

**LOAN PORTIFOLIO MANAGEMENT ANDTHE FINANCIAL PERFORMANCE OF
COMMERCIAL BANKS**

CASE STUDY: ORIENT BANK

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**A RESEARCH REPORT SUBMITTED TO SCHOOL OF MANAGEMENT IN
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DECLARATION

I, Haguma Monica Mbabazi Mugizi declare that this dissertation is my original work and that it has not been presented in any other University or institutions for any award.

Signature:

Date:

APPROVAL

This is to certify that this dissertation has been submitted in fulfilment of the requirements for the award of the degree of Masters of Business Administration with my approval as University Supervisor.

Signed

Date.....

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DEDICATION

This work is dedicated to my Husband Haguma Jimmy who has always been there for me, children Josiah and Jollin Haguma who I would painfully leave behind to ensure that I do this research, my dad Mr. Mugizi Patrick who has always believed in me, my mum Miss Nanyondo Maxensia who has always prayed for me and to the almighty God for the wisdom and knowledge He has given me to see the conclusion of this book, To God Be The Glory!!. To all my in-laws Jacinta, Johnson, Jones, Jane and Mr. & Mrs. Haguma John thanks for being there.

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LIST OF ACRONYMS AND ABBREVIATIONS

BOU	Bank of Uganda
CRB	Credit Reference Bureau
GDP	Gross Domestic Product
IMF	International Monetary Fund
LPM	Loan Portfolio Management
MD	Managing Director
MFPE	Ministry of Finance, Planning and Economic Development
NPA	Non-Performing Assets
OBL	Orient Bank Limited
ROE	Return on Capital Employed
SACCO	Savings and Credit Cooperative Associations
SPSS	Statistical Package for Social Scientists
UMFU	Uganda Microfinance Union
UML	Uganda Microfinance Limited
US	United States

ABSTRACT

The research was carried on loan portfolio management and the financial performance of commercial (case study of orient Bank) for period 2012, 2013 and 2014. This is because Orient bank has continuously written off huge sums of money in bad loans and as a result registered a loss of 16 Billion in 2013 and was rated as the worst performer that year by Bank of Uganda. The study was based on four objectives that is; to explore the criteria for determining interest rates, loan size and collateral required before issuing loans in Orient bank, to analyse the loan appraisal, loan monitoring and follow up actions taken in Orient bank, to assess the relationship between loan policy on financial performance of Orient bank and to assess the relationship between Loan control and financial performance of Orient bank.

The study used a case study research design because it excels at bringing us to an understanding of a complex issue and can extend experience or add strength to what is already known through previous research. Both primary and secondary data were utilised. Primary data was obtained through the use of self-administered questionnaires. Secondary data was got from Bank of Uganda reports, Journals, credit procedure manuals, Offer letters, as well as financial statements of Orient Bank Uganda Ltd for the years 2012, 2013 and 2014.

The findings revealed that: Orient bank has Loan policies in place but the challenge is some loan officers are not compliantly adhering to them, the rate of borrowers default is high and this is because there is timely follow up by those concerned, the bank policies have not attracted loan applicants, bank's lending policies contributes towards reducing risk exposure, loan size advanced doesn't depend on the financial potential of the loan applicant, the interest rate is not favourable on the side of the borrowers, loan officers don't monitor and make follow up of loan applicants and effective loan policies significantly reduce rate of loan default.

I recommend that the management of Orient bank should put in place strong loan portfolio control measures and evaluation procedures that aim at ascertaining the capacity and capability of loan applicants/borrower.

CHAPTER ONE INTRODUCTION

1.0 Back ground to the study

The loan portfolio is typically the largest asset and predominate source of revenue for commercial banks although the problems associated with it have historically been the major cause of bank losses and failures. As such, it is one of the greatest sources of risk to a bank's safety and soundness whether due to lax credit standards, poor portfolio risk management, or weakness in the economy among others.

Effective management of the loan portfolio and the credit function is fundamental to a bank's safety and soundness. Loan portfolio management (LPM) is the process by which risks that are inherent in the credit process are managed and controlled.

Over the years commercial banks have continued to write off bad loans and this has continued to reduce on the banks' profitability or even cause losses as it was the case of Orient Bank for the year ending 2013.

Historical back ground

Loan portfolio is defined as the value of the outstanding principal of all loans in arrears. In the second half of the 1980s, US commercial banks faced declines in capital adequacy ratios and rising funding costs against a background of non-performing loans. As a result, bank managements became increasingly aware of the need to shrink their balance sheets and boost their earning power, and moved to sell off their non-performing loans and reinforce their credit risk management systems. These moves marked the starting point for the subsequent development of the US credit market (Walenta, 2003).

In the 1990s, the major commercial banks drew on these experiences by establishing Loan Portfolio Management (LPM) departments within their risk management divisions, and started

proactive initiatives to reduce credit concentration risk aimed at their large corporate credit portfolios (Galena, 2003).

While the profitability of loans to large companies declined in the second half of the 1990s, the credit market's liquidity increased, encouraging commercial banks to view LPM as an effective way of increasing their Rate Of Return (ROE) (Smithson & Hayt, 2001).

Theoretical background

Modern portfolio theory, although not directly applicable to banks, as well as the concept of herding behaviour tend to imply that banks' loan portfolios should mimic the industry composition of the total loan market, the modern theory is about finding optimal risk (Diamond, 1984).

Orient bank is involved in all aspects of commercial banking with a total of 22 branches in Uganda, as of December 2011 it was the 11th largest commercial bank in Uganda, with an estimated asset valuation of US\$176 million (UGX:435+ billion) (BOU Supervisory Report, 2012).

The bank was founded in 1993 by a group of business people who were related by blood and marriage. In 2002, the bank beat out other financial institutions when they acquired Trans-Africa Bank Limited, which had been declared insolvent by the Bank of Uganda (BOU).

1.2 Problem Statement

The purpose of commercial banks in offering loans is to make profits and also improve the business of their customers. However, Orient Bank has continued to write off huge sums of money in bad loans meaning there is a low level of loan recovery compromising the bank's financial performance (Orient Bank Annual Report, 2013). It is not yet clear if the loan policy adopted by the bank in terms of interest rates, loan size and collateral and loan control in terms

of loan appraisal, loan monitoring and follow up action have a direct bearing on the financial performance.

If this problem remains unchecked then Orient Bank's financial performance in terms of loan portfolio growth and risk exposure of loan portfolio is likely to continuously be affected adversely. This is evident in the Statement of Financial Performance of Orient Bank Limited for the year 2013 that the Bank registered 43billion in bad loans which almost doubled as compared to the previous year (Mwesigwa, 2014).

1.3 Purpose of the Study

The study sought to examine the effect of loan portfolio management on the financial performance of commercial banks in Uganda.

1.4 Objectives of the study

1. To explore the loan policies and ascertain adherence by the lending department.
2. To examine the loan control measures followed in orient bank.
3. To assess the relationship between loan policy and financial performance of Orient bank.
4. To assess the relationship between Loan control and financial performance of Orient bank.

1.5 Research questions

- i) What are the loans polices in orient bank and are they effectively adhered to by the lending department?
- ii) What loan control measures are followed in orient bank?
- iii) What is the relationship between loan policy and financial performance of Orient bank?
- iv) What is the relationship between loan control financial performance of Orient bank?

1.6 Scope of the study

1.6.1 Subject scope

The research focused on loan policy and loan control by specifically looking at loan size, interest rates, collateral, loan appraisal, loan monitoring and follow up actions, this is because they are all components of loan portfolio management. Further the study focused on the financial performance which is the dependent variable by specifically looking at loan portfolio growth, and risk exposure of loan portfolio in Orient Bank.

1.6.2 Geographical scope

The study was conducted in 13 branches of Orient Bank located in Kampala. The Kampala branches of Orient Bank were chosen because most of orient bank branches are concentrated in Kampala and have been experiencing loan portfolio management problems. Orient Bank has continued to write off huge sums of money in bad loans meaning there is a low level of loan recovery compromising the bank's financial performance (Orient Bank Annual Report, 2013)

1.6.3 Time scope

This research covered the last three years of Orient bank's loan portfolio management and the bank's financial performance ranging from 2012 to 2014 because this is the period where the bank registered huge sums of bad loan written off.

1.7 Significance of the study

My findings will help management of Orient bank identify potential risks arising out of the banks prevailing lending rates and their impact on loan portfolio performance in order to strengthen its internal control system and design. This may balance and contain overall loan portfolio risk by anticipating and controlling exposure to various identified markets, customers and operational conditions.

The findings are of practical significance to both academicians and general practitioners by providing a better insight into the understanding of the effect of loan portfolio management and financial performance of commercial banks in Uganda.

As a result of my findings the employees of orient bank and other commercial banks' 'employees will be in better position to adhere to loan portfolio management policies and procedures to avoid fraud, defaults and job negligence that result into incurring losses in the bank so as to improve performance.

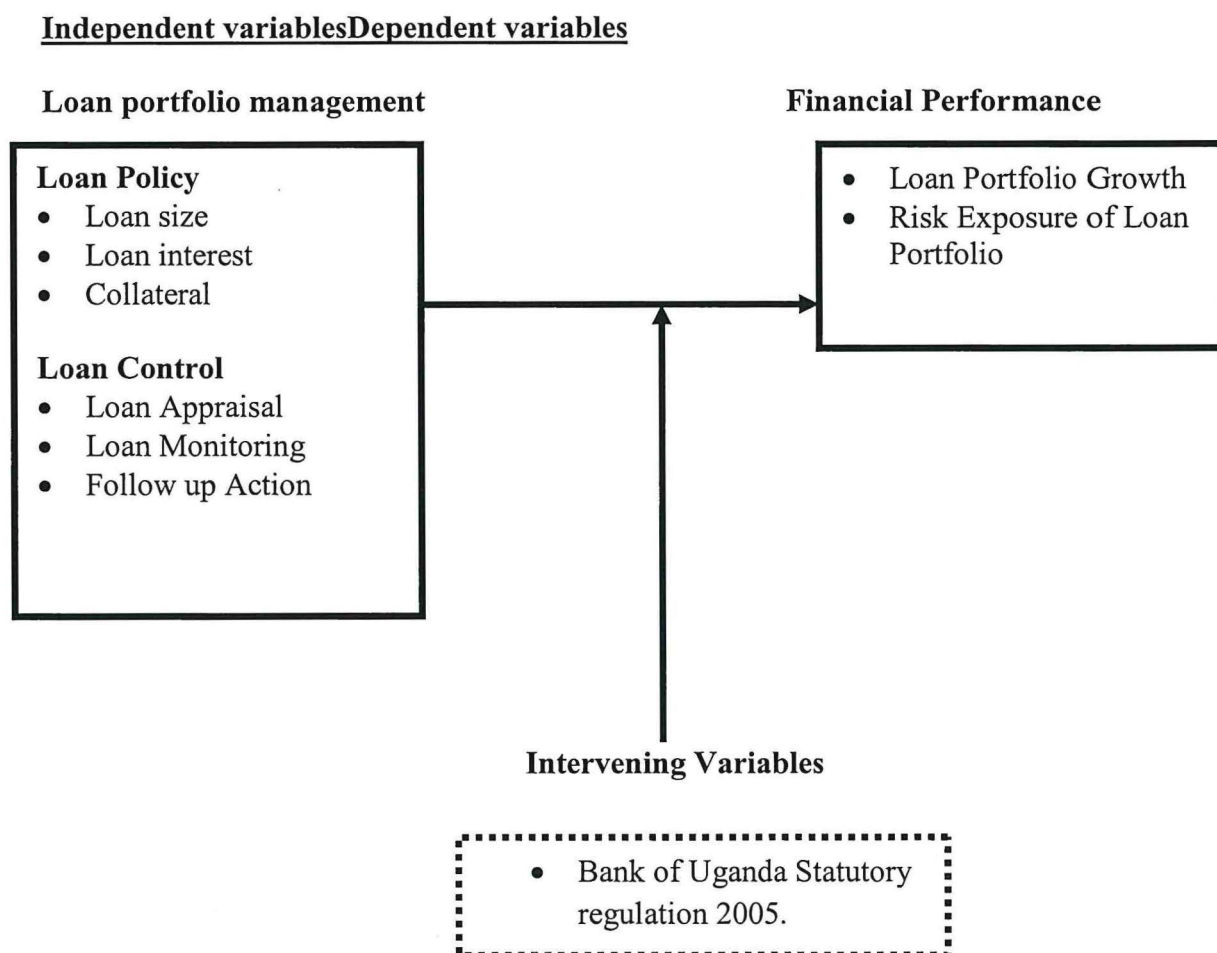
From my findings the customers of orient bank will be more responsible and comply with the agreements of borrowing by providing the authentic documents and making payments as agreed to help the bank reduce losses that result from loan defaulters.

1.8 Conceptual framework

The conceptual framework to which most of this current literature adheres (Figure 1) is quite helpful because it gives direction to the study and it will show the relationship of the different variables that I will investigate in order to be able to understand the tenets of loan portfolio management and performance of commercial banks in Uganda.

Loan policies and loan controls must be consistent with one another and operate as a unit to influence the financial performance. It is the total relationship between loan policies and loan control as a package that influence the dependent variable Financial Performance.

Figure 1: Conceptual Framework



Source: Developed basing on literature cited by (Marchland(2001), Kunliano (2010), Devellis (1991).

Financial performance is the prime variable of interest; the dependent variable was looked at in terms of Loan payment, loan portfolio growth and risk exposure of loan portfolio. A number of factors contribute to loan portfolio performance (Marchland et al. 2001). For purpose of this study, the independent variable was looked at basing on the loan policy and loan control. Under loan policy the following elements were studied: loan size, interest rates and loan collateral. Loan control elements studied are loan appraisal, loan monitoring and follow up actions (Kunliano (2010).

Loan policy involves three decision variables namely credit terms (interest charge, loan size, loan period, collateral requirement and eligibility criteria) credit standards and collection effort (Pandey 1995). It is therefore important to scrutinize the three loan policy decision variables of the two institutions in order to account for the differing loan portfolio performance.

Pandey (1995) argues the absence of review of policies exceptions may indicate that the policy is too vague, and a tightening of the policy could strengthen the controls on loan quality. According to Yunus (1996), collateral is the borrower's asset pledged in exchange for the receipt of a loan. Banks request for collateral before extending loans to customers. The collateral is always higher value than the loan taken to ensure that the loan is paid back.

According to IMF (2003), loan policies and loan controls such as lending rates, appraisal and monitoring have a positive relationship with profitability of commercial banks in Uganda. Loan pricing has a critical impact on bank's profitability and its willingness to accept higher risks. Similarly Ogunleye (2001) argues that when interest rates rise or fall, it exerts an impact on banks' profits through adjustment to revenues; and this comes about in two ways. Increase in market rates raises the amount of income a bank can earn on new assets it acquires.

The intervening variable was the Bank of Uganda statutory regulation powers where Credit is classified and loan Provisioning is also defined. (BOU Regulations, 2005) this influences the relationship between the independent variables loan policy & loan control and the dependent variable financial performance. The intervening variable was controlled by matching it with independent variable (loan portfolio management) and the dependent variable (financial performance). Therefore, to manage the challenges that hinder financial performance, the study focused on several strategies that improve financial performance such as risk exposure of loan

portfolio and portfolio growth (*Devellis, 1991*). It is believed that if such strategies are well implemented they can result into good financial performance of commercial banks.

1.10 Conclusion

In conclusion this chapter explains why the research is needed, purpose of the research, and explains how the variables in the topic are related, the scope of the study and the background of the study.

CHAPTER TWO

LITERATURE REVIEW

2.0 Introduction

This chapter is a review of the existing literature related to understanding loan portfolio management, challenges of loan portfolio management, loan policies in commercial banks, interest rates and how they are determined in commercial banks, collateral security in commercial banks, loan control and financial performance in commercial banks, loan appraisal, loan monitoring, loan follow up actions undertaken by commercial banks, financial performance of commercial banks, the banking sector in Uganda and the credit risk exposure. It does not only brings out an appreciation of what has been done on the variables under study but also, the gaps that were identified in the existing body of literature that make the focus of this study.

2.1 Loan Portfolio Management in Commercial Banks

2.1.1 Understanding of Loan Portfolio Management

Loan portfolio management involves loan portfolio planning, client screening and portfolio control. In commercial banks loan portfolio management deals with coming up with policies by which loans are segmented, priced, and their sizes and associated risks determined. (Kasibante, 2001; Kasekende and Aleema, 1999)

According to Smithson & Mengle (2006), Loan portfolio management consists of identifying concentration in the credit portfolio, the risk/return profile and other factors in accordance with the objectives set for LPM. More specifically, it means identifying counterparties with high credit concentration risk, assets that have significant amounts of risk, and low-return counterparties in order to provide objective information that will contribute to the formulation of credit portfolio management policies. However, what the authors failed to put is why many

commercial banks fail to register the desired financial performance targets yet they have loan portfolio management which this study intended to address.

All banks need to have basic loan portfolio management principles in place in some form (Pische, 2001). This includes determining whether the risks associated with the bank's lending activities are accurately identified and appropriately communicated to senior management and the board of directors, and, when necessary, whether appropriate corrective action is taken. However, what the author did not state is how basic loan portfolio management principles can be translated into good financial performance in terms of loan portfolio growth and risk exposure which this study sought to verify.

Specific measurable goals for the loan portfolio management are established by loan portfolio objectives. They are an outgrowth of the credit culture and risk profile (Walenta, 2003).

According to Nekaba 2010, the board of directors must ensure that loans are made with the following three basic objectives in mind; to grant loans on a sound and collectible basis, to invest the bank's funds profitably for the benefit of shareholders and the protection of depositors, to serve the legitimate credit of their communities, banks require that senior management and the board of directors develop medium- and long- term strategic plans to meet objectives for the loan portfolio, these strategies should be consistent with the strategic direction and risk tolerance of the institution.

In order to maintain a sound loan portfolio, a bank must have an established formal transaction evaluation and approval process for the granting of credits (Bohnstedt, 2000). Approvals should be made in accordance with the bank's written guidelines and granted by the appropriate level of management. There should be a clear audit trail documenting that the approval process was complied with and identifying the individual(s) and/or committee(s) providing input as well as

making the credit decision (Ingrassia and Greatrex, 2005). Banks often benefit from the establishment of specialist credit groups to analyse and approve credits related to significant product lines, types of credit facilities and industrial and geographic sectors. Banks should invest in adequate credit decision resources so that they are able to make sound credit decisions consistent with their credit strategy and meet competitive time, pricing and structuring pressures (Credit management, 1999). However, what the authors missed out is how loan portfolio management leads to loan portfolio growth and risk exposure of loan portfolio in commercial banks which the study wanted to address.

2.1.2 Significance of Portfolio Management in commercial banks

Banks have traditionally been the principal credit intermediaries and consequently have the highest exposures. They are also the main beneficiaries of improved credit management techniques (Pandey, 2009). Other institutions are now increasingly involved in the credit markets and they need to adopt a consistent, rigorous risk management platform if they are to avoid some of the problems experienced by banks. Regulators are applying increasingly sophisticated measures in analyzing portfolios (Allen 2009). However, what was not highlighted is how measures in analyzing portfolios can lead to good financial performance which the study focused on.

According to Galena 2003, loan portfolio management aims to increase efficiency and returns by: identifying credit concentrations; calculating the exposure arising from those risks; assisting management in allocating economic capital to internal businesses; identifying the marginal contribution that a particular credit adds to risk and what return compensates the institution for it; and deciding which assets to hedge, sell or securitize. However, the author did not indicate how loan portfolio management can be translated into loan portfolio growth which the study wanted to establish.

Ongwae, 2010 states that economic capital is an important concept in loan portfolio management, and an important tool in measuring and managing business risks. Economic capital is internal equity and provides a sound theoretical basis to calculate risk because it reflects the fact that credit returns are not normal. Commercial Banks typically seek to estimate the amount of economic capital using credit models whose key output is the probability density function of credit losses. However, what the author did not state are the credit models which are suitable for commercial banks which the study wanted to ascertain.

Smithson @Hayt 2001 argues that Loan portfolio management has become a matter of central importance for commercial banks in allowing them to measure their exposures and hedge portfolio risk. There are a number of convergent trends that are driving credit portfolio management: stock market pressures on banks to improve their performance; availability of models to assess risk; regulatory changes – Basel II; accounting standards leading to requirement for mark-to-market prices; alignment of internal and external ratings; and increased scrutiny from regulators. However, what was not noted is whether hedging portfolio risk can lead to portfolio growth in commercial banks which this study focused on.

2.1.3 Challenges of Loan Portfolio Management in commercial banks:

According to Ingrassia and greatrex 2005, the banking industry in Uganda has been through a process of dramatic change over the past two decades. A number of factors have contributed to this: the globalisation of financial markets; deregulation within national markets; competition from non-bank entities for retail funds; intense competition in wholesale lending markets; application of new technologies such as the internet; the growth of the securities markets and the corresponding diminution of direct lending and extreme volatility in rates and financial

markets in general there may be limited resources – a shortage of skills means that many commercial banks cannot cover all sectors and therefore stick to familiar markets.

Pische 2001 argues that Competition has reduced core banking groups and pushed smaller banks out of large corporate syndicates. There has also been a tendency for larger corporate borrowers to access capital markets directly (disintermediation), which pushes prices down. Loans were often treated as loss-leaders and priced at uneconomic levels. Banks increased individual loan exposures to sub-optimal levels with the illusion of generating profitable fee business in other areas, such as foreign exchange, derivatives or advisory. These additional sources of revenue did not always materialise.

Ingrassia and Greatrex 2005 further argue that, lack of centralised management controls; an absence of basic data acquisition and low skill levels may prevent many banks from taking advantage of these developments. However, the consequences are likely to be more severe, for a number of reasons discussed below.

2.2 Loan Policies in Commercial Banks

2.2.1 Loan size

Loan size is the amount of loan advanced to the client. It can be small, medium or big. Banks prefer bigger loans largely because their transaction costs are lower. Efficient loan size should fit the borrower's repayment capacity and stimulate enterprise performance. Pische (2001) argues that poor loan sizing is illustrated by extensive credit rationing, which issues too little credit to too many borrowers. However what was not clearly put is how loan size affects the financial performance of commercial banks and this is what the study sought to verify.

According to Chirwa (1997), relatively large loans may tempt the borrowers to divert a portion for non-business purposes.

2.2.2 Interest rates and how they are determined:

According to Saurina (2005), interest rate is a rate which is charged or paid for the use of money. An interest rate is often expressed as an annual percentage of the principal. It is calculated by dividing the amount of interest by the amount of principal. In general, interest rates rise in times of inflation, greater demand for credit, tight money supply, or due to higher reserve requirements for banks. What was not highlighted according to the author is how interest rates affect risk exposure of loan portfolio.

According to Tumusiime Mutebile 2014, Bank of Uganda has maintained its economic growth forecast of 6 percent for the fiscal year 2014/2015 starting July 1, driven by heavy public investment and compared to a projected 6-6.5 percent expansion in 2013/14. The growth figure for 2013/14 has not been released yet. Before cutting rates in June, the bank had held its benchmark rate at 11.50 percent for five straight months.

According to IMF (2003), Lending rates have a positive relationship with profitability of commercial banks in Uganda. In other words, loan pricing has a critical impact on bank's profitability and its willingness to accept higher risks.

Ogunleye (2001) argues that when interest rates rise or fall, it exerts an impact on banks' profits through adjustment to revenues; and this comes about in two ways. First, an increase in market rates raises the amount of income a bank can earn on new assets it acquires. However, what the author did not state is whether interest rates have a direct bearing on loan portfolio growth which the study focused on.

2.2.3 Collateral Security

According to 'Younus (1996), collateral is the borrower's asset pledged in exchange for the receipt of a loan. Banks request for collateral before extending loans to customers. The collateral is always higher value than the loan taken to ensure that the loan is paid back. However, what the author did not state what type of collateral a customer should have in order to qualify for loan which this study wanted to verify and link the results with the loan portfolio growth.

2.2.4 Loan policies in commercial banks:

Loan Policy provides a general rule to guide decisions concerning credit management. Loan policies provide a framework for credit management process. They set standards and parameters to guide managers and credit officers in evaluating, granting and loan monitoring and follow up actions. They provide Directors, regulators, auditors with a basis for evaluating performance (Naughton, 1992). However, what the author failed to state is whether stringent credit policy can adversely affect loan portfolio growth which the study wanted to find out.

Loan policy involves three decision variables namely credit terms (interest charge, loan size, loan period, collateral requirement and eligibility criteria) credit standards and collection effort (Pandey 1995). It is therefore important to scrutinize the three loan policy decision variables of the two institutions in order to account for the differing loan portfolio performance.

In order to be effective, credit policies must be communicated throughout the organisation, implemented through appropriate procedures, monitored and periodically revised to take into account changing internal and external circumstances (Pandey 1995). They should be applied, where appropriate, on a consolidated bank basis and at the level of individual affiliates. In

addition, the policies should address equally the important functions of reviewing credits on an individual basis and ensuring appropriate diversification at the portfolio level.

(Pandey 1995) argues that loan Policy review should consider the organizational structure, breadth and complexity of lending activities, capabilities and skills of lending personnel, and strategic portfolio quality and earnings objectives. Changes in regulations and business conditions also need to be considered. For example, a high volume of exceptions indicates that many loan decisions are being made outside the policy. This could mean that the bank is assuming more risk than is desirable or that the policy is too restrictive.

Allen 2009 states that if the bank's policy is too restrictive, easing it could increase business opportunities without unduly increasing risk. Conversely, the absence of exceptions may indicate that the policy is too vague, and a tightening of the policy could strengthen the controls on loan quality. All policy reviews should include the organizational unit responsible for assessing compliance with policy.

According to the governor bank of Uganda (Tumusiime Mutebile), the Credit Reference Bureau (CRB) in Uganda was launched on 3rd December 2008. The aim of the CRB is to avoid multiple borrowing by customers; this is achieved because all commercial banks are able to know if the borrower has loan commitments elsewhere. Furthermore CRB ensures, timely information and accurate information on borrowers' debt profile and repayment history since experience has revealed that when financial institutions compete with each other for customers, multiple borrowing and over- indebtedness increases loan default unless the financial institutions have access to databases that capture clients 'borrowing behaviour; an improved pool of borrowers across the globe; reduced default rates as borrowers seek to protect their reputation collateral by meeting their obligations in a timely manner.

Commercial banks disburse loans based on cash flow requirements of the borrower. However, from the lessons derived from micro finance programmes (Dichter & Kamuntu, 1997), micro finance institutions extend small, short-term primarily for working capital on simplified terms. Short-term loans are intended to test the client's commitment to repay and allow client to learn on the loan. Disbursement is designed to offer on the loan training for the borrower.

According to Yunus(1996), collateral is the borrower's asset pledged in exchange for the receipt of a loan. Banks request for collateral before extending loans to customers. The collateral is always higher value than the loan taken to ensure that the loan is paid back. However according to the findings of this not all loan applicants pledge collateral security on acquisition of loans thus slightly differs from the finding by Yunus (1996).

As correctly pointed out in a paper on universal banking and the future of small business lending, (Allen, 2009), small loans require a strong bank-borrower relationship and are more information intensive. There is thus need for close monitoring in small loans than it is the case for big loans. It should be remembered that each organization has a different repayment mechanism.

According to Michael cook 2014 (Orient bank chairman) I quote, “to stabilise the economy, the bank of Uganda was forced to apply a tight monetary policy and take arrange of tough but necessary remedial measures, foremost among these was the imposition of a central bank rate of 23% although this was gradually reduced over the year to 12% by December 2012, it caused stagnation in bank revenue streams. Credit portfolio contracted, fee income and lending fell and the ratio of non-performing assets increased.

Writing-off should be done in such a way as to provide a clear picture about the real situation of the loan portfolio, indicating the true level of (potentially) earning assets. Write off loans that are overdue for more than 360 days unless there are explicit reasons for doing so earlier. This benchmark was based on the experience that had been accumulated with overdue loans over a number of years. Surprisingly, it was shown that even loans that were overdue for several months could be fully recovered if the loan officers and the borrower intensively work on a solution. So although the entire outstanding balance of an overdue loan is already fully covered by loan loss provision after 180 days, some commercial banks decided not to immediately write the loan off at that time but rather keep it in the portfolio for another 6 months.

2.3 Loan control in Commercial Banks

This sub-section focuses on loan control in commercial banks by looking at loan appraisal, loan monitoring and loan follow up actions as means to improve on loan portfolio management.

2.3.1 Loan Appraisal

Dev& Kim (2006), say that the most basic loan risk control method available to financial institutions is to adjust risk/return when extending new credits and rolling over existing credits. Financial institutions evaluate the credit risk posed by the counterparty whenever they make loans. If they judge that the risk is increasing, they either control it by reducing the size of the loan, or raise the loan interest rate in an endeavor to secure returns that match the risk. Adjusting the amount of the loan or the loan interest rate are not the only tools available. They may also raise the frequency of checks and adjustments of the risk/return profile by shortening the term of the loan, or may require additional collateral from borrowers. Control of the loan approval process can be applied to any counterparty and there are no ambiguities from the legal or accounting view points. However, this approach has problems with flexibility, and it takes a long time to alter the credit portfolio's risk/return characteristics using it alone.

2.3.2 Loan Monitoring

According to the Centenary bank credit policies (2005), it asserts that, at least every month the Head of the branch Credit department shall undertake a thorough review of all loans more than 30 days in arrears and report to Head Office on the reasons for loan failure. This will be valuable feedback on the effectiveness of the bank's loan policy and procedure. In addition, special reports may from time to time be requested by head office.

2.3.3 Loan Follow up actions

According to research done by Nekaba 2005, she put forward the following on follow up actions (loan control), that the bank may use in case of problem loans, each problem loan is different and no routine is universally applicable. A problem loan can be resolved by: Provide a debt restructuring/rescheduling program, Additional collateral/guarantees, Injection of additional funds, Liquidation of collateral, Liquidation of other assets, Calling on guarantors to repay, Arranging for joint venture partner and capital contribution, Working with management to define problems and potential solutions, Arranging sale of operating company to third party and replacing management.

According to Antoinette (2008), all Uganda Microfinance Limited- UML (now equity bank) customers who had been approved for a business loan were randomly assigned to one of the three treatment groups or a comparison group. In the first treatment - "Cash Back" - which provided incentives for on-time repayment, borrowers received a cash back payment equivalent to a 25 percent reduction of the interest rate if they made all their monthly payments on time. This increased the probability of payment by 8.6 percent.

Antoinette continues to say that "Future Interest Rate Reduction" - gave customers a 25 percent reduction in the interest rate of their next loan, if current loan payments were all made in time.

9 percent increase in probability was able to pay every instalment on time. Orient bank management can borrow a leaf to motivate borrowers to pay back on time.

Further to Antoinette's argument, she says when Equity Bank sent "SMS Reminders" - borrowers received SMS reminders every month three days before the payments are due. This increased the probability of paying on time by 7.3 percent.

2.4 Financial Performance of Commercial Banks in Uganda

2.4.1 Concept of Financial Performance of Commercial banks

Financial performance is an approximation for financial success that is, the rate at which the enterprise is satisfied with the profits and growth levels attained (Birley & Westhead, 2001). Financial performance looks at the results of a firm's policies and operations in monetary terms that is, a general measure of a firm's overall financial health over a given period of time, and can be used to compare similar firms across the same industry or to compare industries or sectors in aggregation (Hillman & Keim, 2001). However, what was not stated is whether financial performance is only measured in monetary terms which this study wanted to verify

2.4.2 Loan portfolio risk Exposure

Kithinji 2010, defines loan portfolio risk as identification, analysis and assessment, monitoring and control of loans which has a direct implication on amount of loans and advances extended to customers as well as on the level of nonperforming loans. However, what was not highlighted is how loan portfolio risk can be translated into good financial performance which this study focused on.

Allen 2009 states that because of the size of the loan portfolio, effective management of liquidity risk requires that there be close ties to, and good information flow from, the lending function. She further argues that Most of the developments that improve the loan portfolio's

liquidity have implications for price risk. Traditionally, the lending activities of most banks were not affected by price risk. The level of transaction risk depends on the adequacy of information systems and controls, the quality of operating procedures, and the capability and integrity of employees.

By law, a bank must observe limits on its loans to a single borrower, to insiders, and to affiliates; limits on interest rates; and the array of consumer protection and Community Reinvestment Act regulations (Allen, 2009).

2.4.3 Loan portfolio quality

The banking industry has of late been quite competitive which has led to a situation of survival for the fittest. Many financial institutions have stopped their business operations and others have failed to prosper because of poor loan portfolio quality. It is believed that in five to ten years' time, only the efficient performers will survive while the less efficient ones will be eaten up by the strong ones (Micro Finance Directory, 2006).

2.4.4. Loan portfolio growth

Extending loan products to customers involves a lot of risk such as interest of funds invested in debts, bad debts and collection costs of book debts which require effective loan management strategies. The lending firm must conduct an analysis on the potential borrowers before extending loans to them. Therefore, in the management of loans emphasis should be put on the credit worthiness of customers so that the problem of defaulting at the end of the accounting period is eliminated (Lewellen, 2006).

Van Horne (2008), indicated that a firm may follow a lenient or stringent loan management policy. A lenient loan management policy tends to give credit to customers on very liberal terms and standards. Therefore there is a need to formulate a loan management policy which is

optimum. This means that when the loan management policy has extreme conditions, which give customers no breathing space, then it becomes undesirable to the customers and this increases chances for customers to default the loan extended to them.

2.5 Loan policies, loan controls and financial performance of commercial banks

Banks need to understand to whom they are granting credit. Therefore, prior to entering into any new credit relationship, a bank must become familiar with the borrower or counterparty and be confident that they are dealing with an individual or organisation of sound repute and creditworthiness (Donna, 2010). In particular, strict policies must be in place to avoid association with individuals involved in fraudulent activities and other crimes. This can be achieved through a number of ways, including asking for references from known parties (Credit risk management, 1999).

Accessing credit registries, and becoming familiar with individuals responsible for managing a company and checking their personal references and financial condition. However, a bank should not grant credit simply because the borrower or counterparty is familiar to the bank or is perceived to be highly reputable

According to Donna (2010) loans review check list should contain the following;

Credit Initiation: Review of initial underwriting including analysis of the following:

Financial statements: primary and secondary source of repayment, management and appraisal.

Loan Structuring: Evaluation of repayment terms against the borrower's ability to repay and industry best practices: guarantees, environmental indemnification, and other loan terms.

Loan Approval Procedures: Review of written approval procedures and policies.

Credit/Collateral File Documentation: Verification of all relevant initial and on-going documentation. Review of post-closing procedures for outstanding items. Normal Loan

Monitoring: Verification of on-going monitoring, as appropriate.

Problem Loan Management: Evaluation of problem loan management including reporting to senior management and downgrading of delinquent loans.

Loan Workout Management: Review of action plans and work out agreements for seriously delinquent loans.

2.6 Conclusion

This chapter reviewed the already existing literature about loan portfolio management and performance of commercial banks based on the researcher objectives. The literature available indicates that little research is available specifically about loan portfolio management and financial performance thus the justification of this research study.

CHAPTER THREE

METHODOLOGY

3.0 Introduction

This chapter shows how the study was conducted. It describes the research design, study population, sampling procedure and sample size, data sources and collection instruments, measurement of variables and data analysis.

3.1 Research Design

The study used a case study research design. Basically, a case study is an in depth study of a particular situation. It is a method used to narrow down a very broad field of research into one easily researchable topic. Therefore, a case study research design involves an up-close, in-depth, and detailed examination of a subject (the case), as well as its related contextual conditions. Case-study research can mean single and multiple case studies, can include quantitative evidence, relies on multiple sources of evidence, and benefits from the prior development of theoretical propositions. Therefore, this design was employed because it gives a description about the results of the study by capturing whatever happened and gives opportunity to highlight and bring attention to particular challenges (Neale et al, 2006). The design was selected because it was highly effective in bringing out results on loan portfolio management and financial performance of Orient Bank. Case study method allowed the researcher to have a lot of details to be collected that would not easily be obtained by other research designs.

3.2 Study Population

The study population of the study was 64 and it consisted of 37 junior staff, 13 line managers, 10 middle managers and 4 top managers of Orient Bank staff (Orient Bank payroll, 2014). The reason for selecting them was because they are staff of Orient bank and have knowledge of loans as one of the products the bank offers.

3.3 Sample size and sampling technique

3.3.1 Sample size

The sample size of the study was calculated basing on the Krejcie& Morgan, (1970) table as shown in table 3.1: -

Table 3.1: The sample size determination as guided by Krejcie and Morgan (1970)

According to Krejcie& Morgan, (1970) a population of 64, requires a sample size of 60 to be .within a 95% level of confidence as shown in the table below: -

Categories of Respondents	Population	Sample size
Junior staff	37	34
Line Managers	13	12
Middle mangers	10	10
Top managers	4	4
Total	64	60

3.3.2 Sampling Techniques

Two sampling techniques were used to select the sample size of the study. Managers were selected using purposive sampling technique. The purpose of using purposive sampling technique was to access confidential information relating to loan portfolio management and financial performance. This technique was used since managers had rich and deeper information and yet they were the centre of ensuring good financial performance. Junior staffs in various departments of the Orient Bank were selected using stratified sampling technique to form strata.

This technique was used to make sample selection without any prejudice and to enable every employee in each department to have the same chance to be part of the study.

3.4 Data Sources

3.4.1 Primary Data

Primary data was obtained through the use of self-administered questionnaires to respondents; these were sent randomly to the selected sample of Orient bank staff following a systematic and established academic procedure, as suggested by Nunnally and Bernstein (1994).

3.4.2 Interview methods used

(a) Telephone Interviewing:

It's a quick method, more flexible as interviewer can explain questions not understood by the respondent, Depending on respondent's answer they can skip some questions and probe more on others and it allows greater sample control.

(b) Personal Interviewing:

It is very flexible and can be used to collect large amounts of information, it's fairly quick and Interviewers can also record the respondent's reactions and behavior. This was used because of the busy schedule of top management and therefore I needed to secure appointments to interview them.

3.5 Data Collection Instruments

Self-administered questionnaires were used to collect data from respondents given that they are fairly many in numbers, geographically dispersed and more so it would take much time to interview them face to face. More precise information was collected from the different categories of the respondents. The challenges the researcher faced while using questionnaires

were; some respondents were just ticking for the sake, a number of questionnaires never returned even after several calls were made.

I also used interviews to collect the required data for the study. I based the interview discussion on the study objectives. Various questions relating to the problem under investigation were posed to the aforementioned manager. This instrument was used because managers have rich information about the subject under investigation and they can agree to be interviewed than filling questionnaires. This instrument was used because it is the quickest method of collecting data and questions can be repeated clearly for the respondents to understand them. Also the researcher used this instrument because data collected using such an instrument is reliable and accurate.

3.6 Measurement of the Variables

Loan portfolio management was measured basing on the item scale adapted from Berger and Udell, (2002). The items in the domain was scored on the 5 point Likert scale ranging from strongly disagree (1) to strongly agree (5).

Loan policies were measured basing on the item scale adapted from Orebiyi, (2002). The items in the domain were scored on the 5 point Likert scale ranging from strongly disagree (1) to strongly agree (5).

Financial performance was based on both perceptual and accounting measures using the scales of Lyles *et al.*, 1996; Pengetal., 2000, Hyondong, 2005 , Zhiwu&Knez,1996).

3.7 Reliability and validity of the research instruments

Validity determines whether the research truly measures that which it was intended to measure or how truthful the research results are (Bashir, *et al.* 2010). Drost (2011) asserts that validity is

concerned with the meaningfulness of research components or whether the research instruments measure what they intended to measure. According to Polit and Beck (2006), content validity is the degree to which an instrument has an appropriate sample of items for the construct being measured. It related to whether or not the items sampled for inclusion on the tool adequately represent the domain of content addressed by the instrument. For the researcher to consider those items relevant and valid, the ratings from the experts/supervisor were computed to derive

$$\text{content validity index} = \frac{\text{No of items rated as relevant}}{\text{All items in questionnaire}}$$

Table 3.2 The content validity index (CVI)

Raters	Relevant	Not relevant	Total
1	40	4	44
2	37	7	44
Total	77	12	88

$$\text{CVI} = 77/88 = 0.88$$

Given that the CVI was above .70, the questionnaire was considered suitable for collecting data (Amin, 2005).

According to Drost (2011), reliability is a major concern when a psychological test is used to measure some attribute or behaviour. In other words, reliability is the extent to which measurements are repeatable when different persons perform the measurements. Suanders et al. (2008) define reliability as the extent to which your data collection techniques or analysis procedures will yield consistent findings. Kumar (2010) defines reliability in relation to research instruments as the ability of the instrument to be consistent and table hence predictable

and accurate. Hence, it can be inferred that reliability is the extent to which a questionnaire, test, observation or any measurement procedure produces the same results on repeated trials.

Closed questionnaires were developed in harmony with the guidelines specified by Sekaran (2000). First, an item analysis was done to see whether the items in the instrument belong there and a pre – test was carried out to check validity and reliability so as to minimize on vagueness of the results to be generated. To ensure the reliability, the researcher pre-tested the questionnaire. The Cronbach alpha approach was used to compute the reliability of the questionnaire. The following formula was used to calculate the Cronbach's coefficient alpha

$$\alpha = \frac{k}{k-1} \left(1 - \frac{\sum SD_i^2}{\sum SD_t^2} \right)$$

Where α = coefficient alpha

$\sum SD_i^2$ = sum variance of items

$\sum SD_t^2$ = sum variance of scale

The results in all items were reliable since they generate alphas values above 0.7 (Amin, 2005; Kathuri and Palls, 1993) as shown in table below.

Table 3.3 showing the Cronbach's coefficient alpha

Loan Portfolio management and financial performance	Cronbach Alpha Value
Loan interest, loan size, collateral and financial performance	.7357
Loan appraisal, loan monitoring and follow up actions	.7411
Loan policies and Loan controls on loan portfolio growth	.7537
The risk exposure of the loan portfolio at Orient bank	.7744

The results in all items had high reliabilities with alphas above 0.7 and thus considered highly reliable in eliciting the data that was required for this study (Amin, 2005). This showed me how closely related a set of items are as a group.

3.8 Data Analysis

Data collected from the primary source was compiled, sorted, edited for accuracy and clarity, classified, coded into a coding sheet and analysed using a Statistical Package for Social Scientists (SPSS 16.0). The cross tabulations and frequency tabulations were used to present the results for the sample characteristics, the Pearson's correlation analysis was used to analyse the findings of the study and thus present the relationships between the study variables and a regression analysis was used to study the variance in financial performance caused by a combined effect of loan policy and loan control.

3.9 Limitations of the Study

The following challenges were encountered by the researcher in the course of conducting the research study.

Low response rate: The respondents did not provide all the data requested sometime because of time and fear to disclose bank confidential information. The researcher made follow ups to make sure that the desired data was collected and assured the respondents that the data provided will be treated with utmost confidentiality and only used for academic purposes.

Limited cooperation and unwillingness of the respondents: The target respondents were not willing to cooperate during the research study because of busy work schedule. The researcher sought appointment with the target respondents to collect the questionnaires after they were

answered and further assured the respondents that information collected was for academic purposes and thus will be held with utmost sincerity.

In conclusion therefore, this chapter focused on the research design, area and population of the study, sample size and sample selection techniques, sources of data, data collection instruments, data analysis and limitations of the study. The results solicited in this chapter are presented, analysed and discussed in the next chapter

CHAPTER FOUR

PRESENTATION, ANALYSIS AND INTERPRETATION OF THE STUDY FINDINGS

4.0 Introduction

This chapter is a presentation, analysis, interpretation and discussion of the study findings. It includes respondent's bio data and the four research objectives which are: To explore the criteria for determining interest rates, loan size and collateral required before issuing loans in Orient bank, to analyse the loan appraisal, loan monitoring and follow up actions taken in Orient bank, to assess the relationship between loan policy on financial performance of Orient bank and to assess the relationship between control on financial performance of Orient bank.

4.1 Respondents' bio data

This shows the gender, age, level of education and the duration the respondents have spent in organisation. This was covered in the following four tables: -

4.1.1 Gender of the Respondent

The following table shows the respondents gender that is, whether the respondent was a female or male.

Table 4.1: Gender of the respondents

Gender	Frequency	Valid Percentage
Male	24	40.0
Female	36	60.0
Total	60	100.0

Source: Primary data

The study shows that out of the 36 respondents who participated in the study, there were more female (60 percent) respondents than male (40percent) respondents considered in the study to come out with the aims and objectives of the targeted study. The implication of this finding is that the study was not gender balanced. However, the ideas, opinions and view of the respondents relating to loan portfolio management and financial performance were well presented.

4.1.2 Age of the respondents

The following table shows the respondents' age that is, whether the respondents were mature or not. The age groups covered in the table below were from 20 to 50years

Table 4.1: Age of the respondents

Age of the respondents	Frequency	Valid Percentage
20 – 29	26	43.3
30 – 39	21	35.0
40 – 49	7	11.7
Above 50	6	10
Total	60	100.0

Source: *Primary data*

The findings in table 4.2 above shows that 43.3% of the respondents were in the age bracket between 20-29 years, 35.0% were between 30-39 years, 11.7% were between 40-49 years and the remainder (10%) were 50 years and above. The implication of this finding is that Orient

Bank generally employs young and talented people who can drive the corporate mission towards its intended destination.

4.1.3 Level of education of the respondents.

The table below shows the qualification of the respondents, the highest qualification considered by this research was masters and the lowest qualification was a diploma, the others who didn't fall in the qualifications quoted below were catered for in others.

Table 4.2: Level of education of the respondent

Education qualification	Frequency	Valid Percentage
Diploma	13	21.7
Degree	27	45.0
Professional	9	15.0
Masters	9	15.0
Others	2	3.3
Total	60	100.0

Source: *Primary data*

As shown in table 4.3 above, 45.0% of the respondents had bachelor's degree, 21.7% had diplomas, 15% were masters' holders, 15% had professional papers and others (3.3) had certificates in various fields. The implications of this finding is that the participants in the study had adequate level of education necessary to answer the questions posed to them and this

enabled the researcher to solicit the desired information relating to loan portfolio management and financial performance.

4.1.4 Employment duration work with Orient bank

The numbers of years spent in an organisation are very important in terms of information sharing; the table on the next page shows the durations the respondents have spent in Orient bank.

Table 3.4: Employment duration work with Orient bank

Duration of employment	Frequency	Valid Percentage
Less than 2 Years	10	16.7
3 - 6 Years	30	50.0
More than 6 Years	20	33.3
Total	60	100.0

Source: Primary data

The findings in table 4.4 shows that 50% of the respondents had served Orient Bank for over 3-6 years, 33.3 % had served the Bank for more than six years and 16.7 has spent less than 2 years serving the Bank. The implication of this finding is the majority of the respondents know loan portfolio management problems of the Bank since they have been with the bank for quite good number of years (3-6 years).

4.1.5 Respondents departments

For purposes of accurate information, the respondents were categorised in their departments as shown below. The finding showed that the operations department has the biggest number of staff.

Table 4.4: Respondents departments

Departments	Frequency	Valid Percentage
Operations	27	45.0
Human resource	2	3.3
Loan/credit	8	13.3
Accounts & finance	7	11.7
Procurement	3	5.0
Sales and Marketing	13	21.7
Total	60	100.0

Source: Primary data

The findings in table 4.5 show that the study was majorly dominated by staff in operations section (45.0%) and 21.7% of the respondents were in sales and marketing department of the Bank. This was so because the study was generally centered on the activities of the loan department.

4.2 Loan Policy in Orient Bank

One of the objectives of the study was to explore the loan policies in orient bank and review the adherence by the lending department. This objective was analysed in the following subsections.

4.2.1 Interest rate on loans

4.2.1 Fairness of interest rate on loans

I wished to establish whether the interest rate on the loan is favourable. The findings were presented in table 4.6 below;

Table 4.5: Interest rate on loan

Response	Frequency	Valid Percentage
Strongly agree	7	11.7
Agree	10	16.7
Not sure	9	15.0
Disagree	18	30.0
Strongly disagree	16	26.7
Total	60	100.0

Source: *Primary data*

Majority of the respondents 34 (56.7%) disagreed that the interest rate is favourable, whereas 17 (28.4%) agreed that the interest rate is favourable and only 9 (15%) were not sure. This implies that the interest rate is not favourable on the side of the borrowers and loan applicants always complain about interest rate charged by the bank. According to the finding of the study, on average the interest rate has been in the range of 20% – 23.5%. In an interview with the manager credit, he said interest rates are determined by bank of Uganda (the central bank) and also the fixed deposit rates. The higher the fixed deposit rates, the higher the lending rates. He further said the bank lends mostly from what the customers have fixed.

4.2.2 Loan interest rates in orient bank.

In an interview with the Manager Credit administration, the main determinants and criteria determining of interest rate on loans in Orient bank were revealed as; loan repayment period, amount of the loan and Bank of Uganda lending rate. The finding also revealed that interest rate of Orient bank is almost the same with other bank which implies that the rate is competitive, in line with Bank of Uganda regulations and not negotiable.

4.2.3 Interest rate and borrowers default

The findings regarding whether interest rate lead to borrowers default due to accumulated amounts were presented in the table below;

Table 4.6: Interest rate and borrowers default

Response	Frequency	Valid Percentage
Strongly agree	17	28.3
Agree	20	33.3
Not sure	2	3.3
Disagree	15	25.0
Strongly disagree	6	10.0
Total	60	100.0

Source: *Primary data*

From the table, majority of the respondents 37 (41.6%) were of the view that the interest rate leads to customers default due to accumulated amounts whereas 21 (35%) disagreed and only 2 (3.3%) were not sure. This implies that interest rate is a major factor that has contributed to the rate of default and thus limiting the growth of loan portfolio at Orient bank.

However in an interview with one of the supervisors in credit, she said some companies have their staff given special rates by the bank because of their huge turn over. She concluded by saying interest rates are not uniform for all borrowers of the bank. According to Saurina (2005), loan interest is calculated by dividing the amount of interest by the amount of principal. In general, interest rates rise in times of inflation, greater demand for credit, tight money supply, or due to higher reserve requirements for banks.

4.2.4 Financial potential and loan size

The researcher wished to find out if the size of the loan depends on the financial potential of the loan applicant. The findings were presented in table 4.8 on the next page;

Table 4.8: Financial potential and loan size

Response	Frequency	Valid Percentage
Strongly agree	33	55.0
Agree	5	8.3
Not sure	2	3.3
Disagree	18	30.0
Strongly disagree	2	3.3
Total	60	100.0

Source: Primary data

From the table above: loan size advanced depends on the financial potential of the loan applicant as represented by 51 (85%) of the respondents, 7(11.6%) of the respondents disagreed

and only 5 (3.3%) were uncertain. This implies that loan applicants with a weak financial status are not advanced loans.

According to the credit policy (2005) on restrictions and concentrations; It stipulates that aggregate loans to a single borrower or related group of the borrowers (as defined in the Financial Institutions Act) shall be limited to no more than 25% of the core capital.

Whereas this requirement remains, as an internal control mechanism to ensure that Orient Bank Limited (OBL) penetrates the Commercial/Corporate sector cautiously, the maximum amount of loan for one single individual borrower or group of related borrowers shall be limited to no more than 200M for new borrowers and 300M for recurrent borrowers with excellent performance. The board will consider raising the limit upon recommendation by management from time to time.

4.2.5 Collateral security:

The findings regarding whether the loan applicants are required to present a collateral security before obtaining the loan from Orient bank was presented in table 4.9;

Table 4.9: Collateral security and loan acquisition

Response	Frequency	Valid Percentage
Strongly agree	28	46.7
Agree	4	6.7
Not sure	2	3.3
Disagree	19	31.7
Strongly disagree	7	11.7
Total	60	100.0

Source: *Primary data*

The finding of the study revealed that collateral security is required to acquire a loan at Orient bank represented by majority of the respondents 47 (78.4%), whereas only 11 (18.4%) disagreed that every loan applicants must present a collateral security before obtaining a loan from the bank and only 2 (3.3%) were uncertain. This implies that when borrowers default the bank can sell off their security to recover their money.

Interview with the Executive Director Finance, he said the challenge the bank faces with the loans that went bad is that the securities were exaggerated or non-existent as the loan officers and the relationship officers did not do site visits but prepared reports of site visits by verbally asking the borrowers. He further said some of these staff resigned and the bank cleared them.

4.2.6 Valuation of collateral security

Table 4.10: Valuation of collateral security

Response	Frequency	Valid Percentage
Strongly agree	7	11.7
Not sure	2	3.3
Disagree	10	16.7
Strongly disagree	41	68.3
Total	60	100.0

Source: *Primary data*

In an interview with one of the relationship manager, he said some valuers are comprised by those who want the bank to lend them more than their security value, more to that he said some of the loan officers connive with both the valuers and the borrowers to produce an exaggerated property value. He revealed that these days it is a must after borrowers defaulted. Management resolved that security is required except for quick cash. This implies that in case of default, the bank can sell the collateral in order to recover its money (source: Group Head of Credit Orient bank).He conclude by saying the bank has now identified a group of valuers the borrowers of orient bank must use so that in case of over valuation they are held accountable.

The findings also revealed that collateral security is not valued by professional valuers represented by majority of the respondents 51 (85%), while 7 (11.7%) agreed that the collateral security is valued by professional valuers and only 2 (3.3%) were not sure. This implies that there is either under valuation of the collateral security and this has got an impact on loan the growth of loan portfolio at Orient bank.

4.2.7 Inspection of collateral security

The researcher was interested in finding out whether collateral securities presented by the loan applicants are inspected by the loans/field officers before the loan is advanced. The response obtained using self-administered questionnaires were presented in the table below for analysis;

Table 4.71: Inspection of collateral security

Response	Frequency	Valid Percentage
Strongly agree	10	16.7
Agree	2	3.3
Not sure	4	6.7

Disagree	13	21.7
Strongly disagree	31	51.7
Total	60	100.0

Source: Primary data

From the findings in table 4.11 above, the collateral securities are never inspected by the loan officers represented by majority of the respondents 44 (73.4%) of the respondents, whereas 12 (20%) agreed that collateral security is inspected by the loans officer and only 4 (6.7%) were not sure. This implies that there is a possibility of giving out loans without visiting the borrowers' collateral security. This further implies that the security held by the bank may be of less value than the loan given to the borrower so in case borrowers default the bank may not recover its money 45 (75%).

4.2.8 Collateral security

In interview with the Group Head of Credit of Orient Bank said that, the criteria of determining the collateral security are; the amount of the loan applied for, easy to sell, the collateral security must be owned by the loan applicant, must be easily accessible in case of land, it should have more value than the loan applied for, use of bank valuers, depreciation and appreciation rate of the security, location of the collateral, and the forced and sales value.

Table 4.12 showing the interest rates, loan size and collateral required before issuing loans

Interest Rates	Mean	S.D
Lending rates are higher than those set by the central bank	4.48	0.402
The clients demand for credit depending on the lending rate of the bank at that particular time.	3.98	1.570
High interest rates have greatly caused poor loan repayment rates	4.23	1.087
The bank has lost a number of clients to other commercial banks due to high lending interest rates	3.77	1.102
Loan size		
There has been a direct decrease on the amount of loans acquired by clients	3.99	1.123
Loan size depends on the purpose for which the loan has been applied	4.21	0.851
The financial potential of the borrower determines the loan size the bank can offer to the client	4.03	0.787
The socioeconomic factors surrounding a borrower are major determinants of loan size	3.50	1.112
Collateral		
There are standard collateral requirements for different loan grades in orient bank.	3.84	1.001
There is no way a loan can be accessed without a security	4.39	1.201

The security put by the client is adequate to recover the bank's money in case of default	4.01	0.882
Many people access loan even when they have no security to present	2.39	1.032

Source: Primary data

As shown in table 4.12 above, the respondents said that lending rates of Orient Bank are higher than those set by the central bank (BOU) (Mean = 4.48, Standard deviation = 0.402). Further the results in table 4.12 above shows that majority of the respondents accepted that the clients demand for credit depending on the lending rate of the bank at that particular time (Mean = 3.98, Standard deviation = 1.570). That respondents agreed that high interest rates have greatly caused poor loan repayment rates (Mean = 4.23, Standard deviation = 1.087). It was also agreed by the respondents that the bank has lost a number of clients to other commercial banks due to high lending interest rates (Mean = 3.77, Standard deviation = 1.102).

The findings reflect that majority of the respondents concurred that there has been a direct decrease on the amount of loans acquired by clients (Mean = 3.99, Standard deviation = 1.123). It was accepted that loan size depends on the purpose for which the loan has been applied (Mean = 4.21, Standard deviation = 0.851). The results further reflect that majority of the respondents agreed that the financial potential of the borrower determines the loan size the bank can offer to the client (Mean = 4.03, Standard deviation = 0.787). The respondents were slightly not sure whether the socioeconomic factors surrounding a borrower are major determinants of loan size (Mean = 3.50, Standard deviation = 1.112).

It was also highlighted that there are standard collateral requirements for different loan grades in orient bank (Mean = 3.84, Standard deviation = 1.001). Further majority of the respondents

agreed that there is no way a loan can be accessed without a security (Mean = 4.39, Standard deviation = 1.201). It was also found out that the security put by the client is adequate to recover the bank's money in case of default (Mean = 4.01, Standard deviation = 0.882). The results show that respondents disagreed with the view that many people access loan even when they have no security to present (Mean = 2.39, Standard deviation = 1.032).

4.3 Loan Control

The loan appraisal, loan monitoring and follow up actions taken in Orient bank was one of the objectives of this research study which researcher wished to analyse and this looked as follows;

4.3.1 Loan appraisal

The researcher was interested in finding out if the loan officer's appraisal loan applicant before the loan can be approved. The results were presented in the table below;

Table 4.8: Appraisal of loan applicants

Response	Frequency	Valid Percentage
Strongly agree	4	6.7
Agree	15	25.0
Not sure	12	20.0
Disagree	13	21.7
Strongly disagree	16	26.7
Total	60	100.0

Source: Primary data

Most of the respondents 29 (48.4%) of the respondents were of the view that some loan applicants are not appraised before the loan can be advanced, 19 (31.7%) agreed that the loan applicants are appraised and only 12 (20%) were not sure. This implies that most loan applicants are never appraised to determine the financial potential before the loan is advanced.

According to the Country Head of Operations (Chief Kezie Nwoha), I quote “Orient Bank has an appraisal system that ensures that loans are given to only those creditworthy borrowers although he revealed that there are instances where Branch business managers mislead the credit officers and the loans are issued to none credit worth customers”.

According to some credit officers interviewed, they claim that Orient bank has a stringent appraisal processes which has limited potential borrowers from accessing loans and this is as a result of a number of bad loans which were written off in the previous years, because of this stringent appraisal processes Orient Bank has ended up with increasing cash reserve due to fewer customers qualifying for the loans.

In an interview with of the disbursement officer, she said the bank follows the steps below before the customer accesses the funds. The relationship manager will submit the accepted facility letter and security documentation to the legal department.

Using the “Post Sanction Aide Memoire” the legal department will complete the following: Checks prior to disbursement; check terms and conditions agreed with sanction authority, ensure conditions precedent have been met, ensure security is in place and legal team provide appropriate sign off, if required, obtain agreement from sanctioner to waive in respect of the above, record and diarise to follow up on any waiver issues, check all assets held as security are

insured, the banks interest noted and diarise to obtain renewal premium, ensure current property valuation is held, ensure KYC formalities completed for new customers

4.3.2 Loan monitoring in Orient bank and its effectiveness

Monitoring of loan borrowers is one of the key elements of loan control the researcher wished to investigate; the responses were presented in the table below;

Table 4.94: Monitoring of loan borrowers

Response	Frequency	Valid Percentage
Strongly agree	5	8.3
Agree	5	8.3
Not sure	16	26.7
Disagree	17	28.3
Strongly disagree	17	28.3
Total	60	100.0

Source: Primary data

Most of the respondents 34 (56.6%) disagreed that loan officers monitor and make follow up of loan applicants, whereas 16 (26.7%) were not sure and only 10 (16.6%) of the total respondents agreed that loan applicants are monitored. Basing on the findings of the study it implies that loan officers do not carry out effective monitoring and this probably explains rate of default by Orient bank borrowers.

In an interview with the credit supervisor, she said the primary purpose of lending is to earn interest, recover the principal lent and make profits. She says it is important therefore to closely monitor all advances made by the bank.

The credit supervisor further revealed that Credit and Corporate function call for and peruse the loans issued and loan referral reports daily to ensure: there are no unauthorized drawings in the accounts, the limits, interest rate and maturity dates are as per sanction terms, the a/c balances are within the agreed limits, the loan instalments are being recovered as per schedule, the borrowers are reminded in time of the due date of the credit facilities enjoyed, the limits are not expired, the account is active - there is turnover in the accounts.

4.3.3 Effectiveness of loan monitoring

The findings on the effectiveness of loan monitoring in Orient bank were presented in the table below;

Table 4.105: Effectiveness of loan monitoring

Response	Frequency	Valid Percentage
Strongly agree	7	11.7
Agree	6	10.0
Not sure	16	26.7
Disagree	21	35.0
Strongly disagree	10	16.7
Total	60	100.0

Source: *Primary data*

The findings further reveal that loan monitoring is not effective represented by most respondents 21 (35.0%), 16 (26.7%) were not sure and only 13 (21.7%) agreed that loan monitoring is effective.

According to orient bank credit manual (2013),the procedure of appraisal and monitoring of loan applicants were revealed as; the recovery manager do loan review reports every six months, the credit department need to be strengthened, the loan's officer and credit team do review financial reports of the clients. The key challenges of appraising and monitoring of loan applicants were revealed as; sometimes the loan appraisal is not done on time and some loan applicants do not have the right documents, the bank tries to help them to acquire some.

In an interview with a credit officer, Credit & Corporate shall be in constant contact with the borrowers to be abreast of the activity / operations/difficulties at hand as well as call on the borrower to rectify whatever anomaly is observed in the servicing of the credit facility / operation of the account.

4.3.4 Follow-up actions and loan recovery

The researcher was also interested in finding the follow-up action and loan recoveries in Orient bank. The findings were presented in the table below;

Table 4.116: Follow up of loan borrowers

Response	Frequency	Valid Percentage
Strongly agree	7	11.7
Agree	11	18.3
Not sure	10	16.7
Disagree	11	18.3
Strongly disagree	21	35.0
Total	60	100.0

Source: *Primary data*

According to the findings of the study most of the respondents 32 (43%) disagreed that loan officers make follow-ups on borrowers, whereas 18 (30%) agreed and only 10 (16.7%) of the respondents were not sure. This implies that most of the borrowers are never followed up when they acquire loan from the bank.

The findings further revealed that in case no follow-up is made, the borrowers may not even default represented by 46 (76.7%) of the respondents who disagreed whereas only 12 (20%) agreed that if no follow up is made then borrowers normally defaults. This implies that follow-up has got a significant contribution towards reducing loan default by borrowers.

In an interview with the Group Head of Credit, whilst it is the duty of all functions of the bank to assist in the recovery of any money lent, Credit (Risk) is responsible for all recoveries in Orient Bank Ltd and connections accounts should be transferred to Risk as soon as the risk to the Bank is identified.

The study also wished to establish the mean values and the standard deviations of the test statements posed to the respondents using the five likert scale of ranting. The mean values that can be rounded off to 1.00 and 2.00 indicate disagreement while those that tend to 3.00 reflect that respondents were not sure and finally responses with mean values that can be rounded off to 4.00 or 5.00 indicate that respondents were in agreement with the statements.

Table 4.17: Findings about loan appraisal, loan monitoring and follow up actions taken in Orient bank.

Loan appraisal	Max	Mean
Loan applicants are appraised before issuing loan	4.05	0.382
The criteria used to appraise loan applicants is effective	3.97	1.287
Credit management policies are followed strictly when appraising loan applicants	3.95	1.117
Loans are graded according to the criteria restricted by bank of Uganda.	3.07	1.357
Monitoring		
Each loan officer is given a portfolio to manage and monitors the performance of the loans within his/her portfolio and they are apprehended for loans mismanaged	4.29	1.226
The bank insures all the loans issued to minimize the risks.	4.07	0.931
Credit supervisors or managers some times review the collateral used for loan acquisition if they can cover the loan in case of default.	3.77	1.901
The bank has a loan committee which sits before writing off any loan.	3.61	1.246
The head of credit reviews the grading of all the loans to find out if they are graded correctly.	4.11	0.933
Follow up action plan		
Loan officers meet clients whose loans are going bad and discuss the way forward and come up with suggestions that	3.89	1.163

favor both the bank and the client		
Guarantors liable in case of loans defaulted by the client they guaranteed.	4.00	1.111
Clients who have challenges paying their loan instalments are usually given an extension period.	3.40	0.431
The collateral given on loan requisition can cover the loan in case of the loan going bad.	4.33	1.001

Source: Primary data

Table 4.17 above shows that loan applicants are appraised before issuing loan (Mean = 4.05, Standard deviation = 0.382) and that the criteria used to appraise loan applicants is effective with a mean value of 3.97 and standard deviation of 1.287. The findings of the study further reflected that respondents accepted that credit management policies are followed strictly when appraising loan applicants (Mean = 3.95, Standard deviation = 1.117). However, the study highlighted that the respondents were not sure whether loans are graded according to the criteria restricted by bank of Uganda (Mean = 3.07, Standard deviation = 1.357).

The study highlighted that each loan officer is given a portfolio to manage and monitors the performance of the loans within his/her portfolio and they are apprehended for loans mismanaged (Mean = 4.29, Standard deviation = 1.226). The results of the study further indicated that majority of the respondents were with a view that the bank insures all the loans issued to minimize the risks (Mean = 4.07, Standard deviation = 0.931). The findings of study also indicated that respondents were in agreement that credit supervisors or managers some times review the collateral used for loan acquisition if they can cover the loan in case of default (Mean = 3.77, Standard deviation = 1.901) and that the bank has a loan committee which sits

before writing off any loan (Mean = 3.61, Standard deviation = 1.246). The study indicated that majority of the respondents were in agreement that the head of credit reviews the grading of all the loans to find out if they are graded correctly (Mean = 4.11, Standard deviation = 0.933).

It was stated that Loan officers meet clients whose loans are going bad and discuss the way forward and come up with suggestions that favour both the bank and the client (Mean = 3.89, Standard deviation = 1.163). That guarantors liable in case of loans defaulted by the client they guaranteed (Mean = 4.00, Standard deviation = 1.111). The respondents were not sure whether the clients who have challenges paying their loan instalments are usually given an extension period (Mean = 3.40, Standard deviation = 0.431). It was agreed that the collateral given on loan requisition can cover the loan in case of the loan going bad (Mean = 4.33, Standard deviation = 1.001).

These findings are in line with Lucy (2004), that loan management strategies are the guidelines that are followed in managing the risk which is involved in extending loan facilities to customers such as credit standards, collection efforts, credit term and credit period offered to customers and if such strategies are faulty this increases loan default.

In an interview with the one of the Credit Officer of the Bank, it was revealed that credit management is focused on credit standards, collection efforts, credit term and credit period offered to customers and this helps managers to appraise potential customer thereby answering the question who should qualify for credit. That credit standards focuses on personal character, conditions of the business, capacity, capital of the borrower and the security used to secure the credit as collateral. And that to award credit to customers, the credit control department looks at the time the customers is willing to settle his or her debt obligation so as to set credit terms favourable to customers so as not to exceed the credit limit.

4.4 Loan policies in Orient bank

The researcher wished to establish if loan policies exist in orient bank and how effectives they are in influencing the financial performance of orient bank.

4.4.1 Stipulated loan policies

The researcher was interested in establishing the exiting loan policies of Orient bank as a component of loan portfolio management. The findings are presented in table 4.18 on the next page;

Table 4.128: Loan policies

Response	Frequency	Valid Percentage
Agree	50	83.3
Not sure	5	8.3
Disagree	3	5.0
Strongly disagree	2	3.3
Total	60	100.0

Source: Primary data

The findings of the study revealed that 50 (83.3%) of the respondents said that Orient bank has loan policies while 5 (8.3%) disagreed that the bank does have loan policies and only 5 (8.3%) were not sure. This implies that Orient Bank has got loan policies and therefore their effectiveness need to be assessed.

In an interview with the credit officers the following loan policies were revealed; Loan applicant must have an account with Orient bank for at least six months or present a statement from another bank indicating transaction done for the last six months.

Valuable security/collateral: According to Farouk (Group Head of Credit), Orient bank employs a range of policies and practices to mitigate credit risk. The traditional of these is the taking of security for funds advances which is a common practice. The collateral given by the borrowers should have the market value of at least 120% of the outstanding amount of the accommodation throughout its term; the value is given by the bank valuer who conducts a site visit to the premise.

Good relationship and character of the loan applicant are very key in securing a loan in Orient bank. Performing account and good turnover, the bank doesn't fund nonperforming assets.

According to the Orient Bank Credit manual 2013, The credit policies asserts that, at least every month the Head of the branch Credit department shall undertake a thorough review of all loans more than 30 days in arrears and report to Head Office on the reasons for loan failure.

4.4.2 Following of loan policies by loan officers:

The responses regarding whether the loans officer normally make follow up on the loan policies are presented as follows;

Table 4.139: Following the loan policies

Response	Frequency	Valid Percentage
Agree	7	11.7

Not sure	11	18.3
Disagree	24	40.0
Strongly disagree	18	30.0
Total	60	100.0

Source: *Primary data*

From table above majority of the respondents 42 (70%) revealed that the loan policies are not strictly followed by the loans officers whereas only 11 (18.3%) were not sure. This implies that loans officers are never compliant with the stated loan policies. This implies that the loan applicants are not critically assessed to determine their credit worth before the loan is advanced. Loan follow up actions are done differently as compared to other banks in Uganda for example according to the Centenary bank credit policies (2005), it asserts that, at least every month the Head of the branch Credit department shall undertake a thorough review of all loans more than 30 days in arrears and report to Head Office on the reasons for loan failure. This will be valuable feedback on the effectiveness of the bank's loan policy and procedure. In addition, special reports may from time to time be requested by head office.

4.4.3 Effectiveness of Orient Bank loan policies

The researcher wanted to establish the effectiveness of Orient bank loan policies, the findings obtained were presented in the table below for analysis.

Table 4.20: Effectiveness of loan policies

Response	Frequency	Valid Percentage
Agree	10	16.7
Not sure	8	13.3

Disagree	31	51.7
Strongly disagree	11	18.3
Total	60	100.0

Source: Primary data

From the table above, majority of the respondents 42 (80%) disagree that the loan policies are not effective, 10(16.7%) agreed that the loan policies are not effective. While only 8 (13.3%) were uncertain about the effectiveness of the loan policies of Orient bank. The effectiveness of the loan policies can only yield positive result if they are all followed by the loan officers.

The findings of this study further indicated that loan committees needed to take full responsibility of overseeing the loan acquisition process and report on the portfolio progress as a measure of careful monitoring of the loan portfolio performance in the bank.

Loan policy involves three decision variables namely credit terms (interest charge, loan size, loan period, collateral requirement and eligibility criteria) credit standards and collection effort (Pandey 1995). It is therefore important to scrutinize the three loan policy decision variables of the two institutions in order to account for the differing loan portfolio performance. This study also looked these loan policies to establish whether they existence in Orient bank. The findings revealed that loan policies are not effective.

Pandey (1995) suggests that in order for the loan policies to be effective, credit policies must be communicated throughout the organisation, implemented through appropriate procedures, monitored and periodically revised to take into account changing internal and external circumstances. In an interview with the key informants the following loan policies were revealed; loan applicant must have an account with Orient bank, valuable security/collateral,

loan applicants' turnover, good relationship with the bank, performing account and good turnover, no funding for non-performing assets and good character of the loan applicant.

Nakeba's study went ahead to indicate that problem loans in centenary bank were solved through liquidation of other assets and providing a debt structure programme to guide the bank management in enhancing the bank's loan portfolio performance. This is not a case in Orient bank and the researcher recommends the bank management to adopt it.

4.4.4 Approval of loans

The findings regarding the approval of loan were presented in the table 4.21 as follows;

Table 4.21: Approval of loans

Response	Frequency	Valid Percentage
Strongly agree	9	15.0
Agree	11	18.3
Not sure	7	11.7
Disagree	19	31.7
Strongly disagree	14	23.3
Total	60	100.0

Source: Primary data

Approving of the loans requested by the loan applicants is a major component of loan portfolio management. Most of the respondent 30 (50%) disagreed that sometimes the loans officer approve the loans 23 (38.3%) agreed whereas only 7 (11.7%) were not sure.

My findings reveal that loan officers sometimes approve loans, this should not be the case, it should be the responsibility of the loan committee. The findings of this study share some similarity with Credit management, (1999) which suggests that all loan approvals should be made in accordance with the bank's written guidelines and granted by the appropriate level of management.

According to my findings, i didn't any audit report querying violation of policies and controls in issuing loans, there should be a clear audit trail documenting that the approval process was complied with and identifying the individual(s) and/or committee(s) providing input as well as making the credit decision. However, the contradiction is that not all loans are approved by the top management and lack audit trail documenting was not evident in this current study.

4.5 Financial Performance of Orient Bank

The researcher was interested in establishing the financial performance of Orient bank and this was limited to loan portfolio growth, default rate and risk exposure variables.

4.5.1 Loan portfolio growth at Orient bank

Table 4.142: Loan portfolio growth

Response	Frequency	Valid Percentage
Strongly agree	23	38.3
Agree	8	13.3
Not sure	6	10.0
Disagree	21	35.0
Strongly disagree	2	3.3
Total	60	100.0

Source: Primary data

According to the findings of the study, majority of the respondents agreed that loan portfolio of Orient bank as grown over the past periods represented by 44 (73.3%), whereas 10 (16.3%) disagreed that the loan portfolio has grown and only 6 (10%) were not sure. This implies that the loan portfolio of Orient bank has grown significantly over the past periods.

In an interview with the business growth manager, he said much as the loan portfolio in orient bank has grown, the bank still faces the challenge of default by some customers. He furthered said last year 2013, the bank wrote of 43billion in bad loans.

4.5.2 Portfolio Reporting

According to the Group head Human Capital, she said the Head of Credit is required to report to the Managing Director regularly. This should be done on a weekly basis for Management and to the Board whenever they sit or at any other frequency as required. The format of reporting is based on concise summaries.

It was revealed further that there is clear and simple format the head of credit uses when reporting the loan portfolio to the managing director (MD). This helps management to know the number of performing loans and the number of the non-performing assets (NPA's), management is also able to know the number of doubtful loans and those that are to be written off.

4.5.3 Rate of default by borrowers

The findings on rate of default by borrowers in Orient bank were presented in table below for analysis.

Table 4.23: Rate of default by borrowers

Response	Frequency	Valid Percentage
Agree	28	46.7
Not sure	10	16.7
Disagree	17	28.3
Strongly disagree	5	8.3
Total	60	100.0

Source: *Primary data*

From the table above, majority of the respondents 35 (75%) agreed that the rate of default is high, whereas 10 (16.7%) were not sure and only 5 (8.3%) disagreed that rate of borrowers default is high. Basing on the findings of the study the rate of default is high this is because loan applicants are attracted by other services not specifically the loan policies and these could include and not limited to; long term relationship with the bank, proximity and wide range of products and services.

4.5.4 Write-off of bad loans

Table 4.154: Write-off of bad loans

Response	Frequency	Valid Percentage
Agree	9	15.0
Not sure	8	13.3
Disagree	20	33.3
Strongly agree	23	38.3

Response	Frequency	Valid Percentage
Agree	9	15.0
Not sure	8	13.3
Disagree	20	33.3
Strongly agree	23	38.3
Total	60	100.0

Source: Primary data

Most of the respondents represented by 43 (71.6%) disagreed about the write off of bad loans, whereas 9 (15%) only agreed and only 8 (13.3%) were not sure. This means that write of loan as bad is not done frequently since it is a top management decision and done after all the alternatives of loan recovery as failed.

Writing-off should be done in such a way as to provide a clear picture about the real situation of the loan portfolio, indicating the true level of (potentially) earning assets.

4.6 Effect of loan policies and control and financial performance

4.6.1 Loan policies increase in loan applicants

Table 4.165: Loan policies/control and increase in loan applicants

Response	Frequency	Valid Percentage
Strongly agree	5	8.3
Agree	2	3.3

Not sure	6	10.0
Disagree	33	55.0
Strongly disagree	14	23.3
Total	60	100.0

Source: Primary data

The findings of the study revealed that loan policies are not favourable since the bank policies have not attracted loan applicants represented by majority of the respondents 44 (78.3) whereas 7 (11.6%) agreed that the policies have attracted loan applicants and only 6 (10%) were not sure. It can also be said that loan policies have attracted some loan applicants and improved on loan acquisition. This implies that loan applicants are attracted by other services not specifically the loan policies and these could include and not limited to; long term relationship with the bank, proximity and wide range of products and services.

4.6.2 Loan portfolio management and loan default

Table: 4. 176: Loan portfolio management and loan default

Response	Frequency	Valid Percentage
Strongly agree	4	7.0
Agree	9	15.00
Not sure	10	17.5
Disagree	22	38.6
Strongly disagree	15	26.3
Total	60	100.0

Source: Primary data

According to the findings in the table above, most of the respondents 37 (61.7%) disagreed that lending policies have reduced on the rate of loan default, whereas 13 (22%) agreed that loan policies have reduced on the loan default and only 10 (16.7%) were not sure. This implies that there is a positive relationship between loan policies and loan default rate. Effective loan policies will significantly reduce rate of loan default.

It was further important to determine the mean values and standard deviations of various test statements relating to loan policies and control of loan portfolio growth and the researcher asked the respondents to rank the responses using the five likert scale of ranting and the findings gathered were herein presented, analysed and discussed as follows:

Table 4.27: Findings about loan policies and loan controls on loan portfolio growth

Loan policies	Mean	S.D
We have loan policies in place	4.19	1.101
The loan policies are effective and strictly followed	2.80	1.422
The branches have the loan policies, procedures and guidelines in place.	4.13	1.116
The policies cover credit analysis, credit approval, monitoring and recovery of debts	3.87	1.207
Loan control		
Loans officers practice standard loan assessment, analysis and underwriting	3.01	1.451
There are practices of issuing loans to those clients who don't qualify because some staff are expecting something from	3.31	0.231

them.		
The Loans committee may be given false information by the credit officers or business branch managers and loans are granted on such information.	3.88	1.352
Some Loans in orient bank are applied for through fraudulent procedures	3.11	1.236
Suppression of loan collection is very common in orient bank.	3.90	1.103
The bureaucracy of loan approvals has been revised for efficient performance of the loans granted.	4.02	0.564
Loan portfolio growth		
The branches have high credit risk due to poor portfolio management	3.76	0.897
Debt collection costs are so high that the bank prefers writing off some loans.	3.31	1.321
When Loans officers redeem a bad loan they are given adequate incentives for that exclusive performance.	4.12	1.041
The number of Loan defaulters has increased and this has forced the bank to register a number of court cases.	2.01	0.567
Clients pay their loan on time and this has reduced on the Debt collection costs.	3.75	0.786

Source: Primary data

As shown in table 4.27 above majority of the respondents concurred that Orient Bank has loan policies in place (Mean =4.19, Standard deviation =1.101). However, the respondents marginally disagreed that the loan policies are effective and strictly followed (Mean =2.80, Standard deviation =1.422). The study also shows that the respondents concurred that the branches have the loan policies, procedures and guidelines in place (Mean =4.13, Standard deviation =1.116). Conversely, the respondents slightly agreed that the policies cover credit analysis, credit approval, monitoring and recovery of debts (Mean =3.87, Standard deviation =1.207).

The results shows that the respondents were not sure whether loans officers practice standard loan assessment, analysis and underwriting (Mean =3.01, Standard deviation =1.451). The results of the study also indicated that the respondents were not sure whether there are practices of issuing loans to those clients who don't qualify because some staff are expecting something from them (Mean =4.31, Standard deviation =0.231). The study revealed that respondents marginally agreed that the Loans committee may be given false information by the credit officers or business branch managers and loans are granted on such information (Mean =3.88, Standard deviation =1.352). The respondents were not sure whether some Loans in orient bank are applied for through fraudulent procedures (Mean =3.11, Standard deviation =1.236). The study also shows that respondents slightly agreed that suppression of loan collection is very common in orient bank (Mean =3.90, Standard deviation =1.103). It was agreed that the bureaucracy of loan approvals has been revised for efficient performance of the loans granted (Mean =4.02, Standard deviation =0.564).

However, the findings of the study indicated that respondents were slightly not sure whether the branches have high credit risk due to poor portfolio management (Mean =3.76, Standard deviation =0.897). Further still, respondents were not sure whether debt collection costs are so

high that the bank prefers writing off some loans (Mean =3.31, Standard deviation =1.321). The study shows that the respondents concurred that when Loans officers redeem a bad loan they are given adequate incentives for that exclusive performance (Mean =4.12, Standard deviation =1.041).Conversely, the respondents opposed the view that the number of Loan defaulters has increased and this has forced the bank to register a number of court cases. (Mean =2.01, Standard deviation =0.567). The respondents slightly agreed that clients pay their loan on time and this has reduced on the Debt collection costs (Mean =3.75, Standard deviation =0.786).

According to the findings, policies and controls have a direct bearing on loan portfolio growth and performance. Additionally, the results from the interview held with one Administrators of orient bank, it revealed that credit control department enables the organization to track down the defaulters. The main objective of debt collection is to avoid cash shortages which are tied in accounts receivables. Therefore immediate debt collection improves greatly the financial performance of an organization.

4.6.3 Extent of the relationship between loan policies and control and financial performance

I was interested in establishing the relationship between loan policies and financial performance of orient bank. This was done with the help of Pearson's correlations based on the quantitative data by cross tabulation of the variables. This was broken down into loan policies and loan control as shown in the following sub sections.

4.6.4 The influence of loan policies (interest rate, loan size and collateral) on financial performance

Statistical analysis was further conducted on influence of loan policies on financial performance using Pearson correlation coefficient and the findings are presented as follows;

Table 4.188: Influence of loan policies and performance

		Loan policies	Financial performance
Loan policies	Pearson Correlation	1	.655(**)
	Sig. (2-tailed)	.	.000
	N	60	60
Financial performance	Pearson Correlation	.655(**)	1
	Sig. (2-tailed)	.000	.
	N	60	60
** Correlation is significant at the 0.01 level (2-tailed).			

Source: *Primary data*

The findings in table 4.28 show Pearson's correlation coefficient $r = 0.655^{**}$ generated from the statistical analysis with the $p < 0.01$ implying that there is a significant positive correlation between loan policies and financial performance ($r = 0.655^{**}$, $p < 0.01$). This implies a linear relationship between the loan policies and financial performance. This means that if the loan policies are effective and adhered during the bank's lending businesses it would lead to further improvement in financial performance that loan portfolio growth and reduced risk exposure. Therefore the correlation results indicate that Orient bank loan policies have a positive significant relationship with financial performance since P is less than 0.01 which is the accepted level.

Comparing the two sub variables of loan portfolio management that is loan policies and loan control, loan control significantly influence the financial performance of Orient bank as compared to the loan policies. Strict policies must be in place to avoid association with individuals involved in fraudulent activities and other crimes. This can be achieved through a number of ways, including asking for references from known parties (Credit risk management, 1999).

4.6.5 The influence of loan control (Loan appraisal, loan monitoring and follow up action) on financial performance

To establish the relationship between loan control and financial performance, correlation coefficient was generated using Pearson correlation coefficient. The findings were presented in the table below;

Table 4.199: Influence of loan control on financial performance

		Loan control	Financial performance
Loan control	Pearson Correlation	1	.725(**)
	Sig. (2-tailed)	.	.000
	N	60	50
Financial performance	Pearson Correlation	.725(**)	1
	Sig. (2-tailed)	.000	.
	N	60	60
** Correlation is significant at the 0.01 level (2-tailed).			

Source: *Primary data*

The findings in table 4.29 show Pearson's correlation coefficient $r = 0.725^{**}$ generated from the statistical analysis with the $p < 0.01$ implying that there is a positive correlation between loan control and financial performance of ($r = 0.725^{**}$, $p < 0.01$) which represents a linear relationship between loan control and financial performance. This means that loan control is a major factor that influences the financial performance of Orient bank since the lending is major activity of Orient bank it calls for strong loan control activities of loan appraisal, monitoring and follow-up. Therefore the correlation results indicate that loan control has a positive significant relationship with the financial performance since 0.000 is less than 0.01 which is the accepted level.

4.7 Risk exposure

Determining the risk exposure of loan portfolio at Orient bank was the components of financial performance and the findings collected are reflected as follows;

4.7.1 Risk exposure at Orient bank

The findings obtained using self-administered questionnaires were presented in the table below;

Table 4.30: Risk exposure

Response	Frequency	Valid Percent
Agree	11	18.3
Not sure	6	10.0
Disagree	19	31.7
Strongly disagree	24	40.0

Response	Frequency	Valid Percent
Agree	11	18.3
Not sure	6	10.0
Disagree	19	31.7
Strongly disagree	24	40.0
Total	60	100.0

Source: *Primary data*

Majority of the respondents 43 (71.7%) disagreed that the bank is not exposed to high risk during lending whereas 11 (18.3%) agreed and only 6 (10%) were not sure. This implies that risk is not significant although it exists.

4.7.2 Loan portfolio management and exposure to risk

I was interested in finding the relationship between loan portfolio management and the banks' exposure to risk. The findings were presented in table 4.31 on the next page;

Table 4.31: Loan portfolio management and exposure to risk

Response	Frequency	Valid Percentage
Strongly agree	7	11.7
Agree	12	20.0
Not sure	13	21.7
Disagree	10	16.7
Strongly disagree	18	30.0

Response	Frequency	Valid Percentage
Strongly agree	7	11.7
Agree	12	20.0
Not sure	13	21.7
Disagree	10	16.7
Strongly disagree	18	30.0
Total	60	100.0

Source: *Primary data*

According to the findings in the table above, most of respondents disagreed that loan policies reduces bank's exposure to risks, whereas 19 (31.7%) agreed that the loan policies have reduced on the exposure to risk. However, basing on the findings, the bank's lending policies to some extent contributes towards reducing risk exposure and thus there is a relationship between lending policies and reduction of risk exposure. According to Interagency Policy Statement (1993), lending involves a number of risks and therefore controls should be put in place; the risk of repayment, i.e., the possibility that an obligor will fail to perform as agreed, is either lessened or increased by a bank's credit risk management practices.

It was further important to establish the mean values and the standard deviations of the test statements posed to the respondents and the results were presented using 5 point scale ranging from "SD-strongly disagree" (1) to "SA – strongly agree" (5) as shown on the next page;

Table 4.32: Findings about risk exposure of loan portfolio

Management of credit risk on loan portfolio	Max	Mean
The bank has a risk management policy	4.49	0.692
The bank has pre-set concentration limits in every sector	4.11	1.728
The bank has pre set portfolio limits	4.03	1.410
All staff members are evaluated to ensure effective management of risk	4.17	1.550
The bank quickly responds to market changes	4.00	1.222
We use risk based pricing in our loan portfolio	3.96	1.098
We periodically assess credit quality of our loan portfolio	4.02	1.319

Source: *Primary data*

Table 4.32 above reflects that respondents agreed that the bank has a risk management policy (Mean = 4.49, Standard deviation = 0.692). Further it was stated that the bank has pre-set concentration limits in every sector to effective management of risk policy (Mean = 4.11, Standard deviation = 1.728). The study shows that majority of the respondents agreed with the statement that the bank has pre-set portfolio limits (Mean = 4.03, Standard deviation = 1.410). The findings of the study reflected that all staff members are evaluated to ensure effective management of risk (Mean = 4.17, Standard deviation = 1.550). The results emanating from table 4.32 above indicates that respondents were in agreement that the bank quickly responds to market changes (Mean = 4.00, Standard deviation = 1.222). The study shows that respondents slightly agreed that Orient Bank uses risk based pricing on its loan portfolio (Mean = 3.96, Standard deviation = 1.098). It is reflected that most of the respondents agreed that Orient Bank periodically assesses credit quality of its loan portfolio (Mean = 4.02, Standard deviation = 1.319).

These findings are in agreement with Pollack (2000) that when the firm loosens its credit policy, this increases risk exposure to the business. In this case therefore the firm has to intensify on its supervision and collection efforts to be able to recover the outstanding amounts from the debtors. The investment costs of administering accounts receivables would reduce and the new credit policy can be implemented by the existing credit departments without any additional costs. This is quite possible if the department has unused capacity.

In conclusion therefore, loan portfolio performance enhancement can help Orient bank improve on its cash flows hence make the portfolio more profitable. It involves making accurate forecasts about the future performance of the portfolio and ensuring that there is proper management and monitoring of the loans so as to improve on its financial performance.

CHAPTER FIVE

SUMMARY, CONCLUSIONS, RECOMMENDATIONS AND SUGGESTIONS

5.1 Introduction

This chapter is a summary of the findings, conclusion, recommendations and areas for further research.

5.2 Summary of findings

The study sought to investigate the relationship between loan portfolio management and financial performance of Orient bank in Uganda in general. In particular, the study examined relationships between the study variables that is, loan policies and control as the key components of loan portfolio management and financial performance of commercial banks concentrating on loan portfolio growth and risk exposure.

The results revealed that there was a significant positive relationship between loan portfolio management and financial performance of Orient bank which implied that the loan policies and control significantly contributes to loan portfolio growth and risk exposure.

Therefore, the management of the bank should put in place credit evaluation procedures and loan control that aim at ascertaining the capacity and capability loan applicants/borrower and along with the credit repayment period, monitor closely the borrower while ensuring that the required lending relationship is not compromised in the process. This will greatly enhance the credit repayment performance of the bank and loan portfolio growth.

It was clear that loan policies and control were predictors of loan portfolio growth and risk exposure, therefore, the management of the bank should put a lot of emphasis on development of strong policies and loan controls and collection procedure. Likewise, management should carry out a lot of monitoring and follow-ups to the borrowers sensitize them on how best to

invest the money and be able to pay back their borrowed funds without straining hard. Monitoring and follow up of borrowers will help the bank identify the challenges the borrowers meet during the acquisition of loans and after acquisition of the credit and consequently find solutions.

According to IMF (2003), lending rates have a positive relationship with profitability of commercial banks in Uganda. Loan pricing has a critical impact on bank's profitability and its willingness to accept higher risks. Similarly Ogunleye (2001) argues that when interest rates rise or fall, it exerts an impact on banks' profits through adjustment to revenues; and this comes about in two ways. Increase in market rates raises the amount of income a bank can earn on new assets it acquires.

The results from Orient Bank loan management policy Report (2013) shows that the bank still has a problem in managing its accounts receivables due to volatility in interest rate. When interest rise many customers run away from the bank. The has continued to write off huge sums of money in bad loans meaning there is a low level of loan recovery compromising the bank's financial performance(Orient Bank Annual Report, 2013).

The findings of this study only looked interest rate under loan policies and showed interest rate is not favourable and thus interest rate had insignificant influence on the performance of Orient Bank.

The study revealed that working out loan management problem is one step towards loan recovery. It requires giving clients facing difficulty in repaying their loans periods of extension of credit repayment to enable them pay their bills. This further involves credit rescheduling and pursuing guarantors to help pay the defaulted credit.

However, the study revealed that the major cause of default in credit recovery emanates from the weak internal control systems and policies inhibited in Orient bank coupled with the unrealistic returns expected from the loan portfolios which force them to hike interest rates making it very hard for the borrowers to repay their borrowed amounts an accumulated interest rate.

Loan portfolio growth and risk exposure was influenced by the extent to which Orient bank can recover loans from its clients and the amount of returns that the portfolio yields. However, the study discovered that this can be achieved when the bank lends at favorable interest rates such that the demand for the loans increases, the increasing demand for the loans should not however compromise bank credit management policies, Orient bank should ensure that the customers are adequately screened to eliminate those who cannot repay the loans, the bank credit team should also be rewarded upon attainment of the bank's loan portfolio objectives and for their exclusive performance towards the bank.

5.3 Conclusion

- The findings revealed that loans officers are never compliant with the stated loan policies and this has increased the borrowers default.
- The bank policies have not attracted loan applicants but they contribute positively towards reducing risk exposure.
- Loan size advanced doesn't depend on the financial potential of the loan applicants this has contributed to the high rate of default.
- The interest rate is not favourable on the side of the borrowers but its competitive compared to other commercial banks,
- Results indicate that loan officers don't monitor and make follow up of loan applicants and effective loan policies significantly reduce rate of loan default.

- Results indicate that loan portfolio management has a significant relationship with the financial performance of Orient Bank.
- Results also show that loan control has a significant relationship with the financial performance of orient bank.

5.4 Recommendations

According to the findings, borrower behaviour was found to be a strong predictor of credit repayment performance. Therefore, the management of the bank should draw a lot of emphasis on borrower values, attitudes, experiences and beliefs as this will influence the bank's overall credit repayment performance at the bank.

The findings revealed that there is a significant relationship between loan portfolio management and financial performance of Orient Bank. The management of the bank should invest in the enhancement of relationship lending between the bank and its customers so as to create trust in the bank's brand, products and services. Here the bank should ensure constant contact with its customers through the provision of the required information about the bank's products and services. Also, the management should ensure that bank policies, terms of reference and regulations are clear to both staff and the customers.

Credit officers and management must know their customers very well since such knowledge would easily help in loan administration. Relationship management should be encouraged. A banker should be able to assess the customer's needs, potentials, constraints, strengths and weaknesses and design products that will satisfy him. Through it also the customer's willingness to pay can be assessed.

The study also looked at challenges faced by Orient bank in working out problem loans and loan recovery. A problem loan comes as a result of a client failing to repay a loan. To recover problem loans certain procedures should be taken on for example rescheduling and restructuring of loans, but the decision to reschedule a loan should be taken by the loans committee whose members authorize rescheduling by signing the newly printed committee summary.

There is a significant relationship between loan policies and loan portfolio growth recovery and this call for loan agreements that are incentive compatible. At the time a loan is made, the bank must be sure that after disbursement it will be in the borrower's interest to repay the loan. The bank need to be satisfied that loans given will improve the position of the borrower and this should be brought to the knowledge of the borrower.

The study asserts that, loan portfolio performance is the means of following up and getting better loan results by understanding and carrying out loan portfolio management. For effective loan performance in the Orient bank, the head of credit and loans officers are required to understand the bank's risk profile and credit culture. The approach is grounded in risk management, actionable data, test-and-control iterations, diverse analytic approaches and the fundamentals of consumer credit in order to benefit from the loans.

5.5 Areas for further research

The study concentrated on loan portfolio management and financial performance of Orient Bank A similar research can be carried out on borrower behaviour, relationship lending and credit repayment performance across other banks in Uganda.

Future research can also be carried out on customer care and performance of commercial banks in Uganda as a comparative analysis.

The relationship between information and communication technology and customer service quality in commercial banks in Uganda.

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APPENDICES

QUESTIONNAIRE

I am carrying out a research on: Loan Portfolio management and the performance of commercial banks, case study being Orient Bank U LTD.

Members of staff of orient bank have been selected as a unit of analysis. Please kindly respond to the questionnaire by filling in as appropriate.

The information given through this questionnaire is purely for academic purposes, but the recommendations there from will be beneficial to your organization. Your response will be treated with utmost confidentiality.

SECTION A: GENERAL INFORMATION

(Tick the appropriate box)

1 Name of Institution: Orient Bank U Ltd

2 **Gender**

a) Male ☐

b) Female ☐

3. **Age**

a) 20-30 years ☐ b) 31 -40 years ☐ c) 41 50 years ☐ d) above 50 years ☐

4 **Level of Education**

a) Diploma ☐ b) Degree ☐ c) Masters ☐ d) PhD and above ☐

5. Current position.

6) Have you ever worked in a credit department before?

a) Yes ☐ b) No. ☐

7. Working experience in banks

a) Less than 2 years ☐ b) 2 – 5 years ☐ c) 6-10 years ☐ d) above 10 years ☐

SECTION B: CRITERIA FOR DETERMINING INTEREST RATES, LOAN SIZE AND COLLATERAL REQUIRED BEFORE ISSUING LOANS

NO	QUESTION	SA 5	A 4	NS 3	D 2	SD 1
	Interest rates					
1	Lending rates are higher than those set by the central bank					
2	The clients demand for credit depending on the lending rate of the bank at that particular time.					
3	High interest rates have greatly caused poor loan repayment rates					
4	The bank has lost a number of clients to other commercial banks due to high lending interest rates					
	Loan size					
5	There has been a direct decrease on the amount of loans acquired by clients					
6	Loan size depends on the purpose for which the loan has been applied					

7	The financial potential of the borrower determines the loan size the bank can offer to the client					
8	The socioeconomic factors surrounding a borrower are major determinants of loan size					
	Collateral					
9	There are standard collateral requirements for different loan grades in orient bank.					
10	There is no way a loan can be accessed without a security					
11	The security put by the client is adequate to recover the bank's money in case of default					
12	Many people access loan even when they have no security to present					

SECTION C: LOAN APPRAISAL, MONITORING AND FOLLOW UP ACTIONS:

NO	QUESTION	SA 5	A 4	NS 3	D 2	SD 1
	Loan appraisal					
13	Loan applicants are appraised before issuing loan					
14	The criteria used to appraise loan applicants is effective					
15	Credit management policies are followed strictly when appraising loan applicants					

16	Loans are graded according to the criteria restricted by bank of Uganda.					
	Monitoring					
17	Each loan officer is given a portfolio to manage and monitors the performance of the loans within his/her portfolio and they are apprehended for loans mismanaged					
18	The bank insures all the loans issued to minimize the risks.					
19	Credit supervisors or managers some times review the collateral used for loan acquisition if they can cover the loan in case of default.					
20	The bank has a loan committee which sits before writing off any loan.					
21	The head of credit reviews the grading of all the loans to find out if they are graded correctly.					
	Follow up action plan					
22	Loan officers meet clients whose loans are going bad and discuss the way forward and come up with suggestions that favor both the bank and the client					
23	Guarantors liable in case of loans defaulted by the client they guaranteed.					
24	Clients who have challenges paying their loan instalments are usually given an extension period.					

25	The collateral given on loan requisition can cover the loan in case of the loan going bad.					
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SECTION D: LOAN POLICIES AND CONTROL ON LOAN PORTFOLIO GROWTH

NO	QUESTION	SA 5	A 4	NS 3	D 2	SD 1
	Loan policies					
26	We have loan policies in place					
27	The loan policies are effective and strictly followed					
28	The branches have the loan policies, procedures and guidelines in place.					
29	The policies cover credit analysis, credit approval, monitoring and recovery of debts					
	Loan control					
30	Loans officers practice standard loan assessment, analysis and underwriting					
31	There are practices of issuing loans to those clients who don't qualify because some staff are expecting something from them.					
32	The Loans committee may be given false information by the credit officers or business branch managers and					

	loans are granted on such information.					
33	Some Loans in orient bank are applied for through fraudulent procedures					
34	Suppression of loan collection is very common in orient bank.					
35	The bureaucracy of loan approvals has been revised for efficient performance of the loans granted.					
	Loan portfolio growth					
36	The branches have high credit risk due to poor portfolio management					
37	Debt collection costs are so high that the bank prefers writing off some loans.					
38	When Loans officers redeem a bad loan they are given adequate incentives for that exclusive performance.					
39	The number of Loan defaulters has increased and this has forced the bank to register a number of court cases.					
40	Clients pay their loan on time and this has reduced on the Debt collection costs.					

SECTION E: RISK EXPOSURE ON LOAN PORTFOLIO

NO	QUESTION	SA	A	NS	D	SD
		5	4	3	2	1
41	The bank has a risk management policy					
42	The bank has pre-set concentration limits in every sector					
43	The bank has pre set portfolio limits					
44	All staff members are evaluated					
45	The bank quickly responds to market changes					
46	We use risk based pricing in our loan portfolio					
47	We periodically assess credit quality of our loan portfolio					

Thanks for your time and cooperation

INTERVIEW FOR CREDIT STAFF

1. How interest rates are determined by bank of Uganda (the central bank) and also the fixed deposit rates?
2. Which criteria are followed in Orient Bank when determining interest rates?
3. How do you determine the loan size you give to the clients?
4. Is there any relationship between loan size and financial performance?
5. Which kind of collateral does Orient Bank take when clients want to secure loan?
6. How do you appraise loan applicants?
7. Does appraising loan applicants leads to financial performance of the Bank?
8. Do you monitor loan applicants?
9. How do you monitor loan applicants?
10. Does monitoring loan applicants leads to financial performance of the Bank?
11. Which follow up actions do you take in case clients fail to settle their indebtedness?
12. Does the follow up action plan lead to loan portfolio growth and risk mitigation on loan portfolio?

Thanks for your time and cooperation

Krejcie and Morgan Sample Table for Determining Sample Size from a Given Population

N	S	N	S	N	S	N	S	N	S
10	10	100	80	280	162	800	260	2800	338
15	14	110	86	290	165	850	265	3000	341
20	19	120	92	300	169	900	269	3500	246
25	24	130	97	320	175	950	274	4000	351
30	28	140	103	340	181	1000	278	4500	351
35	32	150	108	360	186	1100	285	5000	357
40	36	160	113	380	181	1200	291	6000	361
45	40	180	118	400	196	1300	297	7000	364
50	44	190	123	420	201	1400	302	8000	367
55	48	200	127	440	205	1500	306	9000	368
60	52	210	132	460	210	1600	310	10000	373
65	56	220	136	480	214	1700	313	15000	375
70	59	230	140	500	217	1800	317	20000	377
75	63	240	144	550	225	1900	320	30000	379
80	66	250	148	600	234	2000	322	40000	380
85	70	260	152	650	242	2200	327	50000	381
90	73	270	155	700	248	2400	331	75000	382
95	76	270	159	750	256	2600	335	100000	384

Note: "N" is population size

"S" is sample size.