen and Pham (2020) conducted study to investigate the effect of interest rate capping on the financial performance of Commercial Banks in Venezuela. Commercial bank performance was evaluated based on overall profit before tax and unusual items, whereas the factors used to limit interest rates were Interest Income, Non-Interest Income, and Interest Expense. The factors

Stratford Peer Reviewed Journals and Book Publishing
Journal of Finance and Accounting
Volume 7||Issue 10 ||Page 1-11||November||2023|
Email: info@stratfordjournals.org ISSN: 2616-4965

were tracked for a full fiscal years' worth of data, four quarters before capping was implemented and four quarters after. Due to the correlation between the variables, a multiple linear regression analysis and paired sample T-test were utilized for the study. Statistical analysis shows that interest rate capping has a negative impact on commercial bank performance, especially from interest income, and that this effect cannot be mitigated by an increase in non-interest income or a decrease in interest expenses, leading to a decline in profits.

Cubillos-Rocha, Gamboa-Arbelaez, Melo-Velandia, Restrepo-Tamayo, Roa-Garcia and Villamizar-Villegas (2021) carried out study to gain an understanding of the effect of interest rate capping on the performance of banks in India, a case of Kashmir Region. For many decades, academics throughout the globe have studied the correlation between interest rates and bank profitability. The research will centre on Keynes's, Caplan's, and Friedman's interest rate theories, which hold that interest rates and the demand for capital from consumers resulting from investment choices based on savings are intertwined. The research method was a cross-sectional survey, and the participants were all 34 Kashmir Region commercial banks. Primary and secondary sources were mined for information. Surveys filled out by employees and upper management at the commercial banks of interest served as the primary source of information. Descriptive statistics were used to summarize the data and provide context, while inferential statistics were used to draw conclusions about the connections between different pieces of information. Borrowing, inflation, discount rates, and the overall performance of commercial banks in the Kashmir Region were all studied using regression analysis. The study's findings can help Indian policymakers plan and predict the impact of interest rate capping on the performance of financial institutions, in particular local commercial banks, with an eye towards ensuring that local commercial banks thrive in their mandate while also protecting and delighting customers. The study found a positive correlation between commercial banks' financial performance and the interest rate cap, with the interest rate cap affecting performance by 58.5% (r square= 0.585) and an influence scale equated at $p<0.001$. With a mean score of 2.810, respondents indicated a considerable degree of agreement with the questions on each of the three variables required (consumer borrowing, inflation, and discount rates). The regression model also implies that commercial banks in the Kashmir Region would reach a financial performance level of 1.932 if all independent variables were held constant. The performance of commercial banks would change by factors of -0.071, -0.257, and 0.611 for consumer borrowing, inflation, and discount rates, respectively, for every unit rise in each of the variables. As a result, the research concluded that interest rate stability or an increase was necessary to guarantee a steady and enhanced performance by commercial banks in the Kashmir Region.

Pozo (2022) performed study to determine the effect of interest rate capping on financial performance of commercial banks in Greece. This research aims to establish the impact of loan supply on Greek commercial banks' financial performance and to analyze the impact of asset quality on Greek commercial banks' financial performance. The research intends to ascertain how the cost of borrowing influences the financial performance of Greek commercial banks. The research is grounded on three major theories: the theory of financial intermediation; the theory of fractional reserve banking; and the theory of credit creation and rational expectation. Secondary data were obtained from 40 Greek commercial banks every quarter between 2013 and 2017 for the research. The choice of era is supported on the premise of data availability and the period when this investigation was initiated. The information was collected from the bank's financial statements and other Central Bank of Greece publications. Descriptive statistics and the Ordinary Least Squares (OLS) regression technique were used to examine the data. The descriptive statistics and the regression findings reveal that Interest rate capping has a beneficial influence on financial performance of commercial banks. The results show that commercial banks benefited from the interest rate restriction. Furthermore, the findings show that financial performance is severely impacted by the quality of assets as determined by the proportion of Non-performing loans. The negative correlation between credit growth (as measured by gross loans and advances) and bank profitability was also apparent. This research concludes that commercial banks may increase their returns on assets by investigating strategies to lower the amount of non-performing loans on their books. One way to do this is to check the credit histories of potential loan recipients. Based on the interest rate's favorable impact on financial performance, the research suggests that the government, via the Central Bank, keep an eye on credit costs to ensure that low-income borrowers have access to loans. This has the potential to enhance demand for bank loans, which in turn may increase the bank's interest income. Financial institutions need to diversify their sources of interest revenue to boost their returns on assets.

Nguyen, Tsai, Hu and Ajay Kumar (2022) conducted study to investigate the short-term implications of the capping of interest rate on the financial performance of commercial banks' in Thailand. This study was guided by three main objectives, which are: to examine the impact of deposit interest rate capping on financial performance of commercial banks, to investigate the impact of interest rate capping on loans on financial performance, and lastly, to determine the effect of the interest rate spread on financial performance. Data analysis included descriptive analysis, correlation analysis, and regression analysis. Before interest rate caps was implemented, the average Deposit Rate was.9403 and the average Interest Rate spread was.9758.Loan Rate Capping averaged 1.1288 before interest rate capping went into force, while Return on Assets was 0.0131.The mean of Deposit Rate Capping after interest rate capping came to effect was at 0.9403 while for Interest Rate spread stood at .9796. Loan Rate Capping averaged 1.1102 after interest rate capping went into force, while Return on Assets averaged.2391. A correlation analysis was done to establish the relationship between the variables and the study found out that there was a positive relationship between Deposit Rate capping and financial performance at pre capping era at r=0.266, was a positive relationship between Interest rate spread and financial performance at pre capping era at r=0.240 and finally a positive relationship between Loan rate capping and financial performance at pre capping era at r= 0.023. Policymakers are urged to reconsider the impact of interest rate limiting legislation in light of its potential long-term impact on credit risk, as shown by the research. The study recommends that a proper balance between capping on loans and deposits needs to be maintained so that banks realize a good return on their assets. Banks also need to diversify their investment portfolio so as to take realize a good return on assets so that they do not perform poorly due to interest cap legislation. Since this does not have any unfavorable effects on financial institutions, the regulator must keep up the enforcement of this rule. Due to its

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Volume 7||Issue 10 ||Page 1-11||November||2023|
Email: info@stratfordjournals.org ISSN: 2616-4965

narrow focus on commercial bank deposits, loans, and ROA, this study cannot be generalized to the entire economy.

Hussain, Quddus, Pham, Rafiq and Pavelková (2020) conducted research was to find out the effect of interest rate caps on the banks' performance in Malaysia. The author conducted hypothesis on banks' average ROE would not change much before and after interest rate limitations, and that banks' average loan book growth would not change significantly before and after the restrictions. The research strategy used in this study was descriptive. The sample included 43 licensed banks in Malaysia that were active both before and after the cap. Secondary data was acquired from the respondents' most recent yearly financial statements using a census sampling technique. The data was analyzed using SPSS, a statistical programme designed specifically for social scientists. To evaluate the hypotheses, the researchers utilized a t-test for paired samples. The average return on equity before the cap was 0.13 and after it was 0.07. After the intervention of interest rate capping, ROE scores decreased to M=0.07, SD=0.136 from pre-intervention levels (M=0.13, SD=0.087); t (30) =3.174, p=0.003. The research also found that there was a statistically significant difference (t (30) =6.22, p=0.000) in the mean scores for loan growth before and after interest rate capping (M=15.56, SD=9.14, and M= -0.77, SD=11.33, respectively). The banks' ROE and loan growth suffered as a result of interest rate capping. The government should, therefore, reassess the policies surrounding interest rate control to promote the country's economic development.

Cavaliere, Muda, Ruby Khan, Vijayalakshmi, Chakravarthi, Rajest and Regin (2021) carried out study to determine the impact of interest rate capping policy on financial performance of commercial banks in Germany and the main case study was Deutsche Bank. The primary research employed three factors to model the association between interest rate capping and financial performance of Deutsche Bank. Three distinct goals were chosen to examine: how interest rate caps affect credit uptake and bank performance; how interest rate caps affect Deutsche Bank's financial exposure; and how interest rate caps affect Deutsche Bank's loaning practices and bank performance. The study also made use of a descriptive research strategy. There were a total of 78 participants in the study, and they were all managers at various levels within Deutsche Bank (operations, credit, and branch management). Questionnaires, which were handled professionally, were utilized to gather the data. Finally, the data collected was analyzed on SPSS and the report generated was used to explain the findings. In order to improve and more gradually affect the bank's financial performance, the study recommended that Deutsche Bank, other banks, and policymakers ensure that lending rates are well stated and follow a well-defined structure. Good loaning practices and policy, as well as strict and close scrutiny to remove those likely to default, can also prevent or reduce exposure to risk brought on by non-performing loans and loan defaulters. Finally, in order to control interest rate capping by Commercial Banks and promote economic growth and stability, the government's role in the form of policies, regulations, and laws is greatly needed.

3.0 Research Methodology

The study adopted the descriptive research design. The target population was 25 commercial banks in Bangkok, Thailand. The study did sampling of 20 respondents that were chosen from the target

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Stratford Peer Reviewed Journals and Book Publishing
Journal of Finance and Accounting
Volume 7||Issue 10 ||Page 1-11||November||2023|
Email: info@stratfordjournals.org ISSN: 2616-4965

population of 25 commercial banks in Bangkok, Thailand. Questionnaires were used to gather the data.

4.0 Research Findings and Discussion

4.1 Correlation Analysis

The findings presented in Table 1 shows the correlation analysis

Table 1: Correlation Analysis

		Performance	Interest Rate Capping
Performance	Pearson Correlation	1.000	
	Sig. (2-tailed)		
Interest Rate Capping	Pearson Correlation	.240 **	
	Sig. (2-tailed)	0.000	0.000

The correlation results from Table 1 indicate that the interest rate capping was positively and significantly related with performance (r=.240, p=.000). This concurs with Nguyen, Tsai, Hu and Ajay Kumar (2022) who noted that policymakers should reconsider the impact of interest rate limiting legislation in light of its potential long-term impact on credit risk. A proper balance between capping on loans and deposits needs to be maintained so that banks realize a good return on their assets. Banks also need to diversify their investment portfolio so as to take realize a good return on assets so that they do not perform poorly due to interest cap legislation.

4.2 Regression Analysis

The section includes model fitness, analysis of variance and regression of coefficient. The results in Table 2 show the model fitness

Table 2: Model Fitness

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.240a	0.261	0.221	0.01304922

The results from Table 2 reveal that interest rate capping was found to be satisfactory in explaining the performance of commercial banks in Bangkok, Thailand. This was supported by the coefficient of determination, which is R square of 0.261. It indicates that interest rate capping explain 26.1% of the variations in the performance of commercial banks in Bangkok, Thailand.

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Table 3: Analysis of Variance

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	4.82	1	4.82	14.012	.000b
	Residual	8.61	25	0.344		
	Total	13.43	24			

The findings in Table 3 reveals that the overall model was statistically significant. The findings indicate that performance is a good predictor in explaining the interest rate capping among the commercial banks in Bangkok, Thailand. This was supported by an F statistic of 14.012 and the reported p-value of 0.000 which was less than the conventional probability significance level of 0.05.

Table 4: Regression of Coefficient

	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
(Constant)	0.349	0.104		3.356	0.076
Interest Rate Capping	0.596	0.242	0.952	2.463	0.006

Based on the findings in Table 4, it was discovered that interest rate capping was positively and significantly associated to performance (β=0.596, p=0.006). This was supported by a calculated t-statistic of 2.463 that is larger than the critical t-statistic of 1.96. These results indicates that when interest rate capping increases by one unit, the performance of commercial banks in Bangkok, Thailand will increase by 0.596 units while other factors that influence the performance of commercial banks remain unchanged. Cavaliere, Muda, Ruby Khan, Vijayalakshmi, Chakravarthi, Rajest and Regin (2021) mentioned that policymakers should ensure that lending rates are well stated and follow a well-defined structure. Finally, in order to control interest rate capping by commercial banks and promote economic growth and stability, the government's role in the form of policies, regulations, and laws is greatly needed.

5.0 Conclusion

In conclusion, the impact of interest rate capping on the performance of commercial banks in Bangkok, Thailand is a multifaceted issue with both positive and negative implications. The regulatory practice of capping interest rates has far-reaching consequences that affect the profitability of banks, competition within the banking sector, risk mitigation, financial inclusion,

Stratford Peer Reviewed Journals and Book Publishing
Journal of Finance and Accounting
Volume 7||Issue 10 ||Page 1-11||November||2023|
Email: info@stratfordjournals.org ISSN: 2616-4965

and overall financial stability. Interest rate capping unquestionably challenges the profitability of commercial banks in Bangkok by limiting their ability to charge higher interest rates on loans and credit products. This results in tighter profit margins, raising concerns about their sustainability and their capacity to cover operational costs. However, this potential reduction in profitability should be considered within the context of protecting consumers from exploitative lending practices. Competition in the banking sector is another dimension of the problem. Interest rate capping encourages commercial banks to find alternative means to differentiate themselves in the market. While this promotes a more competitive environment, it may impact the sector's overall profitability, pushing banks to innovate and focus on customer service and efficiency.

Interest rate capping can also be viewed as a risk mitigation tool. By preventing banks from charging excessively high interest rates, it can contribute to a more stable and lower-risk loan portfolio for banks. This can, in turn, enhance financial stability and reduce the likelihood of borrowers defaulting on their loans, thereby safeguarding the broader economy. One of the key benefits of interest rate capping is its potential to promote financial inclusion by making credit more accessible to a wider range of individuals and small businesses. However, it is essential to strike the right balance to ensure that regulatory measures do not inadvertently exclude certain borrowers from accessing credit. This requires regulators and banks to work together to navigate the complex challenges of risk assessment and lending practices. In the dynamic economic landscape of Bangkok, Thailand, the impact of interest rate capping on commercial banks remains a critical issue that requires careful consideration. The success of interest rate capping depends on how well it balances the needs of both borrowers and lenders, and how effectively banks adapt to changing regulatory requirements. Finding this equilibrium is a continuous process that demands ongoing assessment and collaboration between regulatory authorities, commercial banks, and other stakeholders to maintain financial stability and protect the interests of consumers and the broader economy.

6.0 Recommendations

It is recommended that regulatory authorities in Bangkok adopt a flexible approach when implementing interest rate capping policies. The regulatory framework should allow for periodic reviews and adjustments to interest rate caps, taking into account economic conditions, inflation rates, and the overall health of the banking sector. A flexible approach would ensure that interest rate caps remain relevant and effective without unduly hampering the profitability and stability of commercial banks. Regulators should consider introducing different caps for various loan types to strike a balance between protecting consumers and facilitating a competitive lending environment. Commercial banks in Bangkok should proactively adapt to the changing regulatory landscape by focusing on risk management and innovation. Banks should invest in advanced risk assessment tools and credit scoring models to ensure that they can offer loans to a diverse customer base while maintaining prudent lending practices. Banks should explore alternative revenue streams beyond traditional interest income. This could involve expanding their financial product offerings, such as wealth management, insurance, and financial advisory services. By diversifying their income sources, banks can reduce their reliance on interest income and better weather the impact of interest

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rate capping. To ensure that consumers are well-informed about their borrowing options and rights, a robust financial education program should be promoted in Bangkok. This initiative can help borrowers make informed financial decisions and understand the implications of various loan products. Measures should be taken to enhance consumer protection, including strict enforcement of transparent lending practices, stringent rules against predatory lending, and mechanisms for dispute resolution. These steps will help to create a balanced environment in which borrowers are safeguarded, and banks can operate sustainably within the constraints of interest rate capping regulations.

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